

**EB-2008-0104**  
**Regulatory Accounting Transition Project**  
**Draft Project Work Plan**  
**OPG's Comments—Oct 29, 2008**

Provided below are OPG's comments on Board Staff's draft plan to address the transition to IFRS.

OPG's has commented on the proposed initiative, the proposed process for developing filing guidelines and reporting and record keeping requirements, and the five regulatory accounting issues identified by Board Staff.

**Proposed Initiative:**

OPG supports continued industry discussion of the differences between Canadian GAAP and IFRS and the potential regulatory implications as utilities progress in their transition efforts and IFRS continues to evolve.

OPG observes that differences between external financial reporting and regulatory information are not new or unique to the IFRS transition. The methodologies employed by the OEB to established just and reasonable rates have not always been the same as those used for external financial reporting purposes. Arguably all IFRS implementation requires is an assessment of the reconciliation requirements.

Given the current state of IFRS' evolution, OPG sees few benefits associated with defining specific regulatory requirements at this time. System and process development benefits resulting from early definition of requirements will only be achieved if such requirements do not subsequently change. Presently, there are a number of issues related to the implementation of IFRS in Canada that are still under consideration by the IASB and IFRIC. And a number of their implementation projects are targeted for completion towards 2011 and, as such, the IFRS are not going to remain static.

The current consultation process is useful in identifying the issues, some of the considerations involved and potential options. The consultative process itself should provide adequate assistance to utilities in planning system and process changes required to address potential new or amended regulatory reporting and record keeping requirements.

Finally, in OPG's submission the process as proposed does not appropriately reflect an evaluation of the Board's financial information needs for rate-making purposes. Given the level of uncertainty, OPG recommends that the Board adopt a slower and flexible approach to implementing IFRS. This would accommodate differing utility circumstances, the evolving requirements of IFRS and the OEB's rate-making information needs.

**Filing Guidelines for Generators**

OPG just recently went through a public process to establish filing guidelines for its payment amounts applications, culminating in a Board decision issued in July, 2007. OPG therefore does

not see value in a process to adjust these guidelines at this time, particularly as OPG is planning on submitting an application in 2009 to establish new payment amounts for the 2010 and 2011 fiscal years. This application would be based on OPG's 2009 – 2011 Business Plan which reflects the continued use of Canadian GAAP.

OPG is still in the midst of its IFRS conversion project. The financial implications of IFRS on OPG are therefore not sufficiently defined to allow OPG to forecast their impact with adequate certainty for its next application. OPG recognizes, however, that the implementation of IFRS may have an impact on OPG's revenue requirement in 2011. OPG is reviewing this issue and will include a proposal to address it in its upcoming payment amount application.

### **Reporting and Record Keeping Requirements for Generators**

OPG submits that RRRs and a USoA for generators should be developed through a separate collaborative process between OPG and Board staff. The need for a Generator USoA and RRRs is in many ways separate from the issue of the conversion to IFRS. Hence it would more appropriate to exclude it from this work plan and address the issue separately.

In 2005, Board Staff and OPG held a number of meetings to discuss a framework for reporting financial accounting information modeled on the same approach that was used to establish the RRRs for natural gas and electricity distributors. These discussions were deferred until it became clearer what information would be included in OPG's rate filings as this information base is needed for the development of the related reporting and record-keeping requirements.

In OPG's view, the best approach would be to reconvene these earlier discussions after the OEB issues its decision on OPG's 2010 – 2011 payment application. The information base used in this application and the Board's views on OPG's proposal for addressing IFRS will be reflected in this decision.

OPG does not believe that it is useful to attempt to develop filing guidelines or RRRs for all regulated utilities through a generic process. OPG is the only regulated generator and is subject to a cost of service regulatory methodology. Its rate making issues and related financial information requirements are unique from those of the other sectors regulated by the OEB. As a consequence, OPG believe that its reporting information requirements should be considered separately.

If the Board does decide on some form of generic process, then the OEB should at least assess its financial information requirements for ratemaking purposes on a sector-specific basis. In recent years, the OEB has relied on sector-specific processes to address fundamental ratemaking issues since each of the sectors has unique rate making issues and financial information requirements.

Further, the record keeping and reporting requirements adopted should:

- 1) Reflect a flexible approach: the unique circumstances of individual utilities should be considered. Development of generic requirements should not create a burden of proof on a utility to demonstrate why the generic treatment should not apply
- 2) Support the OEB's financial information requirements to establish just and reasonable rates--this is the primary reason for developing RRRs.

- 3) Balance the regulatory burden on utilities many of whom are exerting considerable efforts to transition to IFRS for external financial reporting purposes, with the information required to establish just and reasonable rates.

### **Key Regulatory Accounting Issues:**

OPG's comments address the specific questions posed by Board Staff on each of the five key issues described in the Draft Work Plan.

#### **1. Entities to Which IFRS Reporting Applies**

**Q1:** Should the Board require all entities to continue to report information to the Board using Canadian GAAP until December 31, 2010?

**Answer:** OPG supports this requirement. OPG is developing its payment application for 2010 and 2011 using information from its 2009 Business Plan which is based on Canadian GAAP. Future applications that require OPG to file historic financial information relating to periods prior to December 31, 2010 will be prepared on a consistent basis (i.e. using Canadian GAAP).

OPG's proposal for the development and implementation of financial reporting and record-keeping requirements assumes an effective date of January 1, 2011. If OPG is required to report historical financial information prior to this date, it will be prepared using Canadian GAAP.

**Q2:** Should the Board require all such entities to report information to the Board using IFRS beginning January 1, 2011?

**Answer:** OPG will be in a position to report financial accounting information to the Board using IFRS beginning January 1, 2011. As discussed under the issue of Filing Requirements, OPG's payment application will continue to use Canadian GAAP and will include a proposal to address the implications of IFRS implementation in 2011.

#### **2. Regulatory Assets and Liabilities**

OPG is concerned that the description of this issue in the work plan states that "IFRS does not permit rate-regulated accounting" and that "this means that regulatory assets or liabilities will not be recognized in general purpose financial statements". OPG does not agree with those statements. In our view, the issue is that IFRS currently does not specifically address rate regulated accounting and does not provide guidance similar to that under Canadian or US GAAP. As such, any implications of regulation on the financial statements (such as variance and deferral accounts) should be recorded only if they meet the requirements of existing standards (such as the definition of an asset or a liability). Ultimately, in the absence of further guidance, each regulated entity's particular facts and circumstances would need to be assessed in light of these requirements and a determination made upon transition to IFRS, with the concurrence of the auditors, as to whether each element of "rate-regulated accounting", including recording of regulatory assets and liabilities can continue under IFRS for general purpose financial reporting.

OPG does not believe that it is useful, in the context of the work plan, to interpret or speculate on what IFRIC will ultimately be asked to provide guidance on or what that guidance might be.

**Q1:** Should the Board continue deferral and variance accounts to achieve regulatory objectives?

**Answer:** Yes. The OEB's approval of specific deferral, variance, earnings sharing accounts and Z factor provisions reflect a long history of reasoned trade-offs between other alternative regulatory mechanisms available to address uncertainty and volatility. The adoption of IFRS and potential considerations about whether regulatory assets and liabilities can be recorded in financial statements should not deter the OEB from approving deferral/variance accounts for ratemaking purposes.

**Q2:** If so, should the Board staff propose definitions for deferral and variance accounts?

**Answer:** No. OPG supports efforts by the Board to facilitate the recognition of variance and deferral accounts as assets and liabilities on financial statements, and OPG is interested in working with the OEB to enhance the ability of accounts to meet the criteria of an asset/liability under IFRS. However, OPG does not believe that attempting to construct generic definitions for these accounts would be helpful. OPG notes that entities subject to OEB regulation are at various stages in their IFRS transition and discussions with their accounting advisors and auditors on the matter of recognition of regulatory assets and liabilities. The consistency of positions amongst the auditors on this issue has not been established at this time. Therefore, OPG is uncertain what actions or additional guidance from the Board may be helpful, or whether meaningful guidance could be developed on a generic basis for all regulated entities.

### **3. Accounting for Property Plant and Equipment ("PP&E") on Initial Adoption of IFRS**

**Q1:** Should the Board require historic cost/NBV to be used at the date of adoption for regulatory purposes?

**Answer:** The OEB has addressed the issue of asset valuation a number of times. In general, it has maintained the value of the assets acquired or developed to serve the public interest. This is consistent with the regulatory principle that ratepayers should typically not pay higher rates simply because an ownership change has affected an asset value and that utilities should generally be permitted to recover the costs of investments made in good faith, even if events subsequently impair their value. This principle supports the use of historic cost. However the application of this principle to PP&E on initial adoption of IFRS will require further discussion as: not all utilities will be able to use historic cost; changes to the opening historical cost and accumulated depreciation balances may be required upon transition, and a fair market value approach may be appropriate for certain, limited issues.

There are likely to be changes to the historical opening cost and accumulated depreciation balances upon transition to IFRS. Such changes are likely to vary among rate regulated entities and therefore they should be considered on a case-by-case basis by the Board.

The proposed IFRS 1 exemption referenced in the work plan would likely not achieve the result of “no changes to PP&E opening balances and retrospective adjustment to depreciation expense and accumulated depreciation” upon transition to IFRS. This is because there are other IFRS requirements, including IFRS 1 requirements, which may impact the opening PP&E and accumulated depreciation balances on transition. For instance, requirements to account for constructive rather than just legal provisions related to dismantlement, restoration or similar activities may not be in the scope of this exemption. The exemption is also limited in scope in that it requires that restatement of PP&E be “impracticable,” as defined by IFRS, in order for the exemption to be used. More broadly, as noted by KPMG in the oral consultation on October 16, 2008, the overall effectiveness of the proposed exemption may be questionable altogether given the stringent conditions required to qualify for it.

Alternatively, an entity may elect under IFRS 1, on an item by item basis, the fair value of its PP&E as the deemed cost on transition. There are many points of consideration in determining whether fair value would be appropriate, including the regulatory impact. Many entities are still working through these complex challenges and therefore it would be premature at this point to determine whether all items should be required to reflect historic cost or fair value for regulatory reporting purposes.

As a result there should be no expectation that this proposed exemption will result in no changes to PP&E opening balances, regardless of whether they are carried at cost or fair value.

#### **4. Accounting for PP&E on an Ongoing Basis**

**Q1:** Should the Board require historic costs/NBV values to continue to be used for regulatory purposes on an ongoing basis?

**Answer:** Subject to the discussion of valuation of PP&E on transition under Issue #3, OPG generally agrees that the cost basis of measuring PP&E should be used subsequent to transition to IFRS.

#### **5. Application of Depreciation Accounting under IFRS**

**Q1:** Should the Board provide further guidance on depreciation policies and principles?

**Answer:** No. OPG’s depreciation methodology has been established on a utility specific basis, reviewed by an independent expert and the public in OPG’s EB-2006-0905 proceeding, and reflects the unique issues and asset base of OPG. OPG does not see value in attempting to develop generic approaches that would not reflect OPG’s unique operating circumstances and asset base.

**Q2:** Should the Board encourage sector-wide depreciation studies by utilities?

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<sup>1</sup> Gannett Flemming, a recognized independent company providing expert depreciation assessments, reviewed OPG’s methodology for determining depreciation expense. Their report concluded that “Gannett Fleming has found that the processes, procedures and methods followed by Ontario Power Generation Inc. adequately meet regulatory objectives regarding depreciation generally accepted by Canadian regulatory authorities. These processes, procedures and methods should also lead to a reasonable and appropriate calculation of depreciation expense for inclusion in the revenue requirement for ratemaking purposes.”

**Answer:** OPG does not support sector-wide depreciation studies. To be IFRS compliant, the assessment of componentization and depreciation policies for accounting purposes is determined by the entity and validated by its auditor. Generic guidance or studies for componentization or depreciation lives would likely not reflect the reality of each entity and, instead of being helpful, may in fact create additional regulatory burden for entities. The burden would arise in situations where entities would have to use one set of componentization and depreciation policies/lives to be IFRS-compliant and another set prescribed by the Board for regulatory filing purposes.