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**BY E-MAIL AND WEB POSTING**

February 24, 2010

All Licensed Electricity Distributors  
All Rate-Regulated Natural Gas Utilities

**Re: Accounting for Overhead Costs Associated with Capital Work**

The *Report of the Board on Transition to International Financial Reporting Standards (IFRS)*, July 2009 (Board Report) addressed the topic of accounting for overhead costs in the cost of new capital works effective January 1, 2011 in Issue 3.3. The Board is providing a clarification on this issue to assist utilities with their transition to IFRS. This matter was covered extensively in consultations EB-2008-0104/0408 including a survey of distributors in April of 2009 concerning their overhead capitalization practices. The Board Report stated:

*3.3 The Board will require utilities to adhere to IFRS capitalization accounting requirements for rate making and regulatory reporting purposes after the date of adoption of IFRS. The utility will file a copy of its capitalization policy, identifying any updates to the policy, as part of its first cost of service rate filing after IFRS adoption. Revenue requirement impacts of any change in capitalization policy must be specifically and separately quantified.*

The Board has received a number of enquiries regarding application of this portion of the Board Report. The enquiries have arisen given that the International Accounting Standards Board (IASB) has issued a draft standard on Accounting for Rate-Regulated Activities that states that a utility can include in the cost of capital works, costs beyond those permitted by the base IFRS standard (IAS 16 - Property, Plant & Equipment) if the regulator allows it and provides sufficient assurance of recoverability. The enquiries have been whether the Board would continue to allow capitalization of administration and other general overhead costs (currently explicitly prohibited by IAS 16, paragraph 19<sup>1</sup>) for distributors currently doing so, if the standard were approved.

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<sup>1</sup> The test generally applied to determine which overhead costs may be capitalized under IAS 16 is that they be costs that would have been avoided only if the specific asset had not been constructed or acquired. Employee benefits costs are included as an example of directly attributable costs (IAS 16, paragraph 17 (a)).

This letter is to clarify that the Board's position on Issue 3.3 from the Board Report applies independently of what the approval outcome of the IASB draft standard may be, as follows:

- As stated in the Board Report at Issue 3.3, the Board is requiring full compliance with IFRS requirements (e.g., IAS 16) as applicable to non-regulated enterprises and only where the Board authorizes specific alternative treatment for regulatory purposes is alternative treatment acceptable.
- Based on IFRS consultations EB-2008-0104/0408 survey results this may mean a reduction in capitalized overhead for some electricity distributors that have previously capitalized administration and other general overhead costs no longer permitted under IFRS. It may mean an increase for those that have capitalized little or no overhead costs in the past. This includes those that have not capitalized such costs as specific capital project engineering costs, the cost of vehicles used in construction and employee benefits costs for staff working on specific capital projects. Benefits costs include but are not limited to statutory benefit costs, medical plan costs, pension costs and the cost of vacation time, holiday time and sick leave (IAS 19 – Employee Benefits).

Utilities are also reminded that the Board Report addresses a number of regulatory accounting, rate application and reporting matters related to the transition to IFRS including the impacts of any policy changes experienced by utilities.

Please direct any questions regarding this matter to the Market Operations Hotline at 416-440-7604 or by e-mail addressed to [market.operations@oeb.gov.on.ca](mailto:market.operations@oeb.gov.on.ca). The Board's toll free number is 1-888-632-6273.

Yours truly,

*Original Signed By*

Kirsten Walli  
Board Secretary

cc. All Participants in Board Consultation on Transition to IFRS (EB-2008-0408)