Parry Sound Power Corporation ("Parry Sound Power")
Disposition of Account 1562 – Deferred PILs
Board Staff Interrogatories
EB-2012-0229

Ref: 2001 to 2005 SIMPIL Models

1) Income Tax Rates

a) Please provide the letter and all related schedules received from Parry Sound Power's auditors that show how the income tax rates were calculated for each year 2002 to 2004.

Response

Appendix 1 provides the details supporting the determination of effective income tax rates by Parry Sound's external auditors for the period from 2002 to 2005.

b) Please explain what Parry Sound Power means by the term "legislated tax rate". Please provide the sources of this quotation, such as the Income Tax Act.

Response

Legislated tax rate means the weighted average actual tax rate that a taxpayer would have paid in each of the years based on taxable income equal to regulatory net income (as approved in the PILs determination models) with due consideration to the availability of the small business income tax deduction.

This is the tax rate that the Board would have used to set rates for Parry Sound if it had full knowledge of what the actual tax rates would have been at the time of rate approval.

c) Did Parry Sound Power's auditors calculate the income tax rate for the 4th quarter 2001? If not, please explain why the auditors did not provide this calculation.

Response

Parry Sound did not request its auditors to calculate an effective rate for Q4 2001. The approval of Q4 2001 PILs was completed at a time when the Board had full knowledge of what the actual tax rate would have been (late 2001 and early 2002).

d) Please explain how Parry Sound Power chose the income tax rate for the 4th quarter 2001.

Response

As stated above Parry Sound used the tax rate used to approve PILS as it was approved by the Board with full knowledge of what the actual tax rate would have been (late 2001 and early 2002).

e) Did Parry Sound Power use rate base of $6,561,667 as the proxy for paid-up capital to determine the eligibility for the small business deduction? If not, please explain how Parry Sound Power determined eligibility for the small business deduction.

Response

The external auditors calculated tax rates assuming the full business limit was available in all years (2002 to 2005) as taxable capital was less than $10 million.

f) Are the calculations of the income tax rates based on the same set of assumptions as the definition of paid-up capital?

Response

See response to e) above

g) Please provide another scenario for the Board's consideration as follows.

i. Please enter the minimum income tax rates as found on page 17 of the Board's Decision in the Combined Proceeding EB-2008-0381 in the five SIMPIL models for 2001 to 2005.

Response

Board Staff have not provided a rationale as to why they feel that the use of minimum tax rates would be appropriate.

PSPC believes that a regulatory approach to the determination of true-up income tax rates is the appropriate approach. The regulatory approach should reflect a taxable income level equal to the regulatory taxable income that was originally used to determine the amount of PILS that were approved to be included in rates. The determination of tax rates should also reflect the entitlement to reduce taxes through the benefit of the small business deduction.

PSPC believes these are the proper rates to utilize, as they reflect the intent of the SIMPILS process to capture changes in legislated tax rates. The PILS included in rates were determined well in advance of the actual tax years using proxies for what the actual tax rates would be. Utilizing the actual tax rates that would be applicable to the same level of regulatory net income as used to set PILS in rates properly captures the changes in legislation. This captures the difference between the rates used to determine PILS included in rates and what the PILS would have been if they were set in the actual tax year with knowledge of any changes in tax rates.

Although PSPC disagrees with this approach, revised SIMPILS models are included in Appendices 3 to 7.

ii. Please file an updated model for 2001 that has sheet TAXREC3.

Response

The 2001 model as filed generates the exact same result as filing a model that contains a TAXREC3 tab. The $94,235 deduction to taxable income due to transition costs capitalized for accounting purposes appears as a material difference as per line 146 on the TAXREC2 tab. As a material difference the SIMPILS model logic wants to true this amount up as per line 116 on the TAXCALC tab. As regulatory asset adjustments are not to be trued up cell I 116 of TAXCALC has been set to zero.

Parry Sound does not see the benefit of submitting a revised 2001 SIMPILS that will show the exact same amount with a zero SIMPILS balance for 2001.

iii. Please submit a revised continuity schedule showing the variances from these five revised SIMPIL models.

Response

A revised continuity schedule is included as Appendix 2.

2) Interest Expense for Tax Years 2001 to 2005

For the tax years 2001 to 2005:

a) Please provide a table for the years 2001 to 2005 that shows all of the components of Parry Sound Power's interest expense and the amount associated with each type of interest.

Response

Appendix 14 outlines the components of Parry Sound's interest expense for the years 2002 to 2005. The stub year financial statements for 2001 did not disclose any interest expense

b) Did Parry Sound Power have interest expense related to other than debt that is disclosed as interest expense in its financial statements?

Response

Yes, see Appendix 14 for details.

c) Did Parry Sound Power net interest income against interest expense in deriving the amount it shows as interest expense? If yes, please provide details to what the interest income relates.

Response

PSPC netted interest revenue and expense related to interest on regulatory assets for 2004 and 2005. It is reported on the Financial Statements as Regulatory Assets Interest. See Appendix 14 for details.

PSPC determined interest on regulatory assets for 2002 to 2004. For the period 2002 to 2004 PSPC utilized an offset balance sheet deferred revenue account. As a result there was no income statement impact for these years. In 2005 PSPC cleared out the deferred revenue accounts to profit and loss. A summary of the transactions is set out in Appendix 15 which details the interest revenue and expense related to regulatory assets for the respective year.

d) Did Parry Sound Power include interest expense on customer security deposits in interest expense?

Response

No, the interest expense related to customer deposits was categorized under Other Administration and General Expense on the Financial Statements. See Appendix 14 for the amounts.

e) Did Parry Sound Power include interest income on customer security deposits in interest expense?

Response

No, PSPC did not net interest revenue on customer deposits against interest expense.

f) Did Parry Sound Power include interest expense on IESO prudentials in interest expense? Please provide the dollar amount of IESO or other prudential expense by year whether disclosed as interest, admin, or other type of expense category.

Response

No, the interest expense related to IESO prudentials was categorized under Other Administration and General Expense on the Financial Statements. See Appendix 14 for the amounts.

g) Did Parry Sound Power include interest carrying charges on regulatory assets or liabilities in interest expense?

Response

See the response to question c)

h) Did Parry Sound Power include the amortization of debt issue costs, debt discounts or debt premiums in interest expense?

Response

No these costs are not applicable to PSPC.

i) Did Parry Sound Power deduct capitalized interest in deriving the interest expense disclosed in its financial statements?

Response

No it did not.

3) Changes in Formulae in SIMPIL Models

a) Does Parry Sound Power agree that the formulae should be corrected in its SIMPIL models filed in evidence?

Response

PSPC agrees with Board Staff that the additions and deductions to taxable income approved in the 2002 determination of PILS related to regulatory assets should be trued up. The addition to taxable income of $8,064 in the 2002 rate approval should be trued up over the 2002 to 2004 years.

b) If yes, please submit revised SIMPIL models for 2002-2005 and a revised continuity schedule that allows for the reversal of the regulatory assets and liabilities in SIMPIL sheet TAXCALC column E rows 100 to 132.

Response

Revised SIMPILS models are set out in Appendices 8 to 12 and a revised continuity schedule is set out in Appendix 13. The true-up of regulatory adjustments to taxable income over the 2002 to 2004 period has increased the amount payable to customers from $120,735 to $129,622.

c) If Parry Sound Power disagrees that the tax impact of regulatory assets and liabilities should be allowed to reverse in the true-up calculations as done in the Combined Proceeding, please provide the Board's regulatory references that support Parry Sound Power's position.

Response

As stated above PSPC agrees with the Board staff position.

4) PILs Recoveries from Ratepayers

a) Please verify the formulae used in the calculations of recoveries to ensure that the dollar amounts are correct and state the outcome of the review.

Response

<u>Recoveries</u>

PSPC has reviewed the customer statistics used to determine the PILS revenue recoveries in the original application. The early 2002 and 2003 billing data for PSPC is somewhat suspect.

Appendix 16 shows a comparison of statistics used to determine PILS revenue recoveries against other load data provided to the OEB.

PSPC has revised these statistics for the 3 largest customer classes as set out in the following customer class discussions.

<u>Residential Class</u>

Normalized 12 month sales for 2002 are 31,424,834 kwh's which appears low relative to the 2004 to 2011 residential average consumption as per PSPC's last cost of service load forecast of 34,213,302. PSPC has increased kwh sales for the 12 month 2002 period to reflect the average monthly sales as per the 2004 to 2011 average (34,213,302 / 12 = 2,851,109 per month.)

Conversely, 2003 sales of 36,574,671 appear high relative to the 2004 to 2011 residential average consumption as per PSPC's last cost of service load forecast of 34,213,302. PSPC has decreased kwh sales for 2003 to reflect the average monthly sales as per the 2004 to 2011 average (34,213,302 / 12 = 2,851,109 per month.)

<u>GS<50kw Class</u>

Normalized 12 month sales for 2002 are 19,634,697 kwh which appears high relative to the 2004 to 2011 GS<50 kw average consumption as per PSPC's last cost of service load forecast of 16,689,647. PSPC has decreased kwh sales for 2002 to reflect the average monthly sales as per the 2004 to 2011 average (16,689,647 / 12 = 1,390,804 per month.) GS<50 kw loads are very consistent over all years.

<u>GS>50 kw Class</u>

The customer count used for 2002 of 40 appears low. PSPC has increased the 2002 customer count to 60 as per 2003.

The demand statistics used are low for both 2002 (45,196 normalized for 12 months) and 2003 (48,210). PSPC has increased the demand to reflect an annual demand of 82,000 kw as reported for 2004 consumption in its latest cost of service rate application load forecast. (82,000 / 12 = 6,833 per month).

Revised recoveries and continuity schedule are set out in Appendix 17. The continuity schedule reflects PSPC's use of regulatory determined true-up interest rates and the true up of regulatory adjustments to taxable income over the 2002 to 2004 period. (true-ups from SIMPILS models)

The adjustments to recoveries along with associated interest improvement have increased the amount payable to customers from $129,622 to $167,915.

Prorate of the fixed charge

PSPC reviewed its billing journals covering the rate change period in 2004. In fact PSPC did prorate both the variable and fixed charges across the rate change.