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Mr. Bill Cowan
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October 29, 2008

Dear Mr. Cowan

Comments on OEB's Draft Regulatory Accounting Transition to IFRS Project Work Plan

Further to the Ontario Energy Board ("OEB" or "the Board") requesting interested parties to provide written comments on the Board's Project Work Plan for the transition to International Financial Reporting Standards ("IFRS"), KPMG LLP is pleased to submit its comments. We also take this opportunity to recognize and congratulate the Board for the significant effort and investment that it has made in seeking to ensure that the industry fully considers the adoption of IFRS on a timely basis.

Background

In February 2008, the Accounting Standards Boards ("AcSB") confirmed that Canadian publicly accountable enterprises will be required to adopt IFRS for fiscal years commencing on or after January 1, 2011. To this end, the OEB 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.

On October 7, 2008 Board staff released its Draft IFRS Project Work Plan and requested interested parties to provide written comments by a revised deadline date of October 29, 2008. This comment letter is in response to this request.

Scope and approach to our comments

The Project Work Plan sets out the key accounting issues and decisions that are expected to impact the industry upon transition to IFRS. We understand that it is not intended to cover every single accounting or project implementation matter relating to the transition to IFRS. The objective of this comment letter is to discuss the most significant matters rather than to develop an exhaustive inventory of issues relating to the Project Work Plan.

This comment letter is intended solely for the information and use of the OEB and is not intended to be, and should not be, used by any other parties without our prior written permission in each specific instance. As this comment letter is a matter of public record, its publication by the Board is not restricted. Neither KPMG LLP nor its affiliates, employees or advisors assume any responsibility or liability for any claims, costs, damages, losses, liabilities or expenses incurred by anyone as a result of the circulation, publication, reproduction, use of or reliance upon this comment letter.

Our detailed comments

We set out below our analysis, views and recommendations on the Project Work Plan:

a) Matters of principle

We believe that there are two important principle issues that need to be addressed in the Project Work Plan, namely:

i) Whether or not the Board expects to continue the current practice of establishing rates based on a form of cost-of-service regulation and related processes and methodologies. Answering this question is key because this form of regulation relies primarily on the recovery of historical costs. The question then becomes one of how such historical costs are measured. In turn, this leads to the measurement and subsequent recovery of costs incurred and recorded on the balance sheet at the transition date under Canadian GAAP and then how to record costs incurred after the transition to IFRS.

A conclusion that confirms that the currently practiced rate-setting methodology will continue would still likely require rate-base and variance/deferral accounts to be the centre-pieces of the revenue requirement calculation. Rate-base as established using Canadian GAAP as a base includes certain costs that may not qualify for capitalization under IFRS. As a result, accounting differences may arise at a transactional level. Since utilities will need to record transactions using IFRS principles for their public reporting, they may encounter significant costs and difficulties in ensuring that their records are always fully reconciled if a different base is used for rate-setting purposes. Some consider that this might even require the utilities to maintain two sets of books.

If, on the other hand, the Board decides to modify the current rate-setting processes and methodologies so that they are based on an IFRS model, a different set of issues will arise. As costs may be measured and capitalized differently under IFRS, the OEB would need to consider the impact of this on revenue requirement and rates. The OEB would of course still be able to use deferral accounts in determining rates, irrespective of whether or not they are allowed under IFRS in public financial statements. We however acknowledge that going through a process such as this would require extensive consideration and consultation, and would likely result in wider implications to the industry.

It should nevertheless be noted that rate-regulation is not unique to Canada, and is practiced in some of the countries that have already adopted IFRS. It is however our understanding that cost-of-service regulation is not widely practiced in those countries, and that rate-setting models differ from those currently applied by the OEB. It seems clear however that a rate-setting process that establishes IFRS as its starting point in order to achieve "just and reasonable rates" would likely result in efficiency.

ii) In the past the Board has not sought to prescribe how the regulatory accounts contained in the Uniform System of Accounts are rolled up for financial reporting purposes or prescribed that the special provisions permitted in the CICA Handbook for rate-regulated enterprises be adopted in the financial statements of utilities. Although it is understood that the rate-setting methodology can also create implications for account structure and accounting policies, matters of general purpose financial statement reporting have been left at the discretion of the utilities to determine in order to meet the needs of their financial statement users.

This is an important consideration because IFRS contains several accounting policy choices. These choices exist in the form of elections upon adoption of IFRS, choices in the recognition and measurement of financial statement items as well as financial statement presentation choices. In practice, management makes its decisions on which choices to apply based on a number of considerations, including the needs of various users.

While we acknowledge the benefits to the OEB of a streamlined set of accounting policies for use by the industry in conducting comparative analysis, it should be noted that general purpose financial statements are aimed at a broad range of users with diverse needs. Developing streamlined accounting policies would need to take into account all these various users. Due to the complications that might arise, it might indeed be more appropriate to maintain a separate process and related returns for gathering and validating financial information that is used for rate-setting purposes outside of a utility's general purpose financial statements. It is for compiling these separate rate-filing returns that the Board would be able to prescribe the specific accounting policies that should be applied.

It would seem that there is adequate merit in continuing with the practice of not prescribing the reporting for general purpose financial statements, but instead prescribing specific accounting policies/rules to be followed in completing returns for purposes of rate-setting.

b) Specific matters identified in the Project Work Plan

With regards to the questions specifically posed in the four sections of the Project Work Plan:

i) Entities to which IFRS reporting applies

It is our understanding that most of the utilities are ultimately controlled by the Government of Ontario. Based on our understanding of the requirements in the Introduction to Public Sector Accounting Standards, most of these utilities would meet the definition of government business-type organizations and, as a result, will be required to adopt IFRS in 2011.

It should also be noted that Canadian GAAP as we currently know it will cease to exist in 2011 and will be replaced by IFRS. Although the AcSB intends to develop a simplified form of GAAP that will be available for all private enterprises, it is possible that such simplified GAAP may not be adequate and appropriate for use by those utilities that are not classified as government business-type organizations. As such utilities will not be compelled to adopt IFRS in 2011, the Board needs to consider how it will deal with this matter should it arise.

Mandating specific transition dates for rate-filing information

We appreciate the challenges that would arise if rate-filing information was prepared in an inconsistent basis across the industry. In order to ensure a smooth transition to IFRS, it might be appropriate for the OEB, as regulator, to specify the transition dates for all utilities to change over the accounting base used in preparing their rate-filing information. This would be similar to the direction given by the Office of the Superintendent of Financial Institutions Canada ("OSFI") to those organizations that it regulates. Such an approach would preclude the early adoption of IFRS in rate-filings for periods prior to 2011, and mandate the use of IFRS in rate-filings for 2011 and periods thereafter.

In addition to the IFRS transition dates, it is also important for the Project Work Plan to indicate as a milestone event the date upon which the Board anticipates having finalized the details of its reconciliation and reporting requirements for establishing rates during the transition period. Although paragraph 2.4 refers to the change-over that will arise, it does not indicate when details of the reporting the requirements for the transition period will be available. This information would enable the utilities to take these requirements into account when planning for their separate IFRS transition projects, as well as in planning for the rate-setting process for 2011.

ii) *Regulatory assets and liabilities*

The use of deferral and variance accounts for purposes of rate-setting is a long-established and effective mechanism for regulating rates. We would therefore support the continued use of this practice in establishing just and reasonable rates.

In order to encourage consistent and appropriate use of deferral and variance accounts within the industry, we believe that it is appropriate to have these accounts fully defined, including a description of the information that must be included in a decision for an approved deferral or variance account. This information would indeed be helpful to all the parties that are participating in the rate-setting process.

We, however, do not believe that definitions by themselves alone enhance the ability for deferral and variance accounts to meet the asset and liability recognition criteria under IFRS. We are of the view that greater certainty regarding this matter can only be established when IFRIC or the IASB make a final pronouncement or provides some additional guidance on this matter. This matter is currently being considered by IFRIC.

We however draw your attention to the fact that in the recently issued Information for Observers notes for the IFRIC meeting that is scheduled to be held during November 2008, IASB staff intend to "recommend that IFRIC should not add this item to its agenda but refer the issue to the IASB for it to be added to the IASB's agenda". It would seem that this matter may take a long time before it is finally resolved for IFRS reporting purposes.

iii) *Accounting for Property, Plant and Equipment ("PP&E") on initial adoption of IFRS*

In several instances, the Draft Project Work Plan refers to the Board requiring entities to "report information to the Board". Greater understanding of the information being referred to could be established by indicating whether the information relates to "general purpose financial statements" or "rate-setting requirements" or both. In order to avoid confusion, we believe that this distinction needs to be clearly made in the Project Work Plan and any other related materials that will be developed. Our comments below are on the assumption that the considerations under the Project Work Plan only relate to rate-setting requirements and do not impact on the reporting that will be done in IFRS general purpose financial statements.

We believe that the simplest approach would be to use the Canadian GAAP historical cost and net book value as the basis for regulatory rate-setting. There could be alternatives in the application. One approach would be to maintain the accounts and balances on a Canadian GAAP basis until they unwind. This could very well result in inefficiencies. Another approach would be to adjust the PP&E balances for rate-setting to an IFRS basis on transition and record the differences in deferral accounts to be dealt with as part of the regulatory process.

We also believe that all parties should monitor the ongoing status of the exemptions proposed in the recent exposure draft issued by the IASB on transition matters. This may or may not have a significant impact on transition depending on the wording in the final standard.

iv) *Accounting for PP&E on an on-going basis*

We would expect that historical cost as opposed to fair value will be established as the basis for determining regulated rates. Should this happen, some of the costs that currently qualify for capitalization under Canadian GAAP may not qualify for capitalization in IFRS financial statements upon transition or on a go-forward basis. In our view, these differences in determining costs will be a challenging aspect of the conversion to IFRS for the industry. As the differences would arise at a transactional level, it will make it extremely difficult to fully track the differences in the long-term. We believe that the Project Work Plan needs to articulate this matter in a clear manner.

Accordingly, the Board will need to decide whether or not to use the IFRS base in determining rates. While this may be the most efficient way, it will be necessary to determine the impact on rates as the timing and recognition of costs through the income statement is likely to change. Of course, the Board always has the ability to use deferral accounts to effectively manage rates.

v) *Application of depreciation accounting under IFRS*

We concur with the points raised in the Draft Project Work Plan. We, however, note the following additional points:

- The underlying objective of a depreciation policy for financial reporting purposes is to ensure that there is a systematic and reasonable allocation of the economic benefits embodied by an item of PP&E over its useful life. We noted that the Project Work Plan refers to the need to match the depreciation expense and "the benefits derived by ratepayers from the consumption of the service value of the assets." Technically, there is a difference between these two requirements, with the latter being applicable for rate-setting purposes only and not for IFRS financial statements.
- We believe that Board-led guidance on depreciation policies and principles, as well as sector-wide depreciation studies by the utilities would be useful. However, as is currently the case, this should be used as recommendation only and should not preclude an entity from justifying more appropriate depreciation methods, useful lives and residual values for general-purpose financial reporting and rate-setting based on entity-specific circumstances.

c) Other matters for consideration

In addition to the points raised above, we draw your attention to the following matters:

i) Changes to Canadian GAAP

AcSB had previously intended to adopt standards that were equivalent to IFRSs in a phased manner. However, this approach was subsequently changed and the full body of IFRSs was included in an Omnibus Exposure Draft that was issued in April 2008. It should be noted that some standards that are equivalent (or substantively equivalent) to IFRS have already been adopted under Canadian GAAP. We note, by way of example, the following: Section 3031 *(Inventories)* which became effective from January 1, 2008 and Section 3064 *(Goodwill and Intangible Assets)* which became effective October 1, 2008. Further, changes to Section 3465 *(Income taxes)* relating to future income taxes for rate-regulated enterprises will become effective from January 1, 2009.

We recommend that the Board considers the effect that these changes will have on the Accounting Procedures Handbook and related regulatory instruments. In particular, the effect of these "early" changes should be acknowledged in the Board's IFRS Transition Work Plan.

ii) Proposed changes to IFRS

IASB has numerous IFRS improvements projects that are currently being undertaken. It is expected that some of these changes will be effective when Canadian enterprises transition to IFRS in 2011 whereas others will only become effective subsequent to 2011, possibly with or without the option for early adoption.

We believe that the Project Work Plan needs to incorporate some flexibility in order to effectively deal with these changes as and when they arise.

If you have any questions regarding our comments or wish to discuss these matters further, please do not hesitate to contact John E. Jackson on +1 403 691 8258 or Clever Ngorima on +1 416 777 3639.

Yours truly

KPMG LLP