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BY COURIER

Ms. Kirsten Walli
Secretary
Ontario Energy Board
2300 Yonge Street Suite 2700,
Toronto, ON. M4P 1E4

Dear Ms. Walli:

EB-2008-0408 – OEB Consultation on Transition to International Financial Reporting Standards – Hydro One Networks' Comments on the Staff Discussion Paper

Hydro One Inc. (Hydro One) is pleased to provide its comments on the Board's EB-2008-0408 Staff Discussion Paper of March 31, 2011 "Transition to IFRS – Implementation in an IRM Environment." Hydro One took an active role in all of the working group meetings which Staff had arranged and provided interim comments as the report was being developed and finalized.

Hydro One would like to highlight that all of the issues discussed in the paper, with the exception of issues 1 and 8, are also faced by distributors and transmitters operating under a cost of service (CoS) regime. This is particularly true for Hydro One Networks Inc., which files its rate applications on a two-year CoS basis. Many of the proposed IRM resolutions are equally applicable to and necessary for CoS applicants. Given that several of these issues are common to both IRM and CoS regulated utilities, Hydro One suggest that the final report explicitly state that the same resolutions are to be applied under both regulatory regimes. Alternately, some other form of explicit Board communication will be required to provide guidance to CoS utilities and to support auditable recognition of the regulatory assets resulting from the new deferral and variance accounts where an entity chooses to adopt US GAAP. In the attached detailed comments, Hydro One has highlighted the reasons why we believe many of the related proposals also apply to CoS utilities.

Sincerely,

ORIGINAL SIGNED BY SUSAN FRANK

Susan Frank

HYDRO ONE INC. COMMENTS ON STAFF DISCUSSION PAPER "TRANSITION TO IFRS – IMPLEMENTATION IN AN IRM ENVIRONMENT"

All of the issues discussed in the paper, with the exception of issues 1 and 8, are faced by distributors and transmitters operating under a cost of service (CoS) regime. This is particularly true for Hydro One Networks Inc., which bases its rate applications on a two-year CoS basis. Many of the proposed IRM issue resolutions are equally applicable to and necessary for CoS entities. Given that several of these issues are common to both IRM and CoS regulated utilities, Hydro One suggests that the final report explicitly state that the same resolutions are to be applied under both regulatory regimes. Alternatively, some other form of explicit Board communication will be required to provide guidance to CoS utilities and to support auditable recognition of the regulatory assets resulting from the new deferral and variance accounts where an entity chooses to adopt US GAAP. In the comments which follow, Hydro One has highlighted the reasons why many of the related proposals also apply to CoS utilities.

ISSUE 1

For distributors that have rebased under CGAAP but who have subsequently adopted IFRS, what, if any, additional guidance does the Board need to provide as to how to recognize accounting changes between CGAAP and modified IFRS in an IRM application? Examples of problem areas include calculations for off-ramps, Z-factors, and the incremental capital module. What level of audit assurance, if any, should the Board require for reconciliation of CGAAP to modified IFRS for these calculations in IRM applications?

Hydro One agrees that it is reasonable and internally consistent to use CGAAP as the basis for calculating such IRM considerations as: Z factors; incremental capital modules; off ramps; group 2 variance and deferral account disposition triggers; and ROE outside the dead band until the affected entity has first rebased under modified IFRS (MIFRS).

We also support Staff's recommendation that separate audit assurance not be required for any mandatory reconciliations between CGAAP and MIFRS as we also expect that the important elements of any such reconciliations will be tested during relevant rate setting processes.

ISSUE 2

Should any differences between costs recorded in the balance sheet accounts and costs built into rates that:

- **arise in the time period between rebasing in CGAAP and the first rebasing under MIFRS, and**
- **are driven by changes in accounting for capital or operating costs, prompted by the adoption of MIFRS, be recovered from or refunded to ratepayers?**

If yes, on what basis?

Hydro One supports the establishment of a generic deferral account to record any CGAAP versus MIFRS differences in the carrying value of property, plant and equipment (as this term is defined in the

Staff recommendations). Potential differences between property, plant and equipment expressed on a CGAAP versus MIFRS basis can arise as the result of capitalization policy differences, depreciation changes, asset retirements etc. occurring during the IRM period and prior to the utility's first MIFRS rebasing. It is also certain that both IRM and CoS utilities will incur such transitional differences at a minimum over the comparative year prior to their formal date of adoption of IFRS for external reporting purposes.

Such a deferral account is required to ensure that property, plant and equipment differences are not lost but are instead either recovered from or refunded to customers. In the absence of such an account, there could be a significant and unresolved discontinuity between the CGAAP and MIFRS rate bases upon transition between the two accounting methods. For example if a CoS utility adopts IFRS effective January 1, 2012, it must effectively adopt IFRS at the beginning of the prior comparative year. As a result, the opening property, plant and equipment balance for 2012 already has CGAAP versus MIFRS differences included to the extent that these occurred in 2011. If the MIFRS carrying value of property, plant and equipment is to be used as rate base going forward, it is important for the continuity of rate base that 2011 CGAAP versus MIFRS differences be recovered or refunded given that the utility is still be under CGAAP for rate purposes in 2011.

Hydro One believes that it would be useful to explicitly state that the approved regulated rate of return should apply to the deferral account balance that Staff has recommended be considered part of rate base. While this is heavily implied in the paper, it is not actually stated.

We agree that this deferral account will be of a fundamentally different nature than other standard deferral accounts and that it should not be interest improved. Given that the account balance results from what is essentially a mathematical calculation, we do not believe that it should subject to the same degree of after the fact prudency review that other deferral accounts are. Amounts recorded in this account should be approved for clearance and recovered from, or refunded to, customers once the amounts are determined to have been properly calculated.

Hydro One agrees that it is reasonable not to approve a generic deferral account for pension and OPEB impacts of IFRS. Instead it is reasonable for utilities to left to request specific regulatory treatments for any differences attributable to the adoption of IFRS as it impacts pension and OPEB accounts. Given the different plan types, utility sizes and accounting methods in use, a generic approach is not warranted.

Finally, Hydro One does not believe that the alternative put forward as Alternative 3 (i.e. no generic deferral account for property, plant and equipment) is reasonable. While it may be fair to say that the return on equity compensates the utility for reasonable risks, it is not reasonable to treat a complete change in the accounting platform used for regulatory accounting and reporting as such a risk. Such a change would not have been considered when setting a reasonable rate of return. Given that Staff has already effectively dismissed the argument for this alternative in the paper, we believe that it should be rejected.

ISSUE 3

Are there special implications associated with IFRS-related corporations tax or PILs impact during an IRM period for which additional IFRS transition related guidance is required from the Board?

We agree that we do not currently have any indication that the Canada Revenue Agency will make significant changes in its interpretation of the tax treatment of expenditures made under IFRS compared to prior interpretations based on CGAAP. However, if such changes do occur in future , we believe that they should be seen as being strongly analogous to changes in statutory tax rates. As such, we would anticipate that both industry groups and Board Staff will remain watchful for early indications of any such changes and that appropriate regulatory mechanisms will be put in place to deal with them on timely basis.

ISSUE 4

Should the Board permit rate applications or RRR reporting using USGAAP?

Hydro One supports the Staff recommendation not to prohibit use of US GAAP as a basis for regulatory accounting and reporting where a utility can provide evidence of reasons for and eligibility to make its periodic securities filings based on US GAAP. We also agree that it is reasonable for the utility to provide supplementary information on resulting regulatory issues, such as favourable rate impacts resulting from the use of US GAAP, that it can reasonably identify at the time of filing an application.

Hydro One supports Staff's assertion that US GAAP provides "a more accurate representation for financial reporting purposes of the economic reality of a rate regulated enterprise than IFRS" [through recognition of regulatory assets and liabilities for example]. Where a utility selects US GAAP as its basis for financial reporting, the use of US GAAP will eliminate or at least minimize differences between external financial reporting statements and financial information provided to the OEB in its role as the rate regulator. Further, as compared to IFRS, US GAAP is expected to minimize rates and earnings volatility, which is to the benefit of the ratepayer and the utility.

We note Staff's concerns that US GAAP would introduce a second set of standards and agree that there is some potential for an increase in complexity and a reduction in consistency among utilities financial information used in the regulatory environment. However, we believe it is important not to overstate this concern. While there are certainly significant differences between US GAAP and IFRS, these differences are concentrated in specific well defined areas where the potential impacts can be relatively easily understood. For example differences exist in the acceptability of the use of rate regulated accounting, in capitalization policy and in the acceptability of group depreciation. Many recent accounting standards have been developed under joint projects between US and international standard setters and this joint approach is expected to be the norm going forward. The result is expected to be a fewer and fewer differences between US GAAP and IFRS and a closer convergence as the two sets of standards mature over time.

We support the Staff recommendation that CGAAP to US GAAP reconciliations should be required for entities reporting on a US GAAP basis in all cases where the Staff recommendations result in a requirement for entities using MIFRS to reconcile with CGAAP.

We strongly support the Staff recommendation that no reconciliations should be required between US GAAP and MIFRS as this would be very costly and labour intensive. We believe that such a reconciliation would result in limited value to stakeholders.

ISSUE 5

Should the Board grant a generic deferral account, for utilities that have rebased under modified IFRS, for the impacts of changes resulting from new IFRS standards or changes in existing IFRS standards arising during an IRM regime?

Hydro One agrees with the Staff recommendation that no generic deferral account is required for the impact of new or changed IFRS standards. Hydro One Networks Inc. does have approved variance accounts for the impact of such potential changes resulting from its recent Distribution and Transmission rate decisions. However, circumstances when these Board decisions were made were significantly different as the International Accounting Standards Board was still struggling with the acceptability of rate regulated accounting and the outcome of their project was still in doubt.

In the future, Hydro One expects that there will be sufficient lead time to enable an appropriate industry wide regulatory response to new or changed standards or to major changes in interpretation by auditors or others. If this is not the case, Hydro One expects that utilities will request relief on their own behalf or on behalf of the industry as a whole.

ISSUE 6

Should the Board grant a generic variance account, for utilities that have rebased under modified IFRS, to mitigate volatility in certain expenses that may arise from the application of IFRS rules? In particular, differences in depreciation or amortization expense caused by changes in estimated useful life of in-service PP&E or intangible assets included in rate base, gains and losses arising from early retirement of in-service assets and differences in pension and post-employment benefit expenses should be considered.

Hydro One cannot agree with Staff's recommendations that no generic variance account is needed for the impact of such events as depreciation service life changes or significant premature retirement losses of fixed or intangible assets. Although Staff states that it has no data with which to assess the likely materiality of these events, it still asserts that an account is not required.

It is important to realize that this general issue applies equally to IRM and CoS utilities, particularly to those that make two-year CoS applications, such as Hydro One Networks Inc.

With respect to in period depreciation changes, it should be noted that a utility that is making an interim service life change will almost always do so in response to an arising externally-driven asset life limiting event or circumstance. As a result, the risk of not reflecting a change in depreciation expense in rates should not be seen as being borne symmetrically by the utility and its customers. The most likely impact of an interim depreciation change, whether resulting from the IFRS requirement to review rate annual or from the inability of the utility to defer the implementation of known depreciation changes until they can be reflected in rates, will almost always be an increase in depreciation expense. As such, the utility is disproportionately at risk for not recovering the capital value eroded by such changes.

In addition, Hydro One believes that it is more likely than not that many utilities will incur premature retirement losses that are significant enough to be considered material for regulatory purposes. We also believe that it is unlikely that utilities will have the ability to forecast future premature retirement losses with enough precision to justify their inclusion in the calculation of forecast revenue requirement. It is also expected that there will either be no or insufficient evidence available to support the inclusion of such amounts in revenue requirement.

Some utilities will have greater difficulty in forecasting premature retirement losses. For example, utilities that have more finely componentized their assets will have greater difficulty in indentifying the assets to be retired or replaced on forecast basis. As a result, forecasting the related net book values that will result in a loss when the asset components are retired or replaced will be virtually impossible. Similarly, utilities that are more at risk for storm damage or other demand-driven asset retirements or replacements will have more difficulty in accurately projecting losses because they are event-driven. Historical information may become available over time but may never be indicative of future losses, even when normalized over multiple years.

Again the risk is primarily on the utility as asset gains happen rarely and only when sales with proceeds occur. However, premature retirement losses will be common and if the full historical cost of prematurely retired assets is not recovered, utilities will not be recovering their prudently invested capital costs. We do not believe that volatility is the primary issue of concern; rather we believe that meeting the utility’s expectation of achieving full capital recovery is.

We believe that a generic deferral account should be provided to accommodate the impacts of both interim depreciation changes and asset retirement gains and losses. Further, we do not believe that enough information exists at this time to lock in a sunset date of use of such an account. We believe that it would be more appropriate for the Board to withdraw the account at some future date when it has been proven that a reasonable forecast can indeed be included in revenue requirement on a forecast basis for both IRM and CoS utilities.

ISSUE 7

The Board Report in issue 10.4 states “Utilities under incentive regulation are required to include in their annual RRR filing a reconciliation of reported annual performance to the same basis of accounting as that upon which the incentive framework was approved”. Does this mean that a reconciliation from modified IFRS, as reported under RRR, to CGAAP must be performed and filed each year of an IRM period? Or is a reconciliation for the first year of RRR reporting under modified IFRS sufficient? What level of audit assurance should the Board require for this reconciliation?

Hydro One understands the need for the reconciliations recommended by Staff in its recommendations on this issue.

With respect to the Staff recommendation that the first three of the four required reconciliations be audited, we believe it is useful for the Board to realize that the first reconciliation must be provided in the first financial statements after the adoption of IFRS and that they will thereof automatically be subject to the audit assurance found in these statements taken as a whole. We do not believe that audit assurance should be required for the second bullet; the mapping and reconciliation US of A balances. In fact, audit assurance may not even be available as a correct mapping may not be auditable against a defined external standard. Similar to the reconciliation described under issue 1, we believe that stakeholders, including Board Staff, will likely be able to probe this mapping/reconciliation in sufficient detail to provide comfort as to its reasonableness and accuracy.

With respect to the third reconciliation, we agree with the Staff comment that questions whether there will actually be any differences between group 1 deferral accounts recorded on an MIFRS versus CGAAP basis. In such a case, we question whether it makes sense to require a generic reconciliation.

ISSUE 8

Should the Board in some forum consider what adjustments need to be made to the IRM regime itself, if adjustments may be made during an IRM period due to the transition to IFRS?

Hydro One concurs with the Staff recommendation that the Board should consider potential adjustments to the IRM methodology in its upcoming 4th generation IRM project.