Ontario Energy Board

Commission de l’énergie de l’Ontario

EB-2012-0079

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

AND IN THE MATTER OF an application by Toronto Hydro-Electric System Limited for an accounting order to establish a deferral account.

BEFORE: Marika Hare
Presiding Member

Cathy Spoel
Member

DECISION AND ORDER
June 7, 2012

Toronto Hydro-Electric System Limited (“THESL”) filed an accounting order application with the Ontario Energy Board, (the “Board”) on February 28, 2012 under section 78.1 of the Act. The application sought approval to establish a deferral account to accumulate the differences between Canadian Generally Accepted Accounting Principles (“CGAAP”) and the Generally Accepted Accounting Principles of the United States (“USGAAP”). The Board assigned the application File No. EB-2012-0079.

On March 12, 2012, the Board issued its Notice of Application and Hearing and Procedural Order No. 1, in which it stated that it would adopt as intervenors and observers in this proceeding the intervenors and observers from THESL’s electricity distribution rate application for the 2012, 2013 and 2014 rate years (EB-2011-0144) and established dates for interrogatory and submission processes.

On March 28, 2012, Board staff filed interrogatories. No other party filed any interrogatories. On April 10, 2012, THESL responded to these interrogatories.

On May 1, 2012, submissions were received from Board staff and the School Energy Coalition ("SEC"). On May 15, 2012, THESL filed a reply submission.

THESL requested that the Board establish a deferral account to record certain accounting differences between CGAAP and USGAAP, effective January 1, 2012, with 2011 comparability. The referenced differences pertained to post-employment benefits. THESL stated that its post retirement benefit difference between CGAAP and USGAAP is estimated to be approximately $30 million as at January 1, 2011.

THESL justified this request on the basis that given CGAAP is no longer available beyond December 31, 2011, a transition to a different accounting standard is externally imposed on it and is clearly outside of management's control. THESL stated that it had determined that it would transition to USGAAP on January 1, 2012 for external financial reporting purposes and the use of a consistent financial accounting framework for external financial reporting and regulatory reporting would allow it to preserve the existing link between the audited consolidated financial statements and the documentation that it will utilize in its rate applications and regulatory reports.

THESL argued that the establishment of a deferral account to manage USGAAP differences is justified and consistent with the Board's principles governing the transition to a different regulatory accounting standard and would not impact rates for rate payers.

THESL concluded that if it was denied the use of the deferral account, there would be a significant negative impact on the shareholder's equity reported in THESL's general purpose financial statements as for regulatory purposes the costs would be recognized immediately in the profit and loss as out-of-period costs.

Positions of the Parties

Board staff supported THESL's proposal arguing that the deferral account requested by THESL was required to appropriately track the effects of the change in accounting standard upon THESL's transition and implementation to USGAAP as of January 1, 2012.

Staff, however, expressed the concern that there was the potential for double recovery related to the amounts recorded in the proposed deferral account and submitted that THESL should demonstrate before being allowed to recover any costs that may accumulate in the proposed deferral account: (1) that these costs are incremental to what is already being recovered in THESL's approved rates and (2) that the incremental increase is specifically related to the transition from CGAAP to USGAAP and would not have occurred in the absence of this transition. Board staff invited THESL to clarify this matter in its reply submission.

THESL responded that there was no issue of double recovery since it is requesting a regulatory asset account in order to recognize the unamortized actuarial losses and past service costs as a regulatory asset on the balance sheet instead of recognizing the balance in shareholder's equity, as USGAAP does not allow these actuarial losses and past service costs to be off-balance sheet.

THESL argued that the deferral account would act as a "holding area" for yet-unrealized other post employment benefits ("OPEB") costs and the total amount in the 'holding area' would never be disposed in a single year. THESL explained that only the amounts representing current period costs would be charged to revenue requirement, after going through the 'holding area' and these amounts would be no different than those that would occur otherwise in the absence of the deferral account.

THESL stated that the essential difference is that the 'holding area' would be recognized as a regulatory asset on the balance sheet (offset by the corresponding obligation), rather than as a reduction to shareholder's equity. THESL submitted that if the 'holding area' is not recognized as a regulatory asset and instead was recorded as a reduction to shareholder's equity, this would introduce a material distortion in THESL's financial statements.

Board staff suggested that the Board might wish to consider incorporating certain caveats should it decide to approve THESL's request for the deferral account. These were:

1. The establishment of the deferral account does not guarantee that the amount in the deferral account will be disposed, consistent with the principles underlying all Board-approved deferral accounts, and

2. The establishment of the deferral account would not be predictive of the Board's ultimate decision on USGAAP for regulatory purposes for THESL and that in the event the Board did not approve of the use of USGAAP for regulatory purposes, the requested deferral account would not be required and the balance recorded in the account would not be recognized.

SEC opposed THESL's proposal arguing that the application did not support the establishment of the proposed deferral account for three reasons.

First, while THESL stated that the only material impact of the change to USGAAP is the $30 million charge to retained earnings as of January 1, 2011, the application did not provide a precise amount even though at the time of the application, the 2011 audited financial statements were shortly to be finalized. In addition, the application also did not deal with any OPEB differences applicable to 2011. SEC stated that while it had been unable to determine from the 2011 Audited Financial Statements whether there had been an incremental 2011 impact, it submitted that the Board should know this before making a determination on a deferral account.

THESL responded that it was not aware of any requirement to provide the precise actual rather than the approximate, initial liability of the accrual amount and that THESL had provided an approximate amount to communicate the order of magnitude of the amount consistent with the accepted practices of other utilities seeking a USGAAP deferral account. THESL further noted that the referenced $30 million amount was disclosed publicly in Toronto Hydro Corporation's *Management's Discussion and Analysis* ("MD&A") as filed on the System for Electronic Document Analysis and Retrieval ("SEDAR") on March 2, 2012. THESL noted that the precise figure of $30,130,000 was disclosed in note 12(b) of THESL's 2011 Audited Financial Statements filed on SEDAR on March 2, 2012.

The second reason cited by SEC as to why THESL had not justified its request is that the application appeared to be at odds with the evidence filed by THESL in its EB-2011-0144 cost of service application as well as with the disclosure related to USGAAP in the 2011 Audited Financial Statements. SEC argued that this was because the EB-2011-0144 evidence did not disclose the $30 million estimate now provided, nor did it request a deferral account, but it did make a statement that key accounting areas for which CGAAP to USGAAP differences had been identified at that time were: employee benefits, PILs, financial instruments, and customer advance deposits, while the current application referred only to OPEB, but did not deal with any of the other areas mentioned.

THESL responded that the reference in its application to only OPEB was neither an error nor a deficiency in its application. THESL explained that OPEB is the only USGAAP related difference that may result in a negative impact to equity or profit and loss absent a regulatory asset as all other USGAAP-related differences are reclassifications of existing balances within the same categories on the balance sheet that do not require consideration within the requested deferral account.

SEC's concern regarding the 2011 Audited Financial Statements was that they included a statement that Toronto Hydro Corporation did not believe that the adoption of USGAAP will have a material impact on its consolidated financial statements in the future. SEC argued that this statement did not appear to be consistent with the present application which had been filed with the Board two days before the issuance of the Audited Financial Statements.

THESL responded that to the extent clarification of the referenced statement was required, the statement was intended not to refer to the one-time recognition of the OPEB amount, but rather to ongoing statements in the future. THESL stated that in the event the Board did not grant the request for the deferral account, THESL would recognize the OPEB amount in Accumulated Other Comprehensive Income ("AOCI") in the next quarter, which would at that time have a material impact on its financial statements.

SEC's third reason for arguing against THESL's proposal was its view that the deferral account did not provide the accounting result that THESL said it needed. SEC argued that this was because it is not the Board's policy to pre-approve disposition of deferral and variance accounts at the time they are created, although the wording of the relevant Accounting Standard requires both the approval by the Board of the deferral account and pre-approval of recovery from ratepayers. SEC noted that unless the approval of the deferral account results in an allowed regulatory asset, there would appear to be no reason for the account and since THESL is expressly not asking the Board for an approval that would achieve the conditions in the Accounting Standard, the desired result of establishing the deferral account is not logically achievable.

THESL responded that SEC had misconstrued the Accounting Standard, as the language is clear, which is that a utility must only obtain an order that allows for, rather than approves subsequent inclusion of the deferral costs in the utility's rates. THESL stated that its application was limited only to seeking approval for the establishment of the requested USGAAP deferral account. THESL further stated its recognition that the establishment of this deferral account would have no bearing on whether or not the deferred costs will be eligible for recovery in rates. THESL added that, as also recognized by Board staff, the establishment of the requested deferral account does in fact conform to the USGAAP accounting standard at issue.

SEC also included submissions on whether or not THESL should be allowed to use USGAAP for regulatory purposes. SEC acknowledged that while the current application was not cost of service which is when this question would normally be expected to be considered, the Board had in the past allowed an exception to that guideline where circumstances warranted. SEC expressed the concern that THESL's next cost of service application would be for its 2015 rate year and this was too long to wait for a determination on this issue for a utility of its size.

SEC, accordingly, recommended that the Board make a determination on this matter at the present time through either an extension of the current process, or another process this year, even if such a process was an IRM or separate application. SEC suggested that if THESL had further evidence that would support the proposed deferral account on other grounds, it could file such evidence as part of that application as well. SEC argued that such an application should include specific evidence on the comparability of THESL information under USGAAP to that of other LDCs filing under IFRS.

SEC submitted that there was an issue related to the comparability of THESL information to that of other LDCs arising from the use of USGAAP that meant the approval of USGAAP for THESL would not necessarily be as straightforward as may have been the case with Union Gas Limited, Enbridge Gas Distribution Inc., Hydro One Networks Inc. or Ontario Power Generation.

SEC submitted that in the first two cases, the parent company financials already used USGAAP, and the utilities already provided their parent with USGAAP-consistent information, while in the latter two cases the natural comparators in transmission and generation are made up in part of U.S. utilities.

SEC argued that neither of these conditions applied to THESL and suggested that the use of IFRS for THESL similarly to all other Ontario LDCs may be preferable in order to maintain the comparability of THESL's financial information with the financial information being provided under IFRS by other LDCs.

THESL responded that it recognized that the issue as to whether or not it is authorized to use USGAAP for regulatory accounting purposes is outside the scope of this proceeding and it did not seek such approval at this time. THESL stated that it intended to seek approval to use USGAAP for regulatory accounting purposes in the context of its next cost of service application.

THESL stated that its request in this application for relief related only to the establishment of a deferral account to track the differences between CGAAP to USGAAP upon transition and was consistent with the practice of other utilities and Board accounting orders regarding such relief. THESL submitted that there was no compelling reason to delay establishment of the deferral account as SEC's submissions did nothing to suggest that the Board should depart from its prior decisions granting a USGAAP deferral account for other utilities.

Board Findings

The Board approves the establishment of the "Impact for USGAAP Deferral Account" to record the financial impacts resulting from the transition to and implementation of USGAAP as requested by THESL. The account is subject to the following conditions:

- The account is effective January 1, 2012;
- The approval of the establishment of the deferral account should not be considered to be in any manner or degree predictive of disposition of the account; and
- Approval of the establishment of the deferral account should not be considered to be predictive in any manner or degree of the Board's determination with respect to the adoption of USGAAP for regulatory accounting purposes in THESL's next cost of service application.

The extent to which any of the amounts captured in this account would be subject to carrying charges will be determined by the panel deciding the next cost of service application.

The Board notes that THESL must transition from CGAAP to another accounting standard effective January 1, 2012. THESL has determined that it will adopt USGAAP and has estimated that the impact of transition to and implementation of USGAAP is $30 million related to the post-retirement benefit difference.

If the proposed deferral account is not approved, the financial impact could be characterized as an out-of-period cost. In order to make provision so that any balances arising from the transition and implementation of USGAAP may be eligible for recovery, it is appropriate to approve the establishment of the account at this time, even though there is no immediate rate impact.

THESL has notified the Board that it intends to use USGAAP for regulatory accounting purposes, consistent with the guidance provided in the Board's *Report of the Board: Transition to International Financial Reporting Standards* (EB-2008-0408) and the subsequent Addendum to this report. The Board recognizes that it is impossible to describe with precision all of the costs which may ultimately be considered for inclusion in the account and possible future disposition at this time. While more precision would be preferable, it is simply not definitively available now, and the Board is satisfied that the panel considering the next cost of service application will be able to define what amounts, if any, should be eligible for disposition. In the current application the only costs which have been identified for capture in the account are those related to the post-retirement benefit difference.

The Addendum to the Report of the Board on IFRS addressed implementation of IFRS in an Incentive Rate Mechanism environment, and considered the use of USGAAP as an alternative to IFRS. It states:

> The Board requires a utility that adopts USGAAP or an alternate accounting standard other than IFRS, in its first cost of service application following the adoption of the new accounting standard, to:
>
> - 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); and

- set out the benefits and potential disadvantages to the utility and its ratepayers of using the alternate accounting standard for rate regulation.[1]

The Addendum noted that the Board must consider the general public interest in ensuring efficiency and consistency in utility regulation in Ontario[2] and retains the authority to require specific accounting standards and practices for regulatory purposes in any case where the Board finds that the public interest requires uniformity in those standards and practices among utilities.[3]

The Board will consider THESL's application for the use of USGAAP for setting rates in the next cost of service case against the criteria listed in the Addendum.

The Board is mindful in making this finding, of the submissions of SEC in favour of an earlier determination of this matter. However, the Board finds that such an earlier determination would be a departure from the established Board policy that these matters be considered at the first cost of service application following the transition and THESL's circumstances are not sufficiently unique to justify such a departure.

The Board notes that one of the arguments made by SEC in favour of an earlier determination of this matter was the concern that an issue may arise as to the comparability of THESL information to that of other LDCs arising from THESL's use of USGAAP. The Board considers benchmarking and comparisons with other utilities to be an important regulatory tool. As such, THESL should be mindful, that whatever accounting system may be used by a utility, the Board may require the production of evidence, statistics, data or information in such form or format as may be necessary to make meaningful comparisons possible.

As noted in the third deferral account condition, the establishment of the Impact for USGAAP Deferral Account is not predictive of the Board's ultimate decision on USGAAP for regulatory purposes for THESL. In the event that the Board does not approve the use of USGAAP for regulatory purposes, the Impact for USGAAP Deferral

[1] Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment, Appendix A.

[2] Ibid, p 19.

[3] Ibid, Appendix A.

Account would not be required and the balance recorded in the account would not be recognized. In addition, approving the establishment of the Impact for USGAAP Deferral Account does not guarantee that the amount in the deferral account will be disposed, consistent with the principles underlying all Board-approved deferral accounts.

COST AWARDS

The Board may grant cost awards to eligible stakeholders pursuant to its power under section 30 of the *Ontario Energy Board Act, 1998*. When determining the amount of the cost awards, the Board will apply the principles set out in section 5 of the Board's *Practice Direction on Cost Awards*. The maximum hourly rates set out in the Board's Cost Awards Tariff will also be applied.

The Board will issue a Decision on Cost Awards after the steps set out below have been completed.

THE BOARD ORDERS THAT:

1. Toronto Hydro-Electric System Limited shall establish a deferral account, subject to conditions noted in this decision, to be named the "Impact for USGAAP Deferral Account" to be effective January 1, 2012.

2. Intervenors eligible for cost awards shall file with the Board and forward to Toronto Hydro-Electric System Limited their respective cost claims within 14 days from the date of this Decision and Order.

3. Toronto Hydro-Electric System Limited shall file with the Board and forward to intervenors any objections to the claimed costs within 21 days from the date of this Decision and Order.

4. Intervenors, whose cost claims have been objected to, may file with the Board and forward to Toronto Hydro-Electric System Limited any responses to any objections for cost claims within 28 days of the date of this Decision and Order.

5. Toronto Hydro-Electric System Limited shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

All filings to the Board must quote file number EB-2012-0079, 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 boardsec@ontarioenergyboard.ca. 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.

DATED at Toronto, June 7, 2012

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary