

Ontario Energy Board Staff

IFRS Accounting Transition Work Plan

December 8, 2008

Introduction

On February 13, 2008, the Canadian Accounting Standards Board officially confirmed the requirement for publicly accountable enterprises to adopt International Financial Reporting Standards (“IFRS”) for financial reporting purposes in 2011. It is expected that most entities rate-regulated by the Ontario Energy Board will qualify as publicly accountable enterprises and therefore be required to adopt IFRS. The Board has committed to work with entities it regulates to facilitate a smooth transition of Canadian Generally Accepted Accounting Principles (“GAAP”) to IFRS. For regulatory purposes, the Board will need to determine whether all rate-regulated entities it regulates will be required to adopt IFRS for reporting to the OEB, and whether there will be specific rate-making and regulatory needs that would require specialized regulatory accounting and reporting.

Purpose of Work Plan

The work plan sets out the regulatory processes the Board will undertake to address the regulatory implications of the accounting transition to IFRS

Background

As an economic 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. If rates are set based on costs, and those costs are reported and calculated in a manner completely consistent with IFRS, the rate impacts on consumers would be substantial. However, if a significant divergence exists between financial statements based on IFRS and regulatory accounting, the degree of difficulty in managing the regulated enterprises will increase to meet the purposes of both the regulator and the investment community.

Currently Canadian GAAP recognizes the requirements of rate-regulated enterprises as a specialized area of application *within* Canadian GAAP. The same occurs in the United States although there are some areas where the particulars differ.

With the adoption of IFRS in 2011, the basis of accounting will change for financial reporting purposes. The exact impacts and the extent of all the accounting changes on rate-regulated entities are not yet clearly established. 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. How these impacts play out in the rate-regulated environment would require examination through financial and rate impact analyses and the consideration of regulatory rate-making principles. The particular requirements of rate-regulated enterprises are not at this time recognized as a legitimate specialized area within IFRS GAAP.

Staff IFRS Consultations to Date

In order to develop a plan to transition regulatory accounting to IFRS, the Board issued a letter on May 8, 2008 to industry participants to establish a “Transition of Regulatory Accounting to IFRS” consultation. This consultation allowed Board staff to work with interested industry participants on an informal basis to develop the issues associated with the work plan.

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. In addition, interested industry participants were given an opportunity to provide written submissions on the draft work plan proposal prior to approval of the work plan. The Board has reviewed and considered the draft plan including stakeholders’ comments on it in approving this plan. Appendix A of this Plan gives examples of some of the issues discussed with stakeholders.

The Work Plan

This work plan comprises four phases as described below.

Phase I – Initiate a consultation to address the policies and principles on the key IFRS issues. This phase will address the regulatory policies and principles on the key accounting and rate making issues arising from the implementation of IFRS effective January 1, 2011.

Phase II – Amend Regulatory Instruments for Electricity Distributors and Gas Utilities. This phase is the revision of the regulatory accounting and reporting instruments for electricity distributors and gas utilities to implement the Board’s policy regarding the adoption of IFRS. The Board will proceed with the amendments to these regulatory instruments by way of notice and comment. This will occur after the establishment of regulatory policy in Phase I.

Phase III – Training on Revised Regulatory Instruments for Electricity Distributors. After issuance of the revised regulatory documents for the electricity distribution and gas utility sectors, Board staff will conduct workshops to highlight changes to these documents and assist stakeholders in the transition to adopt the regulatory requirements.

Phase IV – New Regulatory Instruments for Electricity Generators and Transmitters. The Board may undertake a separate review of accounting and financial reporting requirements for these utilities as part of this plan, as there are currently only limited financial reporting requirements in place for transmitters and none for generators.

Appendix A – Examples of Issues Discussed during Consultation

1.1 Entities to Which IFRS Reporting Applies for Regulatory purposes

- 1.1.1 Should the Board require all rate-regulated entities that are required to adopt IFRS for financial reporting also to report information to the OEB using IFRS beginning January 1, 2011?
- 1.1.2 Should the Board require all entities to continue to report information to the OEB using Canadian GAAP until December 31, 2010, notwithstanding what may occur by way of ongoing developments within IFRS?

1.2 Regulatory Assets and Liabilities

- 1.2.1 Should the Board continue to use deferral and variance accounts to achieve regulatory rate-setting objectives?
- 1.2.2 If so, should Board approve definitions for deferral and variance accounts to enhance their usage for regulatory purposes and enhance the ability of proposed accounts to meet the definition criteria of an asset/liability under IFRS?

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

- 1.3.1 Should the Board require historic cost/NBV to be used at the date of adoption for regulatory purposes regardless of what is required under IFRS?

1.4 Accounting for PP&E on an Ongoing Basis After Adoption of IFRS

- 1.4.1 Should the Board require historic cost/NBV values to continue to be used for regulatory purposes?
- 1.4.2 Should the Board require PP&E to conform to IFRS capitalization requirements to not capitalize indirect overhead and administration costs?

1.5 Other Key Accounting Issues requiring Regulatory treatment Decisions

- 1.5.1 Should the Board require different regulatory accounting and rate treatments for specific items identified as having different treatment under IFRS (as compared to current Canadian GAAP)? These items include, borrowing costs applied to PP&E (as opposed to deemed interest or AFUDC), customer contributions received for PP&E, inventory valuation (based on lower of cost and net realizable value), asset reclassifications from PPE to intangible assets (e.g., computer software and land rights).

1.6 Application of Depreciation Accounting Under IFRS

- 1.6.1 Should the Board provide further guidance on depreciation policies and principles (e.g., the level at which sub-componentization should 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)?
- 1.6.2 Should the Board encourage sector-wide depreciation studies by utilities (potentially based on pre-defined policies and principles)?

1.7 Electricity Distributor and Gas Utility Reporting and Record-Keeping Requirements (RRR)

- 1.7.1 Should the RRR include requirements for reconciliations between IFRS and regulatory accounting information?
- 1.7.2 Should the RRR include a requirement for supplementary audit assurance regarding regulatory accounting values where they differ from IFRS reported values and that are not otherwise audited?

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

- 1.8.1 What basis of GAAP should the Board require for use in the various rate-year applications after 2010?
- 1.8.2 Should the Board require applications under incentive regulation to file a reconciliation of reported annual performance to the same basis of accounting as that upon which the incentive framework was approved?

Appendix B – Results of Staff Consultations to Develop IFRS Accounting Transition Work Plan

This appendix documents examples of key issues developed by participants in three consultation meetings held in August, September and October 2008. It outlines the considerations that went into creating the project work plan in four sections as follows:

1. **Key Issues for Board Policy Consultation** This section identifies, describes and briefly discusses key regulatory accounting issues for which the Board may need to develop policy applicable to all entities that are rate-regulated by the Board. In addition, this section proposes that the Board could initiate a consultation to consider these and other relevant issues.
2. **Proposed Amendments to Regulatory Instruments arising from the Adoption of IFRS (for Electricity Distributors and Gas Utilities).** This section outlines the scope of potential changes to regulatory instruments for electricity distributors and gas utilities arising from the adoption of IFRS effective January 1, 2011. These amendments would be driven by and result from the policy determinations 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 policy determinations arising from item 1 above.
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.

1.0 Key Accounting Issues and Board Policy required for Regulatory purposes Applicable to Rate-Regulated Entities

This section identifies and discusses key examples of accounting issues the Board needs to consider for regulatory purposes that may apply to all entities that are rate-regulated by the Board. The Board's consideration of the regulatory treatment for these accounting issues is expected to be guided by regulatory ratemaking principles and requirements.

Policy determinations 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 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 determinations on some of these issues (issues 1.2 and 1.3 below in particular) before IASB/IFRIC guidance is provided.

1.1 Entities to Which IFRS Reporting Applies for Regulatory Purposes

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. The Public Sector Accounting Board issued a letter on December 8, 2008 stating that they wished to review the question of whether to continue to apply generally accepted accounting principles for profit-oriented businesses to government business enterprises. Key issues for the Board to consider are:

- 1.1.1. Should the Board require all rate-regulated entities that are required to adopt IFRS for financial reporting also to report information to the OEB using IFRS beginning January 1, 2011?
- 1.1.2. Should the Board require all entities to continue to report information to the OEB using Canadian GAAP until December 31, 2010, notwithstanding what may occur with respect to IFRS?

1.2. Regulatory Assets and Liabilities

IFRS at this time does not permit recognition of specialized rate-regulated accounting. This means regulatory assets and liabilities may not be recognized in general purpose financial statements. While the IASB has agreed to 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 the Board approve 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 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). In addition, IFRS does not permit the capitalization of indirect general and administrative overhead in PP&E.

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

1.4.2. Should the Board require PP&E to conform to IFRS capitalization requirements with respect to indirect overhead after adoption of IFRS?

1.5. Other Key Accounting Issues

There are several other accounting issues that require review to determine their regulatory treatment due to differences arising under IFRS.

These items include borrowing costs applied to PP&E (as opposed to deemed interest or AFUDC), customer contributes received for PP&E, inventory valuation (based on lower of cost and net realizable value), constructive obligations, asset reclassifications from PPE to intangible assets

(e.g., computer software and land rights).

1.5.1. Should the Board require different regulatory accounting and rate treatments for these items identified as having different treatment under IFRS (as compared to current Canadian GAAP)?

1.6. Application of Depreciation Accounting Under IFRS

Depreciation expenses may change due to the required application of componentization accounting and the uncertainty as to whether the group depreciation method will continue 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 will be adopted would be helpful.

1.6.1. 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)?

1.6.2. 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. There is no basis under IFRS for the regulator to specify asset service lives.

1.7. Electricity Distributor and Gas Utility Reporting and Record-Keeping Requirements (RRR)

1.7.1. Should the RRR include requirements for reconciliations between IFRS and regulatory accounting information?

1.7.2. Should the RRR include a requirement for additional audit assurance regarding regulatory accounting values where they differ from IFRS reported values?

Because GAAP in Canada currently recognizes accounting for rate-regulated enterprises as *within* conventional GAAP, opinions of third party auditors on annual audited financial statements generally encompass all the accounts. If there are specialized accounts required by the regulator in an IFRS regime (e.g., deferral and variance accounts), unless the Board so requires, acquiring

an audit opinion on these values will not be automatic.

1.8. 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 consider whether applications involving cost of service review for years after 2010 should be in accordance with IFRS. Additionally, the Board will be asked to consider whether applications for cost of service review for years prior to 2011 are to be in accordance with existing Canadian GAAP. Finally, 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.

1.8.1. What basis of GAAP should the Board require for use in the various rate-year applications after 2010?

1.8.2. Should the Board require applicants' applications under incentive regulation to file a reconciliation of reported annual performance to the same basis of accounting as that upon which the incentive framework was approved?

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.

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.

This reference document sets out a high-level assessment of IFRS areas leading to changes that will be required to the APH. Further research, review and analysis are required to detail the changes. New and amended articles will need to be drafted to provide accounting guidance in various subject areas of the APH. 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 may be considered 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 (See also Section 1.7.2).

2.2 Gas Uniform System of Accounts (Gas USOA)

Board staff expects that the Gas USOA should 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.

As with the electricity sector, a new RRR requirement may be considered by the Board as to 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 Other Amendments to the Electricity and Gas Reporting and Record-Keeping Requirements (RRR)

Amendments to gas and electricity RRR 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 as discussed above.

2.4 Filing Guidelines

Filing guidelines for rate applications for both electricity and gas utilities may have to be amended.

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

The policies 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, Board staff suggests that, in due course, the Board undertake a separate review of accounting and financial reporting requirements for these utilities and have included this as part of the 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. In the interests of expediency, the scope of the associated RRR that emerges is not expected at this time to include non-financial matters. It should be noted that this phase is proposed for inclusion in the work plan for completeness. This phase could be moved to a separate Board process to accommodate completion at a later date.

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).

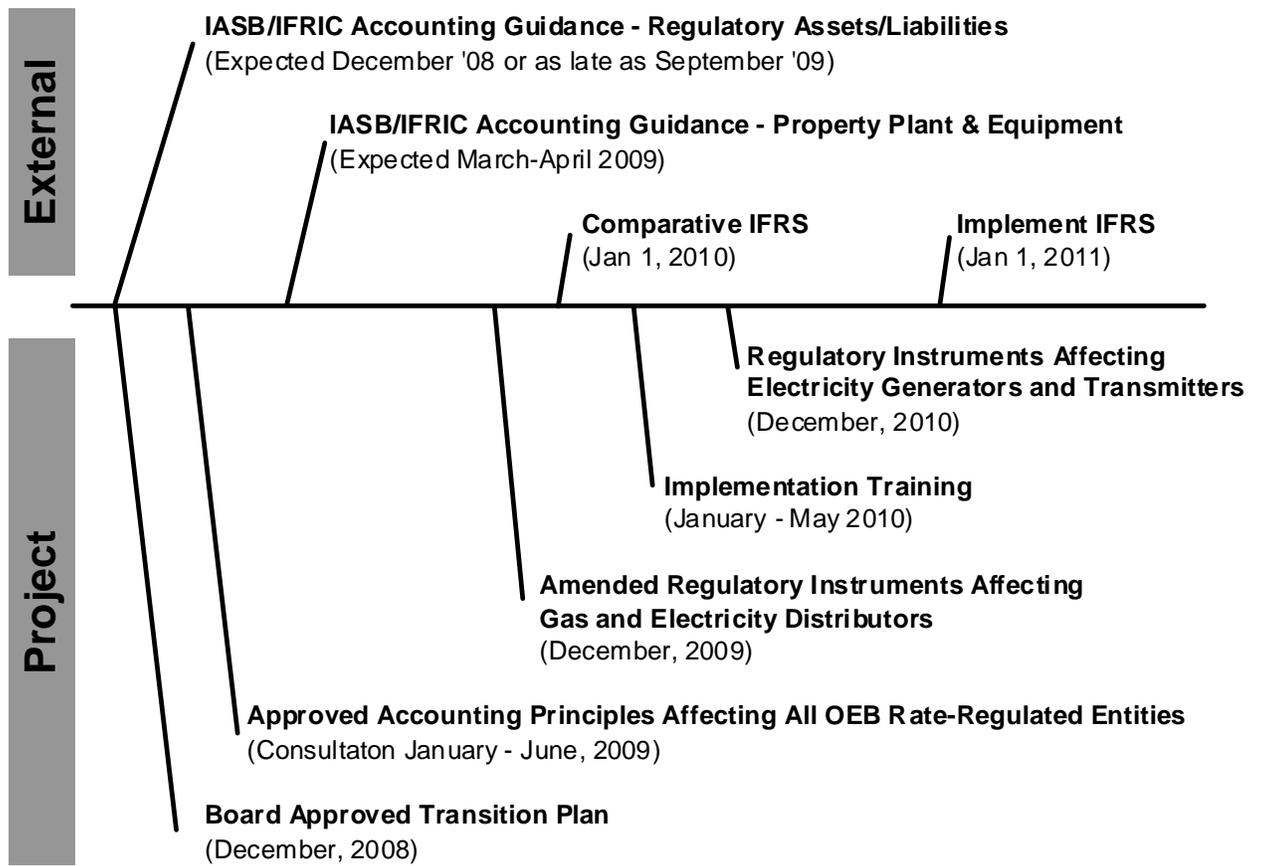
3.4 Rate Applications Filing Guidelines specifying which GAAP to use for each year

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 used in a particular rate application under the review of the Board. See Section 1.7 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.

Summary IFRS Transition Work Plan Figure 1



4.1 Training for electricity distributors

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.