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BY COURIER

October 27, 2008

Ms. Kirsten Walli
Secretary
Ontario Energy Board
Suite 2700, 2300 Yonge Street
P.O. Box 2319
Toronto, ON.
M4P 1E4

Dear Ms. Walli:

EB-2008-0104 – Transition of Regulatory Accounting to International Financial Reporting Standards – Hydro One Networks' Comments on OEB Staff October 7, 2008 Draft entitled "Regulatory Accounting Transition to IFRS Project Work Plan

In response to the OEB Staff's request for comment on its Draft IFRS Project Work Plan, I am providing three paper copies of Hydro One Network's comments. As directed by the Board's web site instructions, Hydro One Networks' comments have also been sent as an attachment to an email sent on this date to IFRSproject@oeb.gov.on.ca.

In the attached comments, we have noted our concerns regarding the timing of the project plan, in particular the first phase dealing with accounting issues, as well as the governing regulatory principles to guide the OEB's decisions during the transition plan.

Sincerely,

ORIGINAL SIGNED BY SUSAN FRANK

Susan Frank

Attach.

Hydro One's Comments on Board Staff's Draft IFRS Project Work Plan

Regulatory Accounting Transition to IFRS Work Plan

Introduction

On October 7, 2008, Board staff posted the IFRS Transition Project Work Plan proposed to amend OEB regulatory accounting instruments affected by the accounting transition to IFRS. Board staff presented and discussed the work plan at the IFRS Consultation meeting held on October 16, 2008. Comments on the proposed work plan have been requested by October 24, 2008.

The following comments are based on a review of the OEB Staff's written draft of the "Regulatory Accounting Transition to IFRS Project Work Plan," as well as the discussions held at three separate IFRS Consultation sessions in August, September and October 2008.

Hydro One welcomes the opportunity to comment on Staff's proposed IFRS transition work plan. Hydro One is generally in support of the draft plan and the key decisions that need to be made along the way to support the development of amended regulatory instruments. We agree that it is critical to make decisions regarding the basic regulatory principles to be used in adapting IFRS to regulator's reporting needs as soon as possible to allow entities time to consider information system requirements and accounting process decisions. However, we have two overall general comments.

Key Issues

Timing of Consultation on Key Regulatory Accounting Issues

In respect of timing, we have some concerns about the proposal to complete the first section of the plan, which involves carrying out a consultation on key regulatory accounting issues and receiving Board approval on final positions, by January 31, 2009. Given that the plan is not expected to be approved by the Board until November 12, we believe that the current schedule for completion by January 31, 2009 will not permit sufficient time for all stakeholders to consider and comment on the complex issues being addressed.

In particular, the schedule under 4.1 envisions a staff discussion paper, receiving written comments and undertaking a stakeholder conference. We believe that it is more important that time be invested at the front end of the process to allow for high quality discussions and decisions on the regulatory principles than in providing detailed implementation guidelines through updated regulatory instruments. We believe the end point for this first phase could be extended to March 31, 2009 without significantly impacting the transition plans for rate-regulated entities.

Establishment of Rate Payer Impact as a Guiding Principle

Given that rate-regulated enterprises will report in IFRS, the question should then turn to what is the regulator's views on those particular IFRS differences, and how to (or not) accommodate those differences with a view to stabilizing rate payer impacts.

The plan has covered several aspects of the regulatory reporting of financial results under IFRS but has provided limited attention to how the move to IFRS will impact on rate applications under cost of service or incentive regulation. We encourage Board staff to expand the work plan to also consider the potential changes to applications and the transition to an IFRS environment from a rate payer perspective.

We also have the following comments on the specific issues identified in Section 1 of the Draft Plan. We will provide more detail regarding our comments as the Board staff positions surrounding these positions are developed and communicated.

1.1 Entities to which IFRS applies –

We believe that Board staff's initial view that IFRS will apply to almost all entities that it currently regulates is correct. While it is necessary to confirm this technical point, we expect that Board staff will require a single regulatory accounting framework to apply to all regulated enterprises of a specific type (e.g. electricity distributors) to allow for comparability. However, we recognize that complying with an IFRS-based regulatory accounting model would pose very real challenges for an entity that does not have to also comply with IFRS for GAAP reporting. For this reason, we agree that the applicability of IFRS for GAAP reporting to all entities that the Board regulates is important to confirm early in the process. We do not believe that this will require exhaustive effort, and moves nonetheless toward what we believe will be the applicability of IFRS across all entities in the future.

Rate-regulated entities will need to apply IFRS in 2011, and as such, the use of a 2010 end-date for Canadian GAAP-based regulatory financial statement reporting is consistent. The use of a 2011 date for commencement of IFRS-based regulatory financial statement reporting makes sense.

Notwithstanding the above, there will be a need to address particular transition issues. For example, should forecast capital expenditures, previously approved under Canadian GAAP, be reported under an IFRS basis. How will this be handled from a rate setting perspective? Will capital that straddles the transition date be a blend of Canadian GAAP and IFRS costing?

1.2 Regulatory assets and liabilities –

We believe that rate payer impacts and stability should be guiding principles for the regulator; therefore, we strongly believe that the Board should continue to use deferral and variance accounts as tools to manage rate issues, irrespective of any decisions that are made by international standard setting bodies or external auditors regarding the application of regulatory accounting in GAAP financial statements prepared under IFRS.

We agree that development of appropriate definitions for deferral, variance, and tracking accounts would be beneficial and that disciplined use of such definitions by all parties to the rate regulation process would encourage consistent usage and greater understanding of underlying regulatory intent. We are not convinced however that developing such definitions or enhancing the support in written Board decisions will have any significant effect on the IASB's or audit firms' views on whether related regulatory assets and liabilities can be recorded under IFRS.

1.3 Accounting for PP&E upon initial adoption of IFRS

The current proposal under IFRS 1, as issued by the IASB on September 25, 2008, permits a rate-regulated entity to use net book value as deemed cost. Given the provisions as currently written, we expect that there could be challenges in meeting the criteria to apply the exemption for IFRS GAAP transition unless changes are made through the exposure process.

Notwithstanding the proposed exemption, a decision from the regulator's perspective must be made on transition. If the proposed exemption is not available, then a rate-regulated entity may need to retrospectively restate its PP & E. In this case, what would be the appropriate rate-base to carry forward? Presumably, a different net book value upon transition would not necessarily lead to rate changes if the guiding principle is stability for rate payers. In an ideal scenario, the net book value would be deemed cost, and would also be the rate base. However, there is no assurance this will occur based on timing of the IFRIC's final decision – thus, the regulator must make that decision now to assist rate-regulated entities.

1.4 Accounting for PP&E on an ongoing basis

The Draft Plan envisions the possibility of using a revaluation model. Hydro One's view is that use of a fair value or revaluation approach for PP&E would cause unneeded administrative complexity and cost. We understand that the revaluation approach is rarely used internationally, particularly in the field of rate regulation. Given the issues such an approach would introduce into the fields of cost-based or incentive regulation, we think this option can be rejected very early in the process, especially if the focus continues to be on stability of rates.

We would recommend that the real focus of the discussion at this stage should instead be on what comprises the cost of PP & E for purposes of setting rates. Clearly, there will be some differences for the costing of PP & E for financial reporting purposes once IFRS is adopted; these can include:

- Capitalization of indirect overheads;
- Capitalization of interest using an IFRS-rate, instead of an OEB-prescribed rate;
- Potentially different componentization levels and depreciation methodologies;
- Different recognition points for retirements, gains / losses on sales, impairments, etc.

Thus, our view is that the regulator should decide early on how to treat these differences for rate setting purposes. However the regulator decides that, there should be recognition that IFRS is the starting point for the financial reporting by rate-regulated entities. This is important since the further IFRS is rooted as the reporting framework, the more difficult it will be to reconcile between the different reporting requirements.

1.5 Application of depreciation accounting under IFRS

We are hopeful that the Board will allow enterprises to use for regulatory purposes the same depreciation method and level of asset componentization adopted for IFRS GAAP. While some smaller entities may benefit from Board guidance offering standardization and comparability, the use of Board-mandated depreciation procedures and policies that differ from GAAP treatments will introduce significant complexity and system issues for larger utilities, including ours.

Similarly, for depreciation service lives, we would prefer the existing regime of allowing entities to carry out their own independent depreciation studies for Board review if they wish. Using depreciation rates compatible with IFRS for purposes of setting rates should be achievable. This would limit reconciliation as well as systems configuration issues.

1.6 Other

Multi-year Rate Submissions

We note that the issue of how to treat multi-year rate orders is considered in the draft plan in the section on proposed work on filing requirements. We believe that this will constitute a major principle issue that should be addressed through the first section of the project. The question is when, and how to handle the transition to IFRS. Where IFRS has a significant impact on rates, it behoves the regulator to use all tools available to minimize impacts to rate payers.

Level of Assurance

The Draft Plan often refers to the need for reconciliation between IFRS and reporting for regulatory purposes. There is recognition that additional assurance will be required from a rate-regulated entity's external auditors for purposes of rate setting applications to the regulator. However, as noted above, the further IFRS is engrained in statutory reporting, the more difficult it becomes to reconcile the two sets of reporting requirements. Instead, our understanding from international experiences is that assurance can be provided to the regulator in the form of attestation on controls. Specifically, have the financial systems been structured enough that transactions and the control environment can be sufficiently tested to ensure that information provided for the regulator meets those needs? We would strongly recommend that assurance be sought other than through audited reconciliations. This assurance could come in the form of special-purpose financial statements, or perhaps a report on OEB schedules / Uniform System of Accounts reporting.