1. Effective date of the new variance tracking account

EDA's LDC member opinions on the effective date varied, some members were satisfied with the timing while others expressed reservation. Those with concerns highlighted the potential for requiring additional actuarial analysis and/or exposing the LDC to a period of unreported data that could result in the LDC not being able to recover these costs through rates. Some LDCs also recognized that it may be appropriate for the proposed account to have an effective date the same as the date that rebased rates took effect; in the alternative, it may be appropriate for the OEB to authorize LDCs to record opening balances that reflect the variance incurred since the date that rebased rates took effect.

2. Mechanics of the new variance tracking account

<u>General comment</u>

The EDA agrees that the journal entries presented in Appendix D appropriately reflect the recommendations of the Report. The EDA looks forward to the OEB providing a more readily integrated example (e.g., one that ties the amount of interest to be cleared to the amounts of cumulative interest recorded) and another that explicitly deals with capitalized Pensions and OPEBs costs.

As a significant majority of Ontario's electricity distributors participate in OMERS the following analysis is confined to OPEBs.

<u>Interest accretion on an asymmetrical basis</u>

The EDA has very significant concerns with the OEB's position that interest accretion on the new variance tracking account is allowed only in circumstances where there is a net credit in the accumulated pension and/or OPEB accrual versus cash variances and suggest that the OEB reverse this finding. The EDA observes that if an accrual versus cash credit is considered equivalent to customers loaning money to the utility, then the corollary is also true. Specifically, if it is inappropriate for this generation of customers to loan funds to the distributor it is, by parity of reasoning, just as inappropriate for the distributor to loan funds to this generation of customers. Either circumstance – whether the customer or the utility is implicitly providing funds – results from rates being inappropriately calibrated relative to the costs of the period.

The OEB's unequivocal statement that the "utility will not be compensated for under-recoveries unless the financial viability of the utility would be compromised" conflicts with the rate making objective that rates should be set to recover the ongoing costs incurred to provide service and allow an opportunity to earn the Allowed Rate of Return. The EDA suggests that this finding conflicts with sound rate making and could, if implemented, compromise the utility's opportunity to earn the Allowed Rate of Return.

Asymmetric treatment is often relied on to provide consumer protection that, in connection with accounting variances, would be appropriate if the regulated entity had some level of control or discretion or influence over the balances recorded. In connection with the accounting for OPEBs transactions, some of the items that a regulated entity would need to be able to influence may include:

- Work force demographics;
- Local labour market conditions, in particular expectations of the balance between direct compensation and benefits, as well as the balance between benefits provided in the current period vs benefits provided in a period in the future;
- Actuarial assumptions, including the applicable Cost of Capital; and
- Accounting requirements.

The EDA notes that the timing of cash expenditures and the inputs to the accrual expense are not managed by the utility. The degree of control that an LDC may have over any of these factors does not give rise to a concern that rate payers require further protection in general or that asymmetric treatment of the application of Carrying Charges is appropriate.

The OEB did not provide any precedent for calculation of interest on an asymmetrical basis for a more traditional forecast versus actual or accrual accounting versus cost variance account. The EDA has reviewed the record in this matter and cannot find communication from the OEB raising the issue of the need for and provision of asymmetry. The EDA does not view the two examples referenced in the OEB's Report as analogous to the subject deferral account and finds the OEB's Report silent on a relevant precedent. Whereas KPMG raised the option of a variance tracking account it did not suggest asymmetrical treatment of carrying charges. Had KPMG – or any other party to the proceeding – raised this possibility, the EDA would have made these comments at that time.

This may be precedent setting. The EDA is of the opinion that precedents should be supported by compelling and meaningful rationale that has been tested and scrutinized through a transparent public process.

<u>Use of the CWIP rate for the variance tracking account</u>

The EDA is also concerned about computing Carrying Charges using the Construction Work In Progress (CWIP) rate. The EDA recognizes that using the OEB authorized CWIP rate achieves consistency across LDCs and may reduce the complexity of capital accounting for the regulator. However, while the CWIP rate may represent a reasonable mid-term interest rate, there are other more relevant rates readily available. Again, a review of the record does not yield consideration of this matter. It may be appropriate to compute the Carrying Charges on long lived balances using other financing cost metrics that achieve a better alignment.

Please see the response to question 3 for a further discussion of the application of the OEB approved CWIP rate.

<u>Type of variance account</u>

The OEB's Report is silent on whether this account will be included with Group 1 accounts that do not require a prudence review, and whether it will be subject to similar administrative practices with respect to disposition. LDCs recognize that the OEB proposes a separate rate rider to dispose of the eligible balance, analogous to the OEB's administration of the LRAM-VA. The EDA looks forward to the OEB clarifying its intended administrative approach.

3. The manner in which carrying charges are applied to balances tracked in previously established variance accounts

As is discussed in the response to the previous question, LDCs took exception to the proposed asymmetric application of Carrying Charges. LDCs were of mixed opinion with respect to the appropriate carrying charge rate to apply. Some LDCs will manage this account for the life of the rebasing period, which is typically 5 or more years. For these LDCs the CWIP rate is poorly aligned with the account's life and may be inappropriate. The EDA recognizes that it may be more appropriate to use each LDC's Allowance for Funds Used During Construction (AFUDC) rate to compute carrying charges that will be disposed of through rates. The EDA observes that using a rate relevant to each LDC is expected to result in a better estimate of the costs eligible for disposition through the rates authorized for that LDC.

Distributors whose rates were set based on cash based accounting for OPEBs and who were previously granted accounting orders in connection with these amounts have clear direction on the appropriate treatment of Carrying Charges. Absent a compelling analysis of the facts these orders should continue to operate. Upon authorization to charge rates on accrual accounting based OPEBs costs these accounts will presumably be treated in the same manner as all other deferral/variance accounts:

- principal amounts will cease to be recorded;
- concurrent with the cessation of recording principal the LDC will commence to dispose of the balance recorded in the account through an OEB authorized rate rider;
- Carrying Charges will accrue on any undisposed Principal balance until the expiration of the rate rider; and
- the residual balance will be transferred to the appropriate sub-account of 1595.

4. The requirement to track only the gross accrual cost as opposed to identifying amounts expensed vs. capitalized

The OEB has determined that, in general, accrual versus cash differences are to be tracked at the gross accrual level, without consideration of capitalized amounts. The analysis below assumes that previously capitalized amounts have been recorded in the appropriate fixed asset accounts and will be grandfathered: these amounts will not be reclassified or revalued. Consistent with the OEB's legal obligation that one panel cannot bind another, exceptions to this generic approach are being allowed for. As the majority of EDA members belong to OMERS they are not subject to pension variances. For this reason, the simple gross method will be the most reasonable approach.

LDCs who use the cash basis for OPEBs for rate making purposes are expected to be eligible to continue to do so until such time as their rates are rebased using IFRS data and, in particular, their OPEBs costs are presented on the accrual basis. Until that rebasing application is processed these LDCs could apply the OEB authorized variance account and will record somewhat larger variances than will an LDC whose rates are based on accrual accounting data.

5. The timing of the OEB's consideration of a transition to the accrual method for utilities currently on cash

The EDA has no significant concerns with the OEB's guidance on adopting the accrual method as outlined in the report. The EDA agrees with the allowance for potential exceptions and future reviews where the accrual method may impact just and reasonable rates or where a material transition impact occurs.

6. The timing of the disposition of both the new and previously established variance accounts

LDCs propose that the balances in the variance account should be eligible for disposition if they meet or exceed the OEB's Z factor materiality criteria and that, at a minimum, disposition should be dealt with in the Cost of Service proceeding.

The following analysis deals with those LDCs who are on, or will transition to, the OEB's Annual Incentive Rate making (AIR) and will not apply to rebase rates.

Those LDCs whose rates were most recently rebased to include recovery of OPEBs using accrual based accounting data will be eligible to apply the deferral account described in the OEB's Report. It is appropriate to provide these LDCs with flexibility as to when they consider it appropriate to seek disposition through rates of the balance recorded in the account and of the type of application that is to be filed (e.g., stand-alone, AIR). In the alternative, and as an expedient measure, these LDCs could propose to offset OPEBs variance account balances against those recorded in other accounts where the same allocation factor is applied to compute customer class responsibility.

The EDA submits that different approaches may need to be considered for those LDCs on the AIR whose rates were most recently rebased using cash accounting data. These LDCs will have transitioned to IFRS subsequent to rates being rebased and will be recording OPEBs using the accrual method. Under this assumption, these LDCs could be eligible to continue to apply previously authorized accounting orders, appropriately amended, to reflect the amounts reported using accrual based accounting for OPEBs, or to apply a variant of the OEB proposed variance account. Regardless, these LDCs should be eligible to seek disposition of the balance recorded in that account when the account balance is considered material, at intervals commensurate with the OEB's rebasing period, upon actuarial review, or based on other relevant considerations.