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Ontario

BY E-MAIL

October 7, 2010

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: Algoma Power Inc.
2010 and 2011 Distribution Rates Application
Board File No. EB-2009-0278

Enclosed is Board staff's submission on the unsettled issue: Establishment of an IFRS Deferral Account.

Please forward the submission to Algoma Power Inc. and to all other registered parties to this proceeding.

Yours truly,

Original Signed By

Richard Battista
Project Advisor – Applications & Regulatory Audit

Algoma Power Inc.
EB-2009-0278

Board Staff Submission on the Unsettled Issue:
Establishment of an IFRS Deferral Account

October 7, 2010

Introduction

Algoma Power is seeking the Board's approval to establish a deferral account ("IFRS Deferral Account") to capture the aggregate impact on the 2011 revenue requirement resulting from any changes to the existing International Financial Reporting Standards and changes in the interpretation and implementation of such standards[1] . This is an unresolved issue in the EB-2009-0278 proceeding.

Submission

Board staff submits that the Board should not approve the establishment of the IFRS Deferral Account as requested by Algoma Power in its 2010 -2011 rates application for two reasons: first, the request is contrary to the treatment described in the Report of the Board (EB-2008-0408), titled *Transition to International Financial Reporting Standards* (the "IFRS Report"), dated July 28, 2009. Second, Board staff questions Algoma Power's assertion that the requested account is similar to the one approved by the Board in its Hydro One EB-2009-0096 decision and so should be afforded similar treatment.

Discussion

<u>Conformance with the IFRS Report</u>

The IFRS Report, pages 27-28, describes the appropriate use of deferral accounts to capture IFRS related impacts on a distributor.

Re: Administrative Costs

> The Board will establish a deferral account for distributors for incremental one-time administrative costs related to the transition to IFRS. This account is exclusively for necessary, incremental transition costs and is not to include the other two types of costs listed at the beginning of this section: ongoing compliance costs or impacts on revenue requirement arising from changes in the timing of the recognition of expenses. (p.27)
>
> The Board declines to establish a deferral account for ongoing compliance costs related to IFRS. Distributors who are filing a cost of service application for rates should forecast ongoing compliance costs as part of the rate application. Distributors under an IRM are expected to work within the general provisions of that mechanism. (p.28)

[1] Source: Ex. 9 /Tab 5 /Sch 1/ pg.1 ln 19-21

Re: Impacts resulting from changes in accounting

> The Board is of the view that the cost consequences of changes in accounting for rate base and operating costs may be sought to be included in revenue requirement in a similar fashion to cost consequences arising from other events. Recovery from customers of such costs would be subject to testing for accuracy and prudence, as well as rate mitigation mechanisms as necessary. Accordingly, the Board will not establish a deferral account to record increases or decreases in costs resulting from the accounting changes. Distributors under an IRM have options to address unexpected and material cost increases if necessary. (p.28)

It is evident from the IFRS Report that the purpose of the deferral account is to capture one time-administrative costs and not the cost consequences resulting from IFRS related changes in accounting for rate base and for operating costs. With respect to the latter, the Report indicates that these costs should be addressed through a review of the utility's revenue requirement as impacted by such costs.

There is very little in the evidentiary record that suggests that Algoma Power's requested revenue requirement for 2011 reflects the impact, estimated or otherwise, of IFRS based accounting and reporting. When asked by Board staff to confirm whether the revenue requirement numbers for 2010 and 2011 are based on CGAAP, and not IFRS accounting principles, Algoma Power confirmed that the revenue requirement numbers for 2010 and 2011 Test Years are based on CGAAP. [2]

When asked in which year Algoma Power will begin reporting its audited actual results on an IFRS basis, Algoma Power indicated that, given the Canadian Accounting Standards Board ("AcSB") exposure draft dated July 28, 2010, it would not prepare its financial statements in accordance with IFRS until 2013. Algoma Power described the exposure draft as "proposing that qualifying entities with rate-regulated activities be permitted, but not required, to continue applying the accounting standards in Part V of the CICA handbook for an additional two years." Algoma Power further stated that "prior to the adoption of IFRS in 2013, Algoma Power will review the impacts of IFRS in the aggregate".[3]

[2] Board staff interrogatory No. 6
[3] Board staff interrogatory No. 8

Hydro One EB-2009-0096 Decision

In response to Board staff interrogatory No. 42, which asked whether the proposed account is expected to record any costs specifically excluded in the IFRS Report (i.e. ongoing compliance costs or impacts on revenue requirement arising from changes in timing of the recognition of expenses), Algoma Power stated that:

> The requested variance account is similar to what was approved by the OEB in Hydro One's recent distribution rate application (EB-2009-0096). The account proposed is intended to capture the aggregate impact on the post 2010 revenue requirement, any changes to existing IFRS standards and changes in the interpretation of such standards. [4]

Board staff submits that Algoma Power did not recognise a key element in the referenced Board decision.[5] In that proceeding, Hydro One indicated that it had contemplated the adoption of IFRS, as then understood, and had concluded that if IFRS is adopted in its then expected form, it would have no impact on its cash flows. Below is an excerpt from the Board's decision:

> Hydro One stated that its application for 2011 rates, while based on Canadian Generally Accepted Accounting Principles (GAAP), contemplated eventual adoption of IFRS as it was known at the date of application, including the International Accounting Standards Board (IASB)'s exposure draft on accounting for rate regulated activities. Hydro One stated that adoption of IFRS, in its then expected form, would not have a material impact on its reported cash flows. Hydro One also stated that the impact of IASB approved changes or interpretations between the date of Hydro One's application in this proceeding and the date of adoption on January 1, 2011, should be provided for through the mechanism of the proposed account. (p.59)

It does not appear that Algoma Power has in this proceeding clearly demonstrated that the application of IFRS, as currently understood, results in a financial impact that is materially the same as CGAAP. And even it were the case, it was not evident, and consequently not examined. Further, the Notes to Algoma Power's Audited Financial Statements for the year ended December 31,

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[4] Board staff assumes that Algoma Power's use of the term "variance", to describe its requested account, is an unintended misstatement. Algoma Power's is seeking a deferral account. The account approved in the Hydro One proceeding is a variance account.

5 See Attachment 1 for the Board's finding in EB-2009-0096 decision.

2009 seem to indicate that Algoma Power would not be able to conclude whether the impacts are comparable.

> … uncertainty as to the final outcome of this Exposure Draft and the final standard on accounting for rate-regulated activities under IFRS, has resulted in API being unable to reasonably estimate and conclude on the impact on API's future financial position and results of operations with respect to differences, if any, in accounting for rate-regulated activities under IFRS versus Canadian GAAP. [6]

In that there is no evidence to suggest Algoma Power had undertaken some analysis and had concluded that the results under IFRS and CGAAP are largely comparable, Board staff submit the Board's decision in the Hydro One proceeding is not relevant in this proceeding and so should be weighed accordingly.

For all these reasons Board staff submits that Algoma Power's request for the establishment of the IFRS deferral account should be denied.

All of which is respectfully submitted.

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6 Ex 3/Tab1/Sch 1 Appendix A Notes p.3 Notes to Audited Financial Statements for the year ended December 31, 2009

BOARD FINDINGS

The Board concurs with Board staff and the intervenors. The extended coverage sought by Hydro One is not available to other distributors, and no compelling reason has been provided for why Hydro One should be treated differently.

The Board approves this account on the basis that it be used for the Board cost assessments only.

Impact for Changes in IFRS Account

In this account, Hydro One proposes to track the difference between costs in the current revenue requirement and any difference in revenue requirement directly attributable to changes which may arise in IFRS standards between now and the conclusion of the test period. The application has been filed based on IFRS standards as they are reflected in the publications of the relevant accounting authorities. It is possible that IFRS standards may change during the test period, and this proposed account is designed to capture the revenue requirement consequences of any such changes.

Board staff pointed out that the creation of such an account has been specifically considered by the Board and rejected (EB-2008-0408, Report of the Board, Transition to International Financial Reporting Standards, July 28, 2009) and submitted that such an account should not be approved in this case. VECC, CCC, SEC, CME, AMPCO and Energy Probe all submitted that the proposal should be denied.

Energy Probe noted that Hydro One has included IFRS transition administration related costs in approved rates and submitted that the Board should require Hydro One to track any difference between the amount included in rates and the actual transition costs in the variance account set out in Section 8.2 of the EB-2008-0408 Report. Hydro One has not explicitly identified the amount included in revenue requirement in this proceeding.

Hydro One responded that the nature of the requested IFRS account was misunderstood by Board staff and intervenors. Hydro One maintained that the requested account would conform to Board policy and would not include revenue requirement impacts arising from changes in the timing of the recognition of expenses, as specifically excluded from the deferral account in the Board's EB-2009-0408 Report which is effective from January 1, 2011. Hydro One submitted that it requires the account to address changes in IFRS or its interpretations that could not be predicted arising between the date of its application in this proceeding and January 1, 2011.

Hydro One stated that its application for 2011 rates, while based on Canadian Generally Accepted Accounting Principles (GAAP), contemplated eventual adoption of IFRS as it was known at the date of application, including the International Accounting Standards Board (IASB)'s exposure draft on accounting for rate regulated activities. Hydro One stated that adoption of IFRS, in its then expected form, would not have a material impact on its reported cash flows. Hydro One also stated that the impact of IASB approved changes or interpretations between the date of Hydro One's application in this proceeding and the date of adoption on January 1, 2011, should be provided for through the mechanism of the proposed account.

BOARD FINDINGS

In its EB-2008-0408 Report, the Board stated that it will:

> "…require(s) distributors to specifically identify financial differences and any revenue requirement impacts that result from adoption of modified IFRS requirements in the distributor's first cost of service application after adoption. Revenue requirement impacts of any change in capitalization policy must be specifically and separately quantified."[12]

The Report also noted that:

> "There was general agreement among participants that rate mitigation mechanisms currently used by the Board, such as deferral accounts and rate riders, could be used to reduce any impacts resulting from IFRS-related costs that the Board permits to be recovered through rates." [13]

In addition, the Report stated in Appendix 2:

> "Rate impacts (from adopting IFRS policies) should be considered in aggregate to determine the significance of the cumulative effect. Distributors must provide specific

[12] EB-2008-0408, Report of the Board, p. 25
[13] EB-2008-0408, Report of the Board, p. 25

> information regarding the individual cost drivers making up the aggregate impact."[14]

The Board will approve the creation of the IFRS deferral account to capture the aggregate impact on the 2011 revenue requirement resulting from any changes to existing IFRS standards and changes in the interpretation of such standards. The granting of this account is, in part, in recognition of the fact that this application by Hydro One covers a two year period.

The account is to permit Hydro One to record, for future disposition of revenue requirement, impacts due to changes in IFRS that arise before the next Hydro One cost of service proceeding. It is to provide for mitigation, should it be appropriate, when considering the impact of transition to IFRS in aggregate, as contemplated in Section 7.0 of the EB-2008-0408 Report.

Approval of this account does not indicate approval of any particular regulatory accounting practice. When considering disposition of the account at the next cost of service application after adoption of IFRS, the Board will address the extent to which entries can be directly linked to changes to the IFRS standards which were used for purposes of the current application, as well as the usual parameters such as prudence, materiality, alternatives considered and other management actions taken by Hydro One to mitigate any material aggregate impact.

Fixed Charge for Micro-Generators

This account is intended to record revenue collected from the new fixed meter charge that will be applied to micro-generators. This revenue will be tracked in a variance account to be refunded in the future to customers. Hydro One would be using Account 1508 Other Regulatory Assets: Sub Account Fixed Charge for Micro-Generators to record these amounts.

BOARD FINDINGS

The Board notes that the Fixed Charge for Micro-Generators Account was supported by all parties. The Board approves the account.

[14] EB-2008-0408, Report of the Board, Appendix 2