

Accounting for Specific Items
Incentive Regulation
and Related Accounts

The return calculated on both the non-capital and capital components of deferral accounts should be added to non-capital component of the deferral account as the return is not a capital item.

Amortization of Capital Components within Deferral Accounts

Utilities will be required to amortize the capital components of the Transition and/ or Extraordinary Cost accounts similar to the manner in which those assets would be amortized had they been included in the rate base. The accounting treatment will be a credit to an Accumulated Amortization sub-account within the deferral account and a debit to the non-capital sub-account for the amortization amount.

The amount of the amortization expense will depend on the type of capital asset. Consequently, reference should be made to the guidance provided in Appendix E of the 2000 Electricity Distribution Rate Handbook ("Capital Assets - Amortization Rates").

Note that the treatment described above for regulatory purposes will not change the requirements for income tax purposes. For example, where the capital assets in the deferral accounts are amortized at a rate different from the capital cost allowance rate prescribed by the *Income Tax Act (ITA)*, utilities will still be required to maintain records for the different requirements of the *ITA* as they would for any other asset subject to such differences.

No prior approval will be required for this accounting treatment. However, the Board may review the entries in the future.

Classifying and Recording Transition Costs

Guidance is provided in this sub-section to facilitate consistency in classifying and recording transition costs. The following list provides nine general categories of activities that will be used to record transition costs. The costs collected under each listed general category of activity will be recorded in a separate capital and / or non-capital sub-account within the deferral account. For example, if a utility purchases a new billing system for the sole purpose of facilitating unbundled customer billing that meets all the conditions of the four-part criteria test in the 2000 Electricity Distribution Rate Handbook, the asset would be recorded in a billing activity capital sub-account and the related amortization expense would be recorded in a billing activity non-capital sub-account. Note that the Board will consider other significant activities if the utility can demonstrate that expenses associated with an activity are consistent with the Board's assessment criteria.

Ontario Energy Board	
FILE No.	EB-2009-0278
EXHIBIT No.	K2.2
DATE	5 Sept 29/10
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08/99	

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1. Billing activities (e.g. system modifications/ purchases to support unbundled customer billing, billing for standard supply customers and distributor billing options for retailers).
2. Customer education activities (e.g. billing inserts and call centres).
3. Wholesale market requirements (e.g. metering, settlement systems and validation, editing and estimation process).
4. IMO/IESO requirements (e.g. prudential requirements, registration, communication and market readiness testing).
5. Retailer/ customer requirements (e.g. retailer registration, prudential requirements, customer/ retailer information systems, and electronic business transactions system).
6. Staff adjustment activities (e.g. severance, counseling and retraining).
7. Regulatory costs (e.g. OEB license fee and proceeding costs).
8. Taxes (payments in lieu of taxes) to the extent an allowance is not provided by the Board in base rates.
9. Regulatory requirements (e.g. staff contract assistance and systems to accommodate record keeping, monitoring and filing requirements).

It should be noted transition cost eligibility is based on utility specific circumstances and shall be determined in accordance with the eligibility criteria established in the 2000 Electricity Distribution Rate Handbook. Consequently, utilities will be required to apply the four-part criteria test provided in the 2000 Electricity Distribution Rate Handbook on costs in order to determine their eligibility for "qualifying" transition cost treatment.

The CICA under Section 1000.35 offers a definition of net assets for profit oriented companies as the "equity representing ownership interests in the assets of a profit oriented enterprise after deducting its liabilities". The Board's letter to LDCs of November 9, 2001 regarding transition costs further provided for the use of rate base as defined in the Electricity Distribution 2000 Electricity Distribution Rate Handbook as an alternative materiality measure.

The materiality test for Qualifying Transition Costs should be applied to the cumulative balances of individual accounts that reflect the various activities of the wires company at the date of market opening (May 1, 2002).

It is particularly important to note that the materiality and causality criteria must be applied to transition costs in an ungrouped or segregated basis (i.e. the aggregating of costs that belong in the different general category of activity listed above is not permitted in order to test the materiality and causality criteria of the 2000 Electricity Distribution Rate Handbook).

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With respect to the materiality criterion, a utility should separately record costs in the sub-account (classified by the general category of activity or "other" activity noted above) if the utility expects these costs will be material and subsequently eliminate the recorded amounts if the materiality assumptions proves to be incorrect. This test will be applied to the cumulative balances of each of the activity or "other" activity sub-accounts based on the utility's financial results. Capital and non-capital sub-accounts of each activity are combined for the purpose of applying the materiality and causality criteria.

It is important to note also that the Other Regulated Charges discussed in Chapter 11 of the 2000 Electricity Distribution Rate Handbook are not to be included in the Qualifying Transition Cost. Separate variance accounts will be used to record other regulated charges.

Ineligible Transition Costs

The following is a non-exhaustive listing of ineligible transition cost/ items:

1. Incorporation and corporate reorganization costs (e.g. legal and consulting) of wires company and affiliate/ related company associated with but not limited to transfer-by-law and shareholder agreement.
2. Additions of staff (permanent, temporary, or consultants) required for transition activities unrelated to the "wires only" distribution restructuring.
3. Business plans or studies related to restructured business (external consultant's costs including valuations or studies related to possible merger, acquisition, amalgamation and divestiture).
4. Structural/ physical separation of businesses related to electricity retailing.
5. Y2K compliance related costs.
6. Loss of funds related to contributions in aid of construction and development charges.
7. OEB annual assessment (deemed similar to avoided costs of Ontario Hydro regulation).

The above-noted costs and other costs considered by the Board to be ineligible will not qualify for transition cost treatment. For accounting purposes, these costs will be recorded in the appropriate USoA accounts in the normal manner required. As an example, the costs of incorporation including legal fees will be recorded in account 1606, Organization. For regulatory purposes however, this account will not be included in the rate base, and the related amortization expenses will not be included in the revenue requirement.

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Account 1570, Qualifying Transition Costs

This account shall be used to record transition costs that meet the four qualifying criteria established in the Electricity Distribution Rate Handbook. Note that costs related to corporate reorganization and to the transfer by-law are not eligible for transition cost treatment.

Simple interest shall be calculated based on monthly opening balances in the account exclusive of the accumulated interest.

This account shall be further sub-divided by the appropriate general categories of activities as prescribed by the Board. Consequently, qualifying transition cost transactions shall be recorded in the appropriate sub-accounts to capture such costs as shown in the table below.

Records shall be maintained in a manner that permits ready identification of each cost contained in this account. More specifically, records shall be maintained as to permit the separate identification of any capital and non-capital cost components of this account. The capital sub-account will include capital assets that generally are included in the utility's rate base for rate-making purposes while the non-capital sub-account records the related annual amortization expense and operating and maintenance costs.

Entry at time of deferral

This account shall be debited with the amount deferred to a future period. The offsetting credit shall be recorded in the appropriate cash and/ or asset account as applicable.

Entry to record return on deferred amounts

This account shall be debited with an amount equal to the allowed return on the qualifying transition costs. The offsetting credit shall be to account 4405, Interest and Dividend Income.

Record keeping requirements/ sub-accounts

The following table summarizes the record keeping requirements/ sub-accounts associated with account 1570, Qualifying Transition Costs.

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General Categories of Activity	Capital Sub-account	Accumulated Amortization	Non-capital Sub-account
1. Billing Activities	✓	✓	✓
2. Customer Education Activities	✓	✓	✓
3. Wholesale Market Requirements	✓	✓	✓
4. IMO/IESO Requirements	✓	✓	✓
5. Retailer/ Customer Requirements	✓	✓	✓
6. Staff Adjustment Activities			✓
7. Regulatory Costs			✓
8. Regulatory Requirements			✓
9. Taxes (payments in lieu of taxes if applicable)			✓
10. Others (if applicable)			

Disposition of Account 1570

The Board allowed a partial recovery of transition costs for some electricity distributors in the 2002 rate year that continued in rates to the end of the 2003 rate year. Amounts collected resulting from the partial recovery of transition costs reduced the recovery of these costs in future periods. The Board later reviewed all transition costs against the criteria of both the 2000 Electricity Distribution Rate Handbook and the guidance provided in Article 480 of the APHandbook in the 2004 regulatory assets phase II preceeding and later as part of the 2006 rates applications

Starting in the 2004 rate year, transition cost recoveries were included in rates as part of the overall regulatory assets recovery allowed over a four-year period up to the end of the 2007 rate year. In the 2006 rate application process, the Board reviewed and approved eligible transition costs for distributors that filed applications. Inappropriately recorded or disallowed amounts were required to be written off. Distributors that filed for minimum reviews in their 2006 applications were required to write-off ten (10) percent of the principal amount recorded in account 1570 as a shareholder expense in 2005 net income using account 4380, Expense to Non-Utility Operations. It should be noted that the carrying charges related to the ten percent write-off of the principal amount were also required to be written-off in addition to the ten percent principal write-off amount.