

# **Regulatory Accounting Transition to IFRS Project Work Plan**

**DRAFT**

**Prepared by: Board Staff  
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## **Introduction**

The Ontario Energy Board (“OEB” or “the Board”) has committed to work with those entities it regulates to facilitate a smooth transition of Canadian Generally Accepted Accounting Principles (“GAAP”) to International Financial Reporting Standards (“IFRS”) in 2011. This is required by the Canadian Accounting Standards Board (“AcSB”). To this end the Board issued a letter on May 8, 2008 to industry participants to establish a “Transition of Regulatory Accounting to IFRS” consultation (the “IFRS Consultation”). The purpose of the IFRS Consultation was to allow Board staff to work with interested industry participants on an informal basis in relation to issues associated with the transition. It is expected that most entities rate-regulated by the Board will adopt IFRS.

A key objective of the IFRS Consultation was to allow Board staff to develop an IFRS Transition Project Work Plan to amend regulatory accounting instruments affected by the transition to IFRS. Board staff would then be in a position to present the plan for Board approval by October 31, 2008. To that end, Board staff held three meetings at the Board’s Offices in Toronto with interested industry participants on August 22, September 16 and October 16, 2008, to engage discussion and exchange information on the IFRS accounting and transitional issues. The October 16<sup>th</sup> consultation provided interested industry participants with an opportunity to comment on the draft Transition Project Work Plan prior to approval of the work plan by the Board.

## **Purpose**

This document is Board staff’s IFRS project work plan. It outlines the requirements to amend regulatory accounting instruments that will be impacted by the adoption of IFRS on January 1, 2011. In addition, it identifies the key accounting issues and decisions that are expected to be made by the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC). The plan identifies decisions to be made by the OEB, sets out the major work processes for amending regulatory instruments and their completion dates, provides for stakeholder involvement through consultation and describes the communications and training considered necessary to support its rollout.

A work flow diagram in Appendix A provides an overview of the IFRS transition plan including the timelines. The work flow diagram should be read in conjunction with this document.

## **Background**

As a rate regulator, the Board does not set accounting standards for general purpose financial statements. However, the Board can establish accounting and reporting requirements to support the processes for approving rates and for monitoring utility performance. The more the Board can rely on financial information prepared in

accordance with accounting standards for general purpose financial statements, the lower the burden on the regulated entity, interested parties and the Board to create specialized reporting for the regulator.

Current Canadian GAAP recognizes specialized rate-regulated accounting and therefore minimizes the differences between financial accounting and regulatory reported information. For example, while the list of account values reported in accordance with the Board's Uniform System of Accounts (USOA) may not match precisely distributors' financial statements, the Board has generally been able to rely on an auditor's opinion on those financial statements as a basis for accepting the USOA information as being in accordance with GAAP. The presence of an auditor's opinion gives assurance to the regulator as to the credibility of the values presented by the company.

In moving to IFRS in 2011, the basis of regulatory accounting will change. At this time, it is difficult to be certain of the exact impacts of all these changes on rate-regulated entities. However, it is clear that in applying IFRS as currently published, without taking advantage of certain exemptions, elections or exceptions, there will be impacts on the cost streams reported by utilities which, in turn, may have impacts on their revenue requirements. Key impact areas include regulatory assets and liabilities and property, plant and equipment. Several key impacts were illustrated in pro-forma IFRS financial statements and reconciliations of before/after IFRS income statements to regulatory income and revenue requirements documents. These documents prepared by Board staff and presented at the IFRS Consultation meeting on September 16, 2008. Copies of these documents can be obtained from the Board website at:

<http://www.oeb.gov.on.ca/OEB/Industry+Relations/OEB+Key+Initiatives/Transition+of+Regulatory+Accounting+to+IFRS>).

Board staff's initial assessment is that there is a strong need to continue specialized regulatory accounting in several areas (as per current Canadian GAAP). For example, Board staff believes it will be appropriate to continue to pass through the historic cost of property, plant and equipment (as opposed to the fair market value) and to use deferral and variance accounts to achieve rate-setting objectives. This may result in utilities having to report to the Board on a different basis than their audited financial statements and to provide reconciliations between regulatory and financial accounting presentations. This project work plan includes addressing these issues.

## **Structure of this Work Plan Document**

This document details the project work plan in four sections as follows:

1. **Key Regulatory Accounting Issues and Board Decisions Applicable to Rate-Regulated Entities.** This section identifies, describes and discusses the key regulatory accounting issues and Board decisions that will be applicable to all entities that are rate regulated by the Board.

2. **Amendments to Regulatory Instruments arising from the Adoption of IFRS (for Electricity Distributors and Gas Utilities).** The section outlines the scope of planned changes to regulatory instruments for electricity distributors and gas utilities arising from the adoption of IFRS effective January 1, 2011. It builds on the common decisions from section 1.
3. **Regulatory Instruments Arising from the Adoption of IFRS (for Electricity Generators and Transmitters).** The section outlines a separate process for largely new regulatory instruments for electricity generators and transmitters to address financial reporting requirements. This part of the project work also depends on the common decisions from section 1.
4. **Project Work Plan Processes and Deliverables.** This section summarizes the work plan processes and deliverable including the timelines for each. The main elements of the plan are illustrated in Figure 1 in section 4.0 and in Appendix A.

## **1.0 Key Regulatory Accounting Issues and Decisions Applicable to Rate-Regulated Entities**

This section identifies and discusses the key regulatory accounting issues and Board decisions that will apply to all entities that are rate-regulated by the Board. Decisions on these issues will need to be made in advance of any changes to existing or proposed new regulatory instruments. Mindful of the relatively tight time horizon for transition to IFRS for many entities, this work will provide rate-regulated entities the earliest possible insights and some degree of certainty with regard to key regulatory accounting requirements. This should assist them with their own IFRS adoption decisions and planning processes.

These accounting issues will likely be influenced by further IASB/IFRIC guidance, which may in turn affect the outcomes of OEB decisions. Specifically, the Board will likely need to make decisions on some of these issues (issues 1.2 and 1.3 below in particular) before IASB/IFRIC guidance is provided.

The OEB will consult with participants on these key accounting issues in the fall of 2008 (see Section 4.0 below). Board decisions on these are expected by January 31, 2009.

### **1.1 Entities to Which IFRS Reporting Applies**

Board staff will ask the Board to provide direction to rate-regulated entities that report financial information (e.g. audited financial statements) to the Board for regulatory purposes. Entities meeting the definition criteria provided by the AcSB of a publicly accountable enterprise (“PAE”) are required to adopt and report in accordance with IFRS in 2011. The AcSB

issued a Decision Summary on September 23-24, 2008. In this decision, AcSB defined a PAE, in part, as follows: “A PAE should be described as a profit-oriented entity that has issued (or is in the process of issuing) debt or equity securities that are (or will be) outstanding and traded in a public market, or holds assets in a fiduciary capacity for a broad group of outsiders.” It is unclear whether all rate-regulated entities, including electricity distributors, meet the AcSB’s definition as a PAE. Key issues for the Board to consider and/or decide are:

- 1.1.1 Should the Board require all entities to continue to report information to the Board using Canadian GAAP until December 31, 2010, notwithstanding what may occur with respect to IFRS?
- 1.1.2 Should the Board require all such entities to report information to the Board using IFRS beginning January 1, 2011?

During the development of these decisions, through the consultation process, Board staff will establish whether there are or are not any exceptions to the January 1, 2011 implementation date.

## 1.2 Regulatory Assets and Liabilities

IFRS does not permit specialized recognition of rate-regulated accounting under IFRS. This means regulatory assets and liabilities will not be recognized in general purpose financial statements. While IFRIC may give this matter further reconsideration in the future, there are no expected changes to this position prior to the rollout and implementation dates for revised regulatory instruments under this project.

- 1.2.1 Should the Board continue deferral and variance accounts to achieve regulatory objectives?
- 1.2.2 If so, should Board staff propose definitions for deferral and variance accounts? This could aid the Board in their usage for regulatory purposes and enhance the ability of proposed accounts to meet the definition criteria of an asset/liability under IFRS. These definitions could be an aid for OEB regulators. They could also include a description of the information that must be included in a Board decision for an approved deferral or variance account considered necessary to meet the recognition criteria of an asset or obligation for financial reporting purposes.

## 1.3 Accounting for Property, Plant and Equipment (“PP&E”) on Initial Adoption of IFRS

There are requirements specified in IFRS affecting the accounting for PP&E. These include whether an exemption would be permitted for first time *rate-regulated* IFRS adopters allowing them to use historic cost/NBV (net book

value) valuation as their deemed costs (i.e., no changes to PP&E opening balances and retrospective adjustments to depreciation expenses and accumulated depreciation). Statement IFRS 1 specifies some options available to first time IFRS adopters. An IASB exposure draft on this matter was issued on September 25, 2008. An IASB decision is expected in early 2009.

- 1.3.1 Should the Board require historic cost/NBV to be used at the date of adoption for regulatory purposes?

#### 1.4 Accounting for PP&E on an Ongoing Basis

After IFRS adoption (and initial recognition of PP&E), IFRS provides that an entity shall choose the cost or the revaluation basis to measure PP&E on an ongoing basis (i.e., it permits for the potential revaluation of PP&E at balance sheet date each year).

- 1.4.1 Should the Board require historic cost/NBV values to continue to be used for regulatory purposes on an on going basis?

#### 1.5 Application of Depreciation Accounting Under IFRS

Depreciation expenses may change due to the required application of componentization accounting and the uncertainty of the group depreciation method continuing under IFRS. There are potential upward pressures on annual depreciation expense and potential major accounting system changes for utilities. Therefore, prompt consideration of whether a uniform regulatory approach would be helpful is appropriate.

- 1.5.1 Should the Board provide further guidance on depreciation policies and principles (e.g., the level of sub-componentization to be applied to specified asset classes to ensure that depreciation expenses represent a reasonable matching of recoverable costs in rates and the benefits derived by ratepayers from the consumption of the service value of the assets)?
- 1.5.2 Should the Board encourage sector-wide depreciation studies by utilities (based on defined policies and principles)? This is especially important for electricity distributors since their current generic depreciation rates have been in effect at least as far back as 1992. There may be benefit in determining asset service lives in common for like assets. This needs to be done recognizing that asset service life is determined by an assessment of physical reality (wear and tear in use, erosion due to the action of the elements, obsolescence, etc), not by the regulator.

## 2.0 Amendments to Regulatory Instruments arising from the Adoption of IFRS (for Electricity Distributors and Gas Utilities)

The following is an outline of the scope of planned changes to regulatory accounting instruments for electricity distributors and gas utilities arising from the adoption of IFRS effective January 1, 2011. Consultations are planned for the revision of these regulatory instruments in the spring of 2009 and Board approvals of these are expected by October 31, 2009 (see Section 4.0 below). This will allow electricity distributors and gas utilities sufficient time to incorporate these changes in their overall conversion plans to IFRS. It is expected that the decisions made in response to issues set out in Section 1.0 of this work plan will provide sufficient regulatory certainty to enable the respective utilities to plan adequately on how to meet the information requirements of the regulator at a high level. It is expected that the development of the specific instruments below will provide application details that will reflect the broad decisions of Section 1.0.

### 2.1 Accounting Procedures Handbook (APH) and Electricity Uniform System of Accounts (Electricity USOA)

Board staff prepared a document entitled “Areas of Potential Changes to the Accounting Procedures Handbook (APH),” which was discussed at the IFRS Consultation meeting on September 16, 2008. It can be obtained in the OEB’s website under the following link:

<http://www.oeb.gov.on.ca/OEB/Documents/EB-2008-0104/APH+Areas+of+Potential+Changes.doc>

This reference document sets out a high-level assessment of IFRS priorities requiring changes to the APH. Further research, review and analysis are required to facilitate changes. New and amended articles will be drafted to provide accounting guidance related to the relevant subject matter. The focus for the APH will concentrate on areas where the regulatory treatment is different from IFRS for general purpose financial statements, providing explanations to clarify these differences and their potential impacts.

In anticipation that there will be differences between financial reporting under IFRS and reporting to meet regulatory accounting requirements, a new RRR requirement will reflect a decision by the Board regarding whether regulated entities will be required to obtain additional audit assurance on regulatory accounting values reported (USOA information) where they differ from financial information reported under IFRS.

### 2.2 Gas Uniform System of Accounts (Gas USOA)

It is expected that the Gas USOA will not change from its current format, which does not include accounting guidance on specific items (unlike provided in APH articles for electricity). However, there will be a need to

incorporate guidance in areas where the regulatory treatment differs from IFRS and provide explanations to clarify these differences and their potential impacts.

In anticipation that there will be differences between financial reporting under IFRS and reporting to meet regulatory accounting requirements, a new RRR requirement will reflect a decision by the Board on whether regulated gas utilities will be required to obtain additional audit assurance on regulatory accounting values reported (USOA information) where they differ from financial information reported under IFRS.

2.3 Amendments to the Electricity and Gas Reporting and Record-Keeping Requirements (RRR) arising from changes to the APH, Electricity Distributor and Gas USOAs and other requirements

Reporting and record keeping changes identified in the revised APH/ Electricity Distributor USoA and Gas USOA will be incorporated in the electricity and gas RRR respectively. This may also include requirements for reconciliations between IFRS and regulatory accounting information and the provision of other financial information in specified formats for regulatory purposes. The revisions will also reflect any requirement for additional audit assurance regarding regulatory accounting values where they differ from IFRS reported values (as noted above).

2.4 Rate Applications Filing Guidelines specifying which GAAP to use for each year

The first reporting year for financial statements under IFRS will be 2011. Application filing guidelines will specify the basis of the accounting information to be used in a particular rate application to be made to the Board. Specifically, the Board will be asked to affirm that applications involving cost of service review for years after 2010 will be in accordance with IFRS. Additionally, the Board will be asked to affirm that applications for cost of service review for years prior to 2011 are to be in accordance with existing Canadian GAAP. Finally, it is expected that the Board will be asked to consider whether applications involving multi-year incentive regulation will require reconciliation of reported annual performance to the same basis of accounting as that upon which the incentive framework was approved.

**3.0 New Regulatory Instruments Arising from the Adoption of IFRS (for Electricity Generators and Transmitters)**

All key accounting decisions of the Board identified in Section 1.0 and applicable to gas utilities and electricity distributors in adopting IFRS are expected to apply to generators and transmitters that are rate regulated. However, as there are

currently only limited financial reporting requirements in place for transmitters and none for generators, the Board will undertake a separate review of accounting and financial reporting requirements for these utilities as part of this plan. This will ensure the Board has sufficient reported information prepared on an agreed upon and/or consistent basis.

This transition plan also includes consideration, development and approval of a Uniform System of Accounts (USOA) for generators and transmitters. The scope of these RRR developments is not expected at this time to include non-financial matters.

### 3.1 Electricity Generator Uniform System of Accounts (Generator USOA)

The starting point for developing generator specific USOAs is expected to be the electricity USOA (in the Accounting Procedures Handbook), which currently includes some accounts for generation utility operations. It is contemplated that the USOA current format will not include accounting guidance on specific items similarly provided in APH articles. Where the regulatory treatment is different from IFRS, explanations will be provided to clarify these differences and their potential impacts.

In anticipation that there may be differences between reporting under IFRS and reporting to meet regulatory accounting requirements, a new RRR requirement will reflect a decision by the Board on whether to obtain audit assurance on regulatory accounting values reported (USOA information).

### 3.2 Electricity Transmitter Uniform System of Accounts (Electricity Transmitter USOA)

The starting point for developing transmitter specific USOAs is expected to be the electricity USOA (in the Accounting Procedures Handbook), which currently includes some accounts for transmission utility operations. It is contemplated that the USOA current format will not include accounting guidance on specific items similarly provided in APH articles. However, there will be a need to incorporate guidance in areas where the regulatory treatment differs from IFRS and provide explanations to clarify these differences and their potential impacts.

A new RRR requirement will reflect any decision by the Board to obtain audit assurance on USOA information filed as discussed in 3.1 above.

### 3.3 Amendments to Electricity Reporting and Record-Keeping Requirements (RRR) for Generators and Transmitters

The Electricity RRR will be updated to reflect changes for reporting and record-keeping requirements (i.e., Generator and Transmitter USOA and

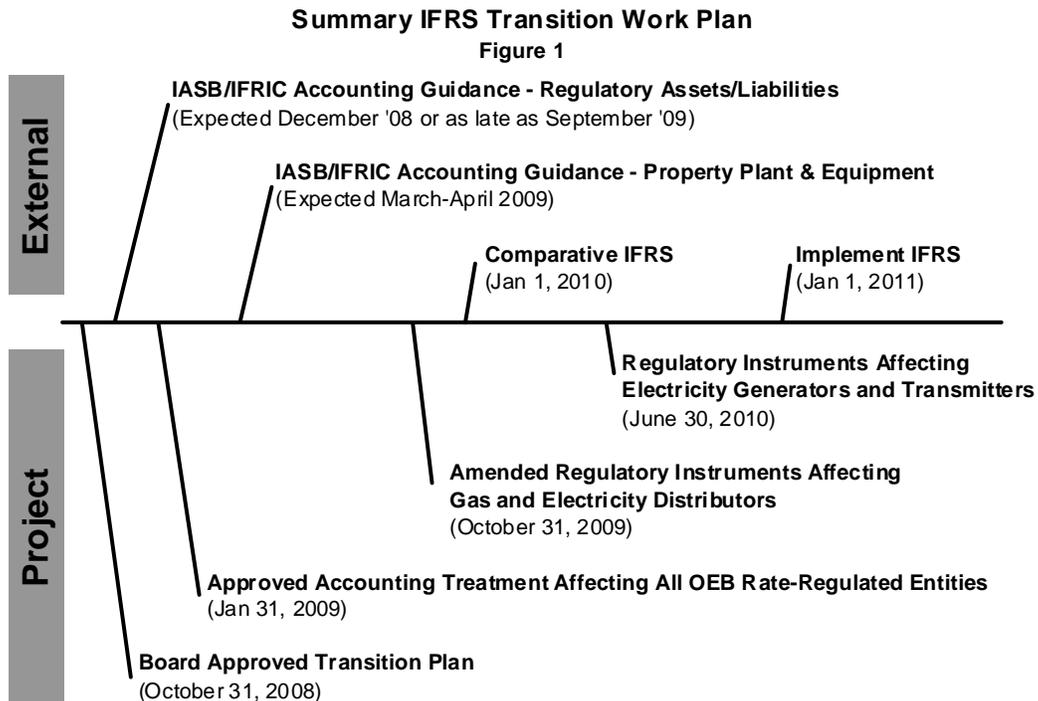
others if approved by the Board). This may also include requirements for reconciliations between IFRS and regulatory accounting information and the provision of other financial information in specified formats for regulatory purposes. The revisions will also reflect any requirement for additional audit assurance regarding regulatory accounting values where they differ from IFRS reported values (as noted above).

3.4 Rate Applications Filing Guidelines specifying which GAAP to use for each year

The first reporting year for financial statements under IFRS will be 2011. Application filing guidelines will specify the basis of the accounting information to be use in a particular rate application under the review of the Board. See Section 2.4 for potential considerations.

4.0 **Project Work Plan Processes and Deliverables**

This section summarizes the work plan processes and deliverables including the timelines for each. A visual summary of the key milestones is provided in Figure 1 below and a more detailed view is provided in Appendix A.



The rest of this section describes the three major deliverables expected from this project as portrayed in the lower portion of Figure 1 above. This section also sets out the project work necessary to develop these deliverables.

#### 4.1 Approved accounting treatment affecting all OEB rate-regulated entities

The Board will commence a written consultation on the key accounting issues summarized in Section 1.0 of this plan in the fall of 2008. A staff discussion paper on these key accounting issues will be issued for comment at that time. A stakeholder conference will be arranged to enable dialogue and inform the process.

The Board is expected to make decisions on these issues by January 31, 2009.

#### 4.2 Amended regulatory instruments affecting gas and electricity distributors

Board staff will continue to research IFRS impacts on Board regulatory instruments and will draft changes to the affected regulatory documents. As part of a consultation on these regulatory instruments and the potential changes, draft revisions will be issued for comment in the spring/summer of 2009. A stakeholder conference may be arranged as part of the consultation if it appears useful to the process. After the consultation, staff will submit final drafts of the documents to the Board for review in the summer of 2009.

Board approval of regulatory instruments is expected by October 31, 2009. The revised regulatory instruments will be posted on the Board's website shortly thereafter.

#### 4.3 Regulatory instruments affecting electricity generators and transmitters

Board staff expects to build on work done in creating the amendments for regulatory instruments for the electricity and gas distributors prior to October 31, 2009. Accordingly, Board staff encourage generators and transmitters to monitor transition work progress of the electricity and gas distributors. The Board will commence a separate process for the regulatory accounting instruments for electricity generators and transmitters in the latter part of 2009. The regulatory instruments for electricity generators and transmitters are outlined in Section 3 above.

Board approval of a USOA and amended electricity reporting and record-keeping requirements (RRR) for generators is expected by June 30, 2010. Similarly, approvals are also expected by this date for a USOA and an amended RRR for electricity transmitters.

#### 4.4 Communications

The Board plans to use a consultative approach to amend the regulatory documents arising from the adoption of IFRS. Consultations are planned for

key accounting issues and draft revisions of the various regulatory documents discussed above. In addition, the Board's website and direct e-mail will serve to communicate key project developments and progress to interested parties throughout the project.

#### 4.5 Training

After issuance of the revised regulatory documents, Board staff will conduct workshops to highlight changes to these documents and assist stakeholders in the transition of adopting these regulatory requirements.

**APPENDIX A**  
**IFRS Transition Plan**  
 Work Flow Diagram  
 All OEB Rate-Regulated Entities

**External Events**

**Project Work**

