



EB-2011-0427

IN THE MATTER OF the *Ontario Energy Board Act*, 1998, S.O. 1998, c.15 (Schedule B);

AND IN THE MATTER OF an application by Hydro One Remote Communities Inc. for an order or orders approving a distribution revenue requirement and rates and other charges for the distribution of electricity;

AND IN THE MATTER OF a request by Hydro One Remote Communities Inc. for approval for the use of the USGAAP accounting standard for Rate Setting, Regulatory Accounting and Regulatory Reporting, as of January 1, 2012.

BEFORE: Paul Sommerville
Presiding Member

Ken Quesnelle
Member

DECISION AND ORDER

April 3, 2012

Background

Hydro One Remote Communities Inc. ("Remotes") is a wholly-owned subsidiary of Hydro One Inc. with its head office in Toronto. Remotes is an integrated generation and distribution company licensed to generate and distribute electricity for 21 isolated communities in Northern Ontario. Consistent with the Board's decision in RP-1998-0001, Remotes is 100% debt-financed and is operated as a break-even company with no return on equity.

Most of Remotes' customers are eligible for Rural and Remote Rate Protection ("RRRP") under Section 79 of the *Ontario Energy Board Act, 1998*. Ontario Reg. 442/01 requires the Board to calculate rate protection for these customers and requires that Remotes charge rates that are not based on its cost of service.

Remotes conducts its operations under a cost recovery model applied to achieve breakeven results of operations after the inclusion of PILs. Any excess or deficiency in remote rate protection revenues necessary to lead to breakeven results of operations is added to, or drawn from, the RRRP variance account, which was established in 2002 for this purpose.

About two-thirds of Remotes' revenues come from RRRP. Remotes does not plan to seek approval to adjust the level of RRRP at this time.¹

On November 23, 2011, the Ontario Energy Board (the "Board") issued its EB-2011-0268 Decision granting approval for Hydro One Networks Inc. Transmission to use United States Generally Accepted Accounting Principles ("USGAAP") rather than modified International Financial Reporting Standards ("MIFRS") as the basis for rate application filings, regulatory accounting and regulatory reporting commencing January 1, 2012. Similarly, on March 23, 2012, the Board issued its EB-2011-0399 Decision granting approval for Hydro One Networks Inc. Distribution to use USGAAP as the basis for rate application filings, regulatory accounting and regulatory reporting commencing January 1, 2012.

The Application

On November 25, 2011, Remotes submitted an application to the Board to set 2012 distribution rates for Remotes under the Board's 2012 IRM3 framework. The Board assigned EB-2011-0175 to this application. As part of the application, Remotes included a request to use USGAAP for regulatory purposes, effective January 1, 2012.

On December 8, 2011 the Board issued a letter acknowledging receipt of this application. In that letter the Board stated: "The Board is of the view that the 2012 IRM3 rate application is not an appropriate forum in which to consider these issues..." and noted that "...Remotes shares certain unique circumstances with Hydro One Transmission and Hydro One Distribution, including a common shareholder and should also not be precluded from requesting, in a stand-alone application, approval to use

¹ Exhibit A, Tab 3, Schedule 1, EB-2011-0175 2012 IRM3 application

USGAAP for regulatory purposes and authorization for deferral and variance accounts associated with the use of USGAAP for regulatory purposes”.

On December 16, 2011 Remotes made a separate application for approval to use USGAAP for rate setting, regulatory accounting and regulatory reporting rather than MIFRS. The Board assigned file number EB-2011-0427 to the application. The application generally follows the steps outlined by the Board in its EB-2011-0268 Transmission USGAAP Decision.

The application included:

- The justification of the move to USGAAP as per the page 19 of the Board’s *Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment (“the Addendum”)*;
- The decision of the Ontario Securities Commission (“OSC”) granting Hydro One Inc., the parent company of Remotes, permission to use USGAAP in its financial statements filed with the OSC for the fiscal year beginning January 1, 2012, as dated July 21, 2011;
- Hydro One Inc.’s request to the OSC, incorporating the rationale for its request, that they grant Hydro One Inc. permission to use USGAAP in financial statements filed with the OSC, as dated July 7, 2011;
- The Board’s Decision With Reasons in Hydro One Transmission’s EB-2011-0268 proceeding; and
- A request to establish an “Impact for USGAAP Account” which will be used to record the 2012 impact of differences between CGAAP and USGAAP.

In the application, Remotes also indicated that it estimated that the 2012 notional Remotes revenue requirement would be \$2 million higher if MIFRS were utilized rather than USGAAP.

The Proceeding

On February 2, 2012, the Board issued its Notice of Hearing and Procedural Order No. 1 regarding the EB-2011-0427 application (the stand-alone USGAAP application for Remotes). The Board granted intervenor status to all intervenors in Remotes' previous cost of service distribution rates proceeding (EB-2008-0232) and indicated that it intended to proceed by way of a written hearing.

Procedural Order No. 1 provided for interrogatories to be submitted by Board staff and intervenors and for Remotes' responses. Interrogatories were submitted by Board staff on February 14, 2012 and Remotes provided responses on February 23, 2012.

On March 6, 2012, Board staff filed its submission and on March 12, 2012 Remotes submitted its reply submission. No intervenor filed interrogatories or a submission in this case.

The Addendum

The Board's Addendum issued on June 13, 2011, set out the Board's expectations regarding proposals to use USGAAP:

A utility, in its first cost of service application following the adoption of the new accounting standard, must demonstrate the eligibility of the utility under the relevant securities legislation to report financial information using that standard, include a copy of the authorization to use the standard from the appropriate Canadian securities regulator (if applicable) showing any conditions or limitations, and set out the benefits and potential disadvantages to the utility and its ratepayers of using the alternate accounting standard for rate regulation.

The Board cautions utilities that the adoption of USGAAP as a short term solution may be counter-productive. If a utility is required to transition to IFRS for financial reporting purposes a few years after adopting USGAAP, certain transitional issues may not have been avoided, but delayed, and additional costs may be incurred if the utility changes its accounting standard twice. The Board will carefully scrutinize the costs incurred to accomplish two successive transitions if the utility seeks to recover these costs from ratepayers.²

² Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment (EB-2008-0408) (the "Addendum") June 13, 2011, page 19

As in the Hydro One transmission and distribution USGAAP cases, the Board will use the principles set out in the Addendum to address the USGAAP request from Hydro One Remote Communities Inc.

Issues raised by Board Staff

Board staff generally supported Remotes' request to use USGAAP for regulatory accounting and rate setting. Board staff agreed that Remotes' use of USGAAP for regulatory purposes is in the best interests of stakeholders, including the utility, its shareholder, and ratepayers. Board staff noted benefits that would be achieved through the use of USGAAP through efficiency and lower costs, an absence of rate impacts and a clearer relationship between the accounting basis used to set rates and that used to report financial results.

On the issue of benchmarking, Board staff also accepted Remotes' evidence that it is not comparable to other Ontario utilities as it provides generation and distribution to a small customer base in isolated, off-grid communities scattered over large distances.

Board staff pointed out that in its EB-2011-0268 decision concerning the adoption of USGAAP for Hydro One Transmission, the Board required Hydro One to conduct a critical review of its current and proposed capitalization policies. Board staff noted that Hydro One uses the same capitalization policies across all of its regulated businesses and submitted that the results of this capitalization review, as it pertains to Remotes, should be included in its next cost of service application.

With regard to deferral and variance accounts, Board staff noted that the Board approved the establishment of an Impact for USGAAP account in the recent Hydro One Transmission proceeding, EB-2011-0268. Board staff submitted that it is reasonable to extend this regulatory treatment to Remotes as the amounts that would be recorded in the account would likely relate to costs in the same corporate structure. Board staff submitted that the account should be limited to potential impacts on the 2012 revenue requirement, and not relate solely to balances incorporated into the audited financial statements.

Board staff requested an explanation from Remotes as to why a \$70,000 variance between actual IFRS conversion charges and the amount recovered for this purpose in the 2009 revenue requirement was recorded in the RRRP variance account, rather than the IFRS Transition Costs Variance Account. Remotes replied that neither Remotes'

net income nor the substances of its regulatory accounting for any of the years from 2009 to 2011 were adversely impacted using this approach.

Board staff also noted that Remotes stated that a “Corporate Finance cost was also charged by Hydro One Networks through approved service level agreements” but did not disclose the amount charged. Board staff asked that Remotes disclose the amount charged and explain the rationale for not including this amount in the incremental IFRS Transition Costs Variance account. Remotes replied that this charge was approximately \$23,000.

Board staff submitted that recording costs in either the RRRP Variance account or in the IFRS Transition Costs Variance account does not imply recovery of the balances in the account. These costs will be subject to a prudence review when Remotes seeks clearance of the balance in this account in a future proceeding, including whether Remotes has adequately reviewed all of the impacts of the accounting changes associated with the transition to USGAAP.

Board Findings

In its Hydro One Transmission USGAAP decision (EB-2011-0268) and in its Hydro One Distribution USGAAP decision (EB-2011-0399), the Board approved Hydro One's request that it be authorized to use the USGAAP accounting standard for regulatory purposes associated with its transmission and distribution businesses.

The Board has reviewed its reasoning in those decisions and finds that it is substantially applicable to this application. The Board finds that it is appropriate that Remotes also be permitted to use USGAAP as the accounting standard for regulatory purposes as of January 1, 2012.

As noted by Board staff, Remotes has demonstrated the required eligibility to use USGAAP in its financial reporting, under the umbrella of its parent, Hydro One Inc. Indeed, Ontario Regulation 395/11 obliges Hydro One Inc. to prepare its financial statements in accordance with USGAAP, beginning on January 1, 2012, with no explicit time limitation.

The Board finds that there are benefits to the utility and its ratepayers of permitting Remotes to use USGAAP for regulatory filing and reporting. Efficiencies are gained if all Hydro One regulated businesses (transmission, distribution and Remotes) are

permitted to use a common accounting standard, and the cost of maintaining records in two accounting standards (one for financial reporting and one for regulatory purposes) is avoided. Potential rate increases, that would result from the adoption of MIFRS (as notional revenue requirement would increase by \$2 million), are avoided under USGAAP, and rate stability is not compromised.

Although the Board in its Addendum noted that the cost of successive transitions of accounting standard would be carefully scrutinized, the Board cannot assess the true potential for a later transition to IFRS by Hydro One or its subsidiaries at this time. If a transition to another accounting standard is necessary, the additional costs can be reviewed at the time those costs are sought to be recovered from ratepayers.

As in the previous two Hydro One USGAAP cases, the Board notes that Hydro One has indicated that it would apply the results of the capitalization review to its Remotes business. The Board expects that the impacts of this review will be addressed in the next Remotes cost-of-service rate application.

With regard to specific deferral and variance accounts, the Board approves the establishment of an Impact for USGAAP Account, which will be a symmetrical variance account to record the 2012 impact of differences between CGAAP and USGAAP. The account will be limited to potential impacts on the 2012 revenue requirement, and not relate solely to balances incorporated into the audited financial statements. The Board approved the establishment of an Impact for USGAAP Account in both the EB-2011-0268 and EB-2011-0399 proceedings. The Board is of the view that it is reasonable to extend this regulatory treatment to Hydro One Remote Communities.

Upon request for disposition of the Impact for USGAAP Account, the Board will take into account whether Hydro One Remotes adequately reviewed in its application all of the impacts of the accounting changes associated with the transition.

Remotes has requested the continuance of the RRRP variance account as expressed in the response to Board staff IR # 4. As Board staff has submitted, the Board agrees that continuance of this variance account is reasonable.

With respect to the \$70,000 variance recorded in the RRRP variance account, the Board has issued guidance (October 2009 FAQ #2 to the *Accounting Procedures Handbook*) that one-time administrative incremental IFRS transition costs are to be

recorded in a sub-account of Account 1508, Other Regulatory Assets. The Board has not issued specific guidance to Remotes to record such a variance in the RRRP variance account.

Accordingly, the Board directs Remotes to remove the amounts recorded for the variance relating to incremental IFRS transition costs in the RRRP Variance Account and record the variance in the sub-account "IFRS Transition Costs Variance" in Account 1508, Other Regulatory Assets. Remotes is to record all amounts related to incremental IFRS transition costs that it included in its 2009 revenue requirement and recovered from its rate payers, i.e., the actual amounts recovered in rates since 2009, as credits in that same sub-account.

The Board is of the view that recording costs in the IFRS Transition Costs Variance sub-account (as with any deferral and variance account) does not imply recovery of the balances in the account. These costs will be subject to a prudence review when Remotes seeks clearance of the balance in this account in a future proceeding. The Board directs Remotes to disclose all amounts embedded in the 2009 revenue requirement when Remotes seeks clearance of the IFRS Transition Costs Variance sub-account.

IMPLEMENTATION MATTERS AND COST AWARDS

Implementation

In this decision, in addition to approving Hydro One Remote Communities' use of USGAAP for regulatory purposes, as of January 1, 2012, the Board has also approved the creation of the Impact for USGAAP Account.

1. Hydro One shall file with the Board a draft Accounting Order for this new account within **10 days** of the date of the issuance of this Decision.
2. Board staff shall file any comments on the draft Accounting Order with the Board and forward to Hydro One within **7 days** of the date of filing of the draft Accounting Order.
3. Hydro One shall file with the Board responses to any comments on its draft Accounting Order within **7 days** of the date of receipt of any comments.

Cost Awards

As no intervenor actively participated in this proceeding, no costs will be awarded to eligible intervenors.

Hydro One Remote Communities Inc. shall pay the Board's costs of and incidental to this proceeding upon receipt of the Board's invoice.

All filings to the Board must quote file number **EB-2011-0427**, be made through the Board's web portal at, www.errr.ontarioenergyboard.ca and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.ontarioenergyboard.ca. If the web portal is not available parties may email their document to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

All communications should be directed to the attention of the Board Secretary at the address below, and be received no later than 4:45 p.m. on the required date.

ADDRESS

Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4
Attention: Board Secretary

E-mail: Boardsec@ontarioenergyboard.ca
Tel: 1-888-632-6273 (toll free)
Fax: 416-440-7656

DATED at Toronto, April 3, 2012

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary