SUP Interrogatory #4

Interrogatory

Reference: 3.2 [& Appendix A]

The illustrative capital account shown in Appendix A on page 14 is potentially confusing. Please clarify:

1) That the entry assumes only in-service assets should be affected (this can be presumed by the depreciation expense and return on rate base elements in the entry provided).
2) How OPG intends to determine which specific capital assets are impacted by the overturning of Bill 124 as this information is presumably needed to apply a depreciation rate and derive a depreciation expense impact.
3) How OPG will identify and apply the appropriate depreciation rate. Will it be at a specific facility/component level or at a higher more aggregated level?
4) How an asset net book value can be determined when depreciation expense is shown being credited without an offsetting accumulated depreciation debit. Is there something missing in this entry?
5) That the entry is intended to be used for both retroactive and go forward impacts? Please comment on whether OPG considered whether some variances, depending on their nature and timing, should impact capital already in-service while others should impact assets under construction (ie CIP)?
6) If there is an interest component to any retroactive compensation amounts negotiated, arbitrated or awarded, whether it would qualify under generally accepted accounting principles (GAAP) as capital.
7) Whether return on rate base is conceptually a regulatory construct rather than an account under GAAP. Does OPG really have a “return on rate base” account in its general ledger? If not, please provide the relevant GAAP revenue or expense entry.
8) Why the OM&A entry is presented net of income tax (per the evidence a 25% rate) while the capital entry is shown gross.

Response

1) Confirmed.

2) OPG would first quantify the total impact of compensation cost changes on forecasted EB-2020-0290 annual capital expenditures as described in Ex. L-SUP-01. Such amounts would be determined at an aggregate level rather than by project. To estimate the in-service timing of these annual capital expenditure

impacts, OPG would then use an estimated average capital project duration based on a set of larger projects forecasted in EB-2020-0290 and an assumption that capital expenditures are incurred on average at the mid-point of this period. For example, assuming a 6-year average project duration, capital expenditure impacts arising in 2023 would be considered to be in-service in 2026, i.e., 2023 plus 6 years x 50%. Given the relatively small impact anticipated on annual capital expenditures (for example, less than $1 million for PWU represented employees) and an even smaller resulting annual revenue requirement impact, OPG believes that this approach reasonably balances accuracy with administrative efficiency.

3) Consistent with the aggregate approach for determining in-service amounts, OPG would use an average overall depreciation rate based on assumptions underpinning the EB-2020-0290 forecasts.

4) The question misunderstands the nature of the entries shown. The entries demonstrate how the balance in the variance account would be built up, with offsetting entries to corresponding components of regulatory earnings (i.e., a regulatory income statement). Thus, the credit to depreciation expense shown means that depreciation expense reported against regulatory earnings in that period would be reduced by the amount deferred to the variance account. The entries do not show the initial recognition of these expenses against regulatory earnings, such as an entry to debit depreciation expense and credit accumulated depreciation, as these entries would occur in the normal course in the absence of the variance account.

   The net book value of the in-service assets for variance account purposes would be determined by rolling forward the annual aggregate in-service amounts determined in part 2) using the depreciation rates derived in part 3).

5) The approach discussed in the various parts of this response would apply to all capital expenditures impacts posted to the account. There is no retroactive component to OPG's request in this Application, as discussed at Ex. L-Staff-02. Refer to part 2) regarding the delineation between capital expenditures and in-service amounts for purposes of variance account calculations.

6) OPG has not investigated the accounting treatment under US GAAP of a hypothetical scenario posed in the question. Such a scenario is not currently applicable to OPG.

7) OPG confirms that return on rate base is a regulatory construct. As noted in part 4) above, the entries shown are intended to represent components of regulatory earnings, which will reflect the recoverable return on rate base amounts (as

lower cost of debt and higher return on equity) recorded in the variance account in a given period. As US GAAP does not generally permit the recognition of the equity component of the return on rate base as a regulatory asset, OPG would limit the recognition of such recoverable return on rate base amounts to the cost of debt and record such recognized amount as a reduction to interest expense for financial accounting purposes, as follows:

DR Regulatory Asset – Overturning of Bill 124 Variance Account
CR Interest Expense.

For clarity, the resulting difference in the return on rate base amounts recognized in regulatory earnings versus financial accounting earnings is due to timing. Namely, the portion of the return on rate base not recognized in financial accounting earnings at the time of the variance account addition would be recognized in financial accounting earnings at the time of approved recovery of such balance. This treatment is consistent with that of OPG's existing deferral and variance accounts that record return on rate base amounts.

8) The difference in the tax treatment noted corresponds to how OM&A and capital costs are treated for regulatory tax purposes as part of revenue requirement determination in the normal course. OM&A expenses are not "grossed up" for income taxes as they are normally deductible for income tax purposes in the period incurred, meaning that recovering an OM&A expense from customers without a tax adjustment yields the same after-tax amount that OPG would incur as a result of such expense. For capital costs, a tax impact is included representing the net effects of the difference between the tax non-deductible depreciation expense and tax deductible capital cost allowance for an asset, and the "gross up" on the return on equity component. Inclusion of such tax impact ensures that recovery of capital costs from customers yields an after-tax amount to OPG that is equal to the sum of corresponding depreciation expense and return on rate base.