Ontario Energy Board
P.O. Box 2319
27th. Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416- 481-1967
Facsimile: 416- 440-7656
Toll free: 1-888-632-6273

Commission de l'énergie de l'Ontario
C.P. 2319
27e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone; 416- 481-1967
Télécopieur: 416- 440-7656
Numéro sans frais: 1-888-632-6273

Ontario

BY E-MAIL

January 14, 2013

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto ON M4P 1E4

Dear Ms. Walli:

Re: Halton Hills Hydro Inc. ("HHH") – Audit Review Results of Deferral Account 1575
Application for 2013 Distribution Rates - Board File Number EB-2012-0130

In its Decision for HHH's 2012 cost of service application (EB-2011-0271), the Board required the Board's Regulatory Audit and Accounting group ("Regulatory Audit") to conduct an audit review of an audit filed by KPMG in the Fall of 2012 of HHH's PP&E deferral account balance. Specifically, in the Board Decision and Order EB-2011-0271, HHH was directed to file with the Board, by September 30, 2012 the results of an audit conducted by KPMG of the PP&E deferral account balance including detail sufficient to support the amount that is to be amortized, whether it is one of the three balances already submitted in the cost of service proceeding or some other amount.

In the 2012 cost of service application HHH had filed updated evidence on March 12, 2012 seeking approval of a revised credit balance of $1,462,823 for the PP&E deferral account owing to ratepayers (the "1st Update"). On March 21, 2012, the day before the oral hearing, HHH revised its March 12, 2012 update and filed an amount of $836,717, as the revised credit balance for the PP&E deferral account (the "2nd Update"). In the EB-2011-0271 proceeding, HHH had stated that the revision reflected results of HHH finalizing its 2011 capital expenditures and depreciation during its 2011 year-end audit process with KPMG. The 2011 CGAAP depreciation figures were reduced from an amount of $2,741,106 in the 1st Update to an amount of $2,115,000 in the 2nd Update. The revision reduced the PP&E deferral account credit balance from $1,462,823 to $836,717 owing to ratepayers (see Appendix A). The Board directed HHH to conduct the above

mentioned audit as a result of HHH filing updated evidence one day prior to the oral hearing with none of the parties having had an opportunity to test this evidence.

HHH made reference to "a spreadsheet calculation error"[1] in the oral hearing for EB 2011-0271 and stated in its reply argument that:

> As noted in EProbe IR#38(c), HHH established a depreciation model to facilitate the implementation to IFRS. The rates were not changed in the model, but the overall depreciation expense is slightly lower. Further, at the oral hearing, it was noted that the change was a result of finalizing the 2011 fixed assets section of the audit file and the correction of a formulaic error.[2]

The Board in its Decision also noted:

> When Regulatory Audit has concluded its audit review of the account, and depending on its conclusions, the Board will determine whether it is necessary to revise the account balance for purposes of issuing a final order prior to HHH's next IRM rate application. If necessary, HHH will be required to prepare a final draft order to that effect at that time.

Further the Board stated:

> The Board understands HHH's dilemma upon discovering the material change to the 2011 fixed assets section of the audit file and the correction of a formulaic error; however, the Board is placed in an awkward position on whether to approve such a material update without appropriate testing.

On September 28, 2012, HHH filed with the Board KPMG's audit of depreciation under CGAAP and MIFRS with respect to the PP&E deferral account. In its independent audit report to the Board, KPMG stated:

> In our opinion, the depreciation under CGAAP and MIFRS in the schedule is prepared, in all material respects, in accordance with CGAAP and MIFRS.

On October 12, 2012, HHH filed its IRM rate application EB-2012-0130 for the 2013 rate year.

During the course of this audit review, HHH explained to Regulatory Audit that the CGAAP depreciation expense is derived by HHHI's internal financial software system. The depreciation expense is calculated on a straight line basis over the estimated useful life of the assets for the purpose of financial reporting and preparation of financial statements. According to HHH, its internal legacy financial software does not have the ability to forecast depreciation and amortization. HHH stated that in an attempt to respond to the

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[1] HHH Oral Hearing Proceeding Transcript EB-2011-0271 dated March 22, 2012, Volume 1, lines 13 and 13, page 11

[2] HHH Reply Argument, EB-2011-0271 dated April 25, 2012, paragraph 41, page 12.

interrogatories during the cost of service proceeding and for the purpose of its rate application, HHH had used an excel model to forecast the depreciation expense for 2011. Using this Excel spreadsheet, the forecast for the depreciation expense was overstated because the opening gross value was not adjusted for assets that were fully depreciated. This methodology was incorrect since it over estimated the depreciation. HHH further explained that the approach it used to calculate depreciation contained errors, not necessarily "formulaic calculations within a specific cell" but rather in totality, the approach and methodology were incorrect.

HHH stated that it subsequently changed its method used and took into account the continuity of the fixed assets additions from date of installation based on the expected useful lives in a new Excel spreadsheet. Under this approach, the depreciation for the year is the sum of the depreciation for the additions from the previous years, excluding fully depreciated assets, plus the current year additions taking into account the half year rule.

As a result the March 12 filing forecast depreciation of $2,741,106 that was filed in the 1st Update was overstated by $626,106 when compare to the revised amount of $2,115,000 that was filed on March 21 and 30, 2102 that was filed as 2nd Update.

HHH explained that as at March 12, 2012, the actual 2011depreciation calculation used in the 1st Update was not finalized. The forecast depreciation of $2,741,106 was based on the inappropriate Excel model spreadsheet . As at March 22, 2012, the date of the oral hearing, the revised 2011 forecast depreciation of $2,115,000 was calculated with the assistance of KPMG.

Regulatory Audit notes that HHH has not changed its depreciation policy for 2011. Regulatory Audit further notes that the actual 2011 depreciation, as per the 2011 audited financial statements dated April 27, 2012 was $2,186,947. The variance between the forecast depreciation of $2,115,000 which was filed as the 2nd update and the actual audited figure of $2,186,947 for the 2011depreciation is $71,947. Regulatory Audit notes that this variance is not material.

Regulatory Audit has now completed its review of the audit filed by KPMG and the audit of HHH's calculation for the depreciation expenses and PP&E deferral account. This review has found no issues from Regulatory Audit's perspective based on its assessment of HHH's revised approach of calculating depreciation. There were no issues found that would materially impact the amount for 2011 depreciation expense of $2,115,000 and the credit balance of PP&E deferral account of $836,717 that HHH filed with the Board on March 21, 2012.

The observations discussed in this letter represent the views of Regulatory Audit and are not binding on the Board.

I wish to thank the HHH's staff for the assistance and support provided to us during this audit review.

Yours truly,

Daria Babaie, P. Eng., CMA
Manager, Regulatory Audit and Accounting

cc: David J. Smelsky - Chief Financial Officer, HHH

APPENDIX A

HALTON HILLS

COMPARATIVE ANALYSIS OF PP&E DEFERRAL ACCOUNT

		PER IRR #48	PER MARCH 12,2012 LETTER 1ST UPDATE*		PER MARCH 21 and MARCH 30,2012 LETTER 2ND UPDATE	
		(A)	(B)	(C=B-A)	(D)	(E=B-D)
		2011	**2011**	**VARIANCE**	**2011**	**VARIANCE**
CGAAP	Opening Net PP&E	27,281,803	27,281,803	-	27,281,803	-
	Additions	4,767,522	2,835,783	- **1,931,739**	2,835,783	-
	Depreciation	- **2,796,463**	- **2,741,106**	- **55,357**	- **2,115,000**	- **626,106**
	Closing Net PP&E	29,252,862	27,376,480	- **1,876,382**	28,002,586	**626,106**
MIFRS	Opening Net PP&E	27,281,803	27,281,803	-	27,281,803	-
	Additions	4,494,747	2,655,235	- **1,839,512**	2,655,235	-
	Depreciation	- 1,139,102	- 1,097,735	- **41,367**	- 1,097,735	-
	Closing Net PP&E	30,637,448	28,839,303	- **1,798,145**	28,839,303	-
	DIFFERENCE	- **1,384,586**	- **1,462,823**	- **78,237**	- **836,717**	- **626,106**

*Amount provided by HHH totaled $1,462,823.