# Ontario Energy Board

# EB-2008-0408

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# Report of the Board

## Transition to International Financial Reporting Standards

**July 28, 2009**

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# Introduction

This Report of the Board sets regulatory policy regarding the transition to International Financial Reporting Standards ("IFRS"). As a result of the work undertaken by the Board and participants, the Board is confident that the transition to IFRS can be accomplished in an efficient manner while continuing to meet regulatory accounting requirements.

As required by the Canadian Accounting Standards Board, Canadian Generally Accepted Accounting Principles ("CGAAP") for publicly accountable enterprises will transition to IFRS, effective January 1, 2011. As IFRS is currently written, most utilities regulated by the Ontario Energy Board will be required to adopt IFRS for financial reporting. This Report addresses the adjustments that should be made to regulatory reporting and filing requirements as a result of the adoption of IFRS for financial reporting purposes.

In the fall of 2008, Board staff conducted a series of meetings involving industry participants (under file number EB-2008-0104). These meetings identified the areas of potential change from CGAAP to IFRS that could affect the accounting performed by regulated enterprises arising from the transition to IFRS. The meetings compared the reporting of financial results under IFRS and CGAAP, illustrated the potential effects on the calculation of regulatory revenue requirement and income, identified and listed key issues to be addressed and proposed an additional development work plan.

On December 23, 2008, the Board initiated a consultation under file number EB-2008-0408 to receive input from experts and stakeholders to assist the Board in making regulatory policy regarding the transition to IFRS.

The first phase of the consultation process, which culminates with issuance of this Report, included the following steps:

- The finalization of an issues list (Appendix 1)
- The release of a report by KPMG, the consultant retained by the Board ("Report on the Transition to International Financial Reporting Standards")
- A question and answer session with KPMG
- A series of discussion sessions regarding answers proposed by Board staff to the questions on the issues list
- A two-day stakeholder conference, during which the Board received nine presentations from stakeholders
- The receipt of written submissions, and written reply submissions from participants following the stakeholder conference.

All materials, presentations, transcripts and submissions relating to the first phase of this consultation are available on the Board's website.

Subsequent to the issuance of this Report, the Board will initiate the second phase of the consultation; namely, the process of amending certain regulatory instruments in accordance with the policy outlined in this Report. Through the consultations to date,

participants have provided significant input and insight and a number of issues have been resolved. As a result, completion of the amendment process is expected to be more expeditious than might otherwise have been the case.

The regulatory instruments that require amendment to implement the transition to IFRS include:

- Gas rules of the Board:
  - Natural gas Uniform System of Accounts ("USoA")
  - Natural gas utilities Reporting and Record-Keeping Requirements ("RRR")
- Electricity reporting requirements:
  - Electricity RRR
  - Electricity USoA
- Policy guidelines:
  - Electricity Accounting Procedures Handbook ("APH")
  - Filing guidelines for natural gas rate applications
  - Filing guidelines for electricity rate applications

This consultation focuses on regulatory instruments applicable to electricity distributors and rate-regulated natural gas utilities. Subsequent to the completion of the consultation, the Board may consider the need for amendments to regulatory instruments applicable to electricity transmitters and Ontario Power Generation Inc. ("OPG").

This Report uses the word "utility" to refer to regulated electricity distributors and rate-regulated natural gas utilities generally and the word "distributor" when referring specifically to electricity or natural gas distributors.

This Report uses the term "modified IFRS" to refer to IFRS accounting as modified for regulatory purposes consistent with this Report

The Board found the following very useful in preparing this Report:

- The draft issues list developed in the consultation
- The alternatives described and discussed in Board's consultant's report (KPMG) provided to participants in the consultation
- The proposals for resolution of the issues, drafted by Board staff in an effort to describe potential solutions and further developed through discussion with participants (referred to in this Report as "staff proposals")
- The presentations and written submissions by participants on the issues and the staff proposals

The Board thanks all participants for the time and effort that they have dedicated to this consultation to date, and appreciates the co-operative manner in which participants have approached this process.

This Report is structured around the issues list (Appendix 1), refers to the proposed resolutions to the issues on the list and provides, in Appendix 2, a summary listing of Board policy structured in accordance with the issues list.

**Participants in the consultation:**

1. Association of Major Power Consumers in Ontario
2. Brantford Power Inc.
3. The Building Owners and Mangers Association of the Greater Toronto Area
4. Burlington Hydro Inc.
5. Cambridge and North Dumfries Hydro Inc.
6. Canadian Manufacturers & Exporters
7. Canadian Niagara Power Inc.
8. Centre Wellington Hydro Ltd.
9. Chatham-Kent Hydro Inc.

10 City of Kitchener

11. Consumers Council of Canada
12. Cornerstone Hydro Electric Concepts Association Inc.
13. Deloitte Canada
14. The Electricity Distributors Association
15. Enbridge Gas Distribution Inc.
16. Energy Probe Research Foundation
17. Enersource Hydro Mississauga Inc.
18. Enwin Utilities Ltd.
19. Erie Thames Powerlines
20. Ernst & Young LLP
21. Festival Hydro Inc.
22. Great Lakes Power Ltd.
23. Greater Sudbury Hydro Inc.
24. Guelph Hydro Electric Systems Inc.
25. Halton Hills Hydro Inc.
26. Horizon Utilities Corporation
27. Hydro One Brampton Networks Inc.
28. Hydro One Networks Inc.
29. Hydro Ottawa Limited
30. Independent Electricity System Operator
31. Industrial Gas Users Association

32. Innisfil Hydro Distribution Systems Ltd.
33. Kingston Hydro Corporation
34. Kitchener Wilmot Hydro Inc.
35. Lakefront Utilities Inc.
36. Lakeland Power Distribution Ltd.
37. London Property Management Association
38. Merritt & Associates
39. Newmarket-Tay Power Distribution Ltd.
40. Norfolk Power Distribution Inc.
41. North Bay Hydro Distribution Ltd.
42. Five Nations Associates Energy Inc. and Natural Resource Gas Ltd.
43. Ontario Power Authority
44. Ontario Power Generation Inc.
45. Orangeville Hydro Limited
46. Orillia Power Distribution Corporation
47. PowerStream Inc.
48. Power Workers' Union
49. School Energy Coalition
50. Toronto Hydro Electric System Ltd.
51. Union Gas Limited
52. Veridian Connections Inc.
53. Vulnerable Energy Consumers Coalition
54. Waterloo North Hydro Inc.
55. Welland Hydro-Electric System Corporation
56. Whitby Hydro Electric Corporation

# Scope

The Board does not prescribe the financial reporting for regulated utilities. The accounting principles required for financial reporting are prescribed by the Canadian Accounting Standards Board and other accounting standards bodies. What the Board does do is set the requirements for regulatory accounting, reporting and filing. The policy in this Report applies only to regulatory accounting, reporting and rate application filings.

The issues list approved by the Board for this consultation stated the scope as follows:

> This consultation examines the effects of the adoption of IFRS on regulatory accounting and rate making, to identify necessary changes to the Board's filing and reporting requirements and rate setting methodologies. It includes changes in Canadian GAAP related to the implementation of IFRS. This consultation will not include a discussion of changes to filing requirements and rate setting methodologies that are not driven by the adoption of IFRS.
>
> This consultation will not include a discussion of the financial risk profile of utilities, and how the adoption of IFRS may affect that risk profile.

At the stakeholder conference, Enbridge Gas Distribution Inc. ("EGD") raised the issue of how the adoption of IFRS might affect the financial risk profile of utilities. The presenters acknowledged that information was insufficient at the present time to address the issue of financial risk profile, but submitted that the Board, in its policy report, should acknowledge the fact that that the issue will need to be considered in the future. The Coalition of Large Distributors ("CLD") (an electricity distributor organization comprising Enersource Hydro Mississauga Inc., Horizon Utilities Corporation, Hydro Ottawa Ltd., PowerStream Inc., Toronto Hydro Electric System Ltd., and Veridian Connections Inc.) and EGD stated in their submissions that the Board should acknowledge that the matter of risk profile will need to be dealt with in the future.

The Industrial Gas Users Association, in its submission, urged the Board to make no comment on the issue of risk profile, as any comment would be premature and without foundation. The Vulnerable Energy Consumers Coalition ("VECC") agreed that it was too early in the evolution of IFRS to assess the effect, if any, of the adoption of IFRS on the risk profile of utilities.

The Board believes that the scope described above is appropriate for this consultation. The Board notes that in their final submissions, parties did not submit that the matter of risk profile should be dealt with in this consultation. The Board concludes that it is premature to anticipate that the adoption of IFRS will have any effect on the risk profile of utilities.

# Guiding Principles

Staff proposed five principles to guide the Board in its consideration of the regulatory effect of the transition to IFRS.

The Group of 8 Ratepayer Groups (Association of Major Power Consumers in Ontario, Building Owners and Managers Association of the Greater Toronto Area (“BOMA”), Canadian Manufacturers & Exporters (“CME”), Consumers Council of Canada (“CCC”), Energy Probe Research Foundation, London Property Management Association (“LPMA”), School Energy Coalition (“SEC”) and Vulnerable Energy Consumers Coalition (“VECC”)) (“Group of 8”) proposed, through its consultant John Browne, six guiding principles and a proposed method of analysis for proposed regulatory accounting changes. SEC, in its submission, proposed a main principle, four collateral principles, and a decision tree involving five analytical steps for evaluating potential regulatory accounting changes. CCC and EGD each proposed the addition of three principles to those proposed by staff.

The Board has concluded that, for the purposes of this consultation, the principles as proposed by staff are generally appropriate, although some modifications are warranted to reflect stakeholder comments. The Board reminds participants that these are guiding principles, not contract terms to be parsed word by word. The following paragraphs provide the Board’s reasoning, and modifications to the principles, in more detail.

**Principle 1 as proposed:**

> 1. The methodologies used by the Board to establish just and reasonable rates have not always been the same as those used for external financial reporting purposes. The Board has and will retain the authority to establish regulatory accounting and regulatory reporting requirements. IFRS accounting requirements will not be the sole driver of regulatory requirements.

There was general agreement with this principle, but BOMA and LPMA (“BOMA & LPMA”), who made a joint submission, SEC and VECC submitted that the last sentence over-emphasized the importance of external accounting standards at the expense of regulatory principles. The Board agrees that when considering regulatory accounting requirements, regulatory principles take precedence over external financial accounting standards. As this Report demonstrates, the Board is not adopting IFRS accounting for regulatory purposes merely because that system is required for financial reporting purposes. The Board will construct a regulatory accounting system that meets its regulatory needs. Nevertheless, the fact that most regulated utilities will adopt IFRS for financial accounting purposes is an important factor in the design of regulatory accounting.

The Board believes that the wording suggested by VECC, with two modifications, would better express the meaning of the last sentence of this principle. The first principle is therefore stated as follows:

1. The methodologies used by the Board to establish just and reasonable rates have not always been the same as those used for external financial reporting purposes. The Board has and will retain the authority to establish regulatory accounting and regulatory reporting requirements. While IFRS accounting requirements are an important consideration in determining regulatory requirements, the objective of just and reasonable rates will continue to be the primary driver of such requirements.

**Principle 2 as proposed:**

2. Future regulatory accounting and regulatory reporting requirements established by the Board will continue to be based on sound regulatory principles. These principles include fairness, minimizing intergenerational inequity and minimizing rate volatility.

There was general agreement with this principle, and the Board sees no reason to adjust it.

**Principle 3 as proposed:**

3. Future regulatory accounting and regulatory reporting requirements established by the Board will, in taking into account IFRS requirements, balance the effects on both customers and shareholders.

Again, there was general agreement with this principle, and the Board has not changed it. Several ratepayer participants emphasized the importance of lack of harm to ratepayers, and the avoidance of changes in rates driven solely by accounting changes. The Board finds that the reference to balancing the effects on customers and shareholders adequately expresses the Board's approach.

**Principle 4 as proposed:**

4. Future regulatory accounting and regulatory reporting requirements established by the Board will be aligned with IFRS requirements as long as that alignment is not inconsistent with sound regulatory rate making principles.

There was a wide range of views on this principle.

The principle as drafted was seen as establishing IFRS as the "default" accounting system for regulatory purposes. The majority of ratepayer groups argued that such an approach would result in regulatory accounting moving too quickly to match IFRS requirements, without a proper consideration of regulatory principles. They argued that the objectives of financial reporting and regulatory rate making are different, and that the primary focus should be on the Board's rate making obligations and associated rate making principles.

Generally, ratepayer groups supported the framework for analysis proposed by Mr. Browne for the Group of 8, which provided for a rigorous testing of any proposed accounting change against the current regulatory accounting policy. That analysis requires data on the impacts of the proposed accounting change on utility revenue requirements and the delaying of policy decisions until such data becomes available. SEC proposed a decision tree that requires an assessment of potential rate impacts through substantive analysis of evidence, and a determination of whether the current CGAAP-based regulatory accounting system or an IFRS-based regulatory accounting system would achieve the optimal regulatory result.

The Board does not accept that to use IFRS principles as the basis for its regulatory accounting system is to abandon a principled analysis. The identification of numerous issues for this consultation, and the choices made by the Board as set out later in this Report not to adopt certain IFRS principles for regulatory accounting, demonstrate that the Board is conscious of the primacy of regulatory and rate making principles in relation to the subject-matter of this consultation.

The submissions of some participants seem to assume that there is an independent “regulatory accounting” regime created by the Board that can continue indefinitely. In fact, the basis of the current regulatory accounting system, CGAAP, will be replaced by IFRS, and will no longer be available for financial or regulatory accounting. The current system is CGAAP, including modifications for regulatory purposes. The new system as at January 1, 2011, will be IFRS, with modifications for regulatory purposes.

Many utilities supported this principle. The Board recognizes that many utilities have requested guidance now to plan their transition to IFRS. Delaying a policy determination may result in increased costs incurred by utilities, as they will have to maximize the flexibility in their systems and processes to record transactions in multiple ways and to cater to potentially multiple reporting requirements. This may result in increased costs to the ratepayer. The Board recognizes that minimization of differences between financial and regulatory accounting is desirable where it is feasible. Large differences between financial accounting and regulatory accounting will inevitably result in increased administrative costs to utilities and, if those costs are passed into rates, to their ratepayers.

The Board does not have the data now to undertake the type of analysis recommended by the Group of 8 and SEC with regard to impacts on revenue requirements. The data available to the Board at this time suggests that the impacts will not be predictable or uni-directional. Impacts on utilities will vary in their nature and magnitude. If the Board is to achieve a consistent regulatory accounting policy, it cannot rely on revenue requirement impact analysis to drive that policy.

Some of the modifications to IFRS that are necessary for regulatory purposes are apparent now, and others will reveal themselves as IFRS and its interpretation evolve. The Board will very likely have to consider adjustments to the regulatory accounting regime on an on-going basis, as it has in the past.

The Board will continue to be mindful of the effect on ratepayers of the transition to IFRS. It will insist that utilities provide data on the revenue requirement impacts of the

transition as that data becomes available. The Board will address unexpected consequences and undue impacts to utilities and ratepayers in the rate applications of individual utilities. The Board will remain vigilant to identify and address developments in IFRS rules and interpretation as they arise.

The Board therefore believes that the fourth principle is appropriate in the form proposed by staff.

**Principle 5 as proposed:**

> 5. Future regulatory accounting and regulatory reporting requirements established by the Board will be universal and standardized for all utilities, while recognizing that utility-specific issues can be addressed through a utility's applications.

Most participants agreed with this principle. The Board recognizes the potential need to deal with utility-specific issues. As pointed out by Union Gas Ltd. ("Union") and others, the effects of the adoption of IFRS on individual utilities and their ratepayers may be unique to that utility, and unique issues can be dealt with through individual rate applications.

The Board recognizes that a few utilities regulated by the Board may not be required by accounting standards bodies or their own auditors to adopt IFRS for financial reporting purposes[1], and agrees that some flexibility may be required to accommodate unique circumstances. The Board has therefore modified the fifth principle such that it reads as follows:

> 5. Future regulatory accounting and regulatory reporting requirements established by the Board will be universal and standardized for all utilities, while recognizing that utility-specific issues can be addressed through a utility's applications. The Board will not require modified IFRS filing and reporting requirements for utilities that are not otherwise required to adopt IFRS for financial reporting purposes.

The Board has considered the suggestions for additional principles proposed by several participants. While the proposals have merit, the Board finds that the five principles modified as above provide an appropriate and sufficient basis to guide the Board in its consideration of the subject matter of this consultation.

[1] Examples of utilities that *may* not be required to use IFRS are utilities owned by First Nations incorporated as not-for-profit organizations under the *Canada Corporations Act*, as well as utilities that may not meet the Canadian Accounting Standards Board criteria for being publicly accountable and for whom some other form of generally accepted accounting principles has been accepted by their auditors as more appropriate. Note that government business enterprises *are* required by the Public Sector Accounting Board to adopt IFRS, e.g., municipally owned utilities.

# External Uncertainties

IFRS is an evolving set of accounting standards, and the interpretation of those standards is also evolving. Decisions are expected, but not yet received, from various accounting standards bodies that will determine the extent to which existing regulatory accounting practices may be incompatible with IFRS.

In the issues list this matter was stated as follows:

> ***Issue 6.1:***[2] **What are the potential implications on the Board's decisions of the questions now before accounting standard-setting bodies? These uncertainties include:**
>
> - **Potential exemption from the requirement for retrospective or fair value restatement of PP&E (being considered by the International Accounting Standards Board "IASB")**
> - **Recognition of regulatory assets and liabilities, e.g., deferral and variance accounts (being considered by the IASB)**
> - **Whether accounting standards will require municipal and provincial government-owned distributors (government business enterprises) to adopt IFRS (being considered by the Public Sector Accounting Board – Canada "PSAB")**
> - **Other developments from accounting standards-setting bodies**

The IASB has two issues before it that are of particular consequence to regulated utilities. The first is the potential exemption from the requirement for retrospective or fair value restatement of property, plant and equipment values upon adoption of IFRS, and the second is the recognition, or lack thereof, for financial reporting purposes of deferral and variance accounts. The IASB is expected to issue an exposure draft on Rate Regulated Activities in the second half of 2009, which will address both of these questions. However, firm decisions will not likely be made by the IASB until mid-2010.

The PSAB is reviewing its previous determination to require government business enterprises, which group includes the majority of the electricity distributors in the province, to adopt IFRS for financial reporting purposes. It appears at the time of writing this Report that the most likely outcome is that government business enterprises will be required to adopt IFRS. The PSAB is expected to issue an exposure draft in the second half of 2009 on the applicability of IFRS to various types of public sector enterprises and to address the question of the type of generally accepted accounting principles ("GAAP") applicable to rate-regulated government business enterprises. The electricity distributors who made submissions in the consultation supported the approach of proceeding as if IFRS adoption would be required. The Board has proceeded on the assumption that municipal and provincial government-owned electricity distributors will be required to adopt IFRS.

[2] Issues are listed in Appendix 1. They are addressed in the body of this Report in the sequence of the Report, not necessarily in numeric order.

The Board is proceeding with this consultation on the intersection of regulatory accounting and IFRS in the absence of final decisions from accounting standard-setting bodies, as it believes that distributors need early guidance on the Board's regulatory accounting and rate application filing requirements. The Board's approach may need to be modified if an unanticipated ruling is received.

# Major Points of Departure between Existing Regulatory Accounting and Rate Making as Compared to IFRS

## *General Observations*

The Board is satisfied that this consultation has enabled it to identify and address the areas of significant potential difference arising from the transition to IFRS. The Board also believes that the policies in this Report will require utilities to provide sufficient disclosure of any impacts arising from the transition to allow the Board to monitor such impacts and consider whether additional policy is required.

The Board notes the following:

- In most areas, the regulatory accounting under IFRS remains the same as under current CGAAP.

- There are a number of areas where accounting information collected previously under CGAAP achieves the same accounting effect but is disclosed in a different fashion in the financial statements under IFRS, e.g., contributions in aid of construction. For these, reclassification is all that is required after IFRS adoption in order to continue to meet the regulatory accounting requirements.

- Property Plant & Equipment accounting has been considered by some utilities to be an area where transition to IFRS might drive major system changes to meet the requirements of IFRS and the Board. The Board is not persuaded that the changes ultimately needed in this area will necessarily be as complex as some have perceived. For instance, while there may be work to be done to address IFRS requirements for more granularity in the breakout of certain asset costs and to determine useful life on a utility specific basis (both with potential impacts on depreciation expense), these requirements do not in and of themselves appear to drive systems changes.

- The Board is not generally introducing accounting requirements in areas where the Board has not taken a policy position in the past (except, for example, regarding a deferral account for up front IFRS transition costs). The focus of this Report is on enabling the transition of *existing* Board regulatory accounting policy.

The Board recognizes that the effect of adopting IFRS will vary among utilities. The Board expects that in considering the implications of the transition, utilities will maintain the required regulatory accounting functionality in a manner that minimizes the impact on ratepayers.

## *Regulatory Assets and Liabilities*

> ***Issue 2.1:* Should the Board continue to use deferral and variance accounts in the event that they are not recognized under IFRS?**

The staff proposal with respect to deferral and variance accounts (sometimes referred to as regulatory assets and liabilities) was as follows:

> 2.1 The Board will continue to use deferral and variance accounts for rate making in appropriate circumstances, whether or not these accounts are recognized under IFRS.

All participants that commented on this issue agreed with this proposal, and the Board confirms that it will continue to use these accounts where appropriate. As VECC indicated in its submission, rate making must deal with uncertainty, and with circumstances that are difficult to forecast and may be beyond a distributor's control. In these circumstances, deferral and variance accounts are critical regulatory instruments that serve to protect the interests of both utilities and ratepayers and also reduce overall costs.

> ***Issue 2.2:* Should the Board approve definitions for deferral and variance accounts if the Board retains their use for regulatory purposes?**

Staff proposed that

> 2.2… the Board … continue to apply the existing approach in the use and establishment of such accounts. The Board may consider the review and adjustment of its existing approach when the rulings from the International Accounting Standards Board are received and the interpretation of IFRS becomes clearer.

Several participants addressed the issue of the level of assurance of recovery of deferral and variance accounts, most submitting that the Board should maintain its current approach, at least until final guidance is available from the IASB.

The Board confirms that it will continue with its current approach to the establishment and clearing of deferral and variance accounts, and notes that aspects of the Board's approach are being considered as part of EB-2008-0046, the Electricity Distributors' Deferral and Variance Account Review initiative. However, the Board wishes to remind distributors that there is no guarantee of recovery of amounts recorded in such accounts where the amounts are subject to a prudence review prior to disposition. The Board may disallow the recovery of some or all of the costs in an account that is subject to a prudence review before disposition. Accounts (such as the commodity pass-through variance accounts) which are comprised of amounts that are purely passed through to customers without a prudence review, provide greater certainty of recovery.

## *Property, Plant and Equipment*

### Basis of PP&E values

> ***Issue 3.1:* For the purpose of first-time adoption of IFRS, should the Board require historic cost (NBV) or the IFRS adoption requirements (fair value or retrospective restatement) to be used as the basis for setting opening rate base values and reporting to the Board?**
>
> **Issue 3.2: After adoption, what should be the basis for reporting PP&E for regulatory purposes (e.g., historical acquisition cost, fair value)?**

All participants agreed with the staff proposals for setting opening rate base value upon adoption of IFRS, and the reporting basis for property, plant and equipment ("PP&E"). Those proposals read as follows:

> 3.1 The Board will require regulated net book value to be used as the basis for setting opening rate base values and reporting to the Board at the time of the first report to the Board or rate application for periods subsequent to the adoption of IFRS. To establish continuity of historic cost, the statement of opening value for regulated net book value includes providing gross capital cost and accumulated depreciation, subject to additional breakout of amounts as necessary to support regulatory accounting requirements…
>
> 3.2 The Board will require the use of historical acquisition cost as the basis for reporting PP&E for regulatory purposes.

The Board notes that the IASB is including this issue in its review of regulatory accounting, for which an exposure draft is expected in the second half of 2009. This exposure draft is expected to address certain matters related to PP&E that may reduce the differences between regulatory accounting and financial accounting.

BOMA & LPMA and VECC submitted that if a utility chooses a value other than net book value on first time adoption of IFRS, administrative costs resulting from this choice should be borne by the shareholder. EGD replied that it should be open to such a utility to justify why ratepayers should be responsible for transitional or ongoing costs.

The Board agrees that regulated net book value should be used as the basis for setting opening rate base values upon the adoption of IFRS accounting, and that historical acquisition cost should be used as the basis for reporting PP&E for regulatory purposes going forward. The responsibility for any administrative costs that may arise for a utility that elects otherwise for accounting for financial reporting purposes can be considered in that individual utility's rate application.

## Capitalization

> ***Issue 3.3:* Should the Board require PP&E to conform to IFRS capitalization requirements (e.g., capitalize less indirect overhead and administration cost than permitted under current Canadian GAAP)?**

In contrast to the consensus that developed around the two proposals above, there was no agreement regarding whether the Board should require utilities to adhere to IFRS capitalization principles. The proposal tabled by Board staff on this issue read:

> 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 rate filing after IFRS adoption.

At the time of the stakeholder conference, it appeared that fewer overhead and administrative costs would be considered capital expenditures under IFRS than is the case under current CGAAP accounting. Some of the reduction in capitalization might result from increased scrutiny of capitalization of expenses undertaken by utilities and their auditors, rather than actual changes in accounting rules. Nevertheless, a reduction in capitalization of expenses would, all other things being equal, result in more costs being expensed in the current period and a consequent increase in near-term revenue requirements.

Data collected by Board staff indicated that the actual effect of the adoption of IFRS capitalization principles would vary greatly among utilities. Those utilities who at present capitalize significant overhead and administrative costs may see some, and potentially significant, shifting of costs to the current period. Some utilities may experience no cost shifting, or even a shift from current expenses to capital. The magnitude of the shift, if any, is not yet known by the utilities.

The ratepayer participants generally submitted that the Board should not decide on the adoption of IFRS capitalization rules at this time, as the potential rate impacts of such a change are unknown, are at present unknowable, and could be significant. The regulatory principle of minimizing intergenerational inequity could be violated and potentially significant rate impacts could arise if utilities alter their capitalization policies to conform to IFRS principles. The majority of ratepayer groups urged the Board not to decide until reliable evidence of the magnitude of rate impacts is available.

The electricity utilities in general supported the adoption of IFRS capitalization rules for regulatory purposes, and argued that any undue rate impacts could be mitigated. The effort involved in keeping two sets of asset ledgers if IFRS capitalization rules were not adopted for regulatory purposes would increase costs to the utilities and their ratepayers.

CCC, alone among the ratepayer participants, supported the adoption of IFRS capitalization principles, arguing that indirect costs such as overhead and

administrative costs should not be capitalized and added to rate base, as such practices ultimately increase total costs to ratepayers. CCC pointed out that capitalization policies vary widely among utilities, and suggested that the Board take the opportunity of the transition to IFRS to standardize regulatory accounting. CCC submitted:

> “Overheads and administrative costs are often fixed, subject to low volatility or immaterial as a percentage of capital expenditure. Expensing these costs directly should have little or no impact on rate volatility in the long term. However, rate volatility may be relevant if there are transitional impacts of standardizing the regulatory accounting principle for all Board-regulated utilities. The transitional impacts would dissipate as capitalized overheads already embedded in rate base are expensed through depreciation.
>
> On a utility-specific basis, once the rate-making impacts of transitioning from the current status quo to the standardized regulatory accounting principles are known, rate mitigation techniques could be considered by the Board.”

The Board agrees with the analysis provided by CCC. It appears to the Board that the capitalization principles as they now appear in IFRS recognize the nature of indirect costs and whether they are truly attributable to capital projects. The ability of the Board to set just and reasonable rates is enhanced by clarity in capitalization principles that emphasize cost causality. The Board recognizes that rate mitigation may be necessary for some utilities where a reduction in capitalization of costs causes near-term rate impacts that are not otherwise mitigated by other business actions, such as reduction or redistribution of indirect activities, or organizational adjustments.

The extent of the rate mitigation that may be necessary is unclear. In addition to the variable effect of the adoption of IFRS capitalization principles on utilities described above, the Board understands that the IASB is also considering some modification of the capitalization requirements for regulated utilities and including this issue in its review of regulatory accounting, for which an exposure draft is expected in the second half of 2009.

The Board will address any need for mitigation in the rate applications of distributors.

It will be important for the Board to have a clear understanding of utility capitalization practices, and the effects, if any, of a shift to IFRS capitalization principles. The Board therefore supports the requirement for utilities to file their capitalization policies in their first cost of service filing after the transition to IFRS, and will also require that the revenue requirement impacts of any change in capitalization be specifically and separately quantified.

The Board’s approach is captured by the following:

> 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.

## Other PP&E Related Items

***Issue 3.4:* What changes to existing regulatory or rate making treatments should the Board require for other PP&E related items as a result of the adoption of IFRS?**

- ***Borrowing costs applied to PP&E (as opposed to deemed interest or AFUDC)***
- ***Customer contributions received for PP&E***
- ***Asset reclassifications from PP&E to intangible assets (e.g., computer software and land rights)***
- ***Asset retirement obligations***
- ***Gains and losses on disposition of assets***
- ***Treatment of asset impairment***

In relation to issue 3.4, staff proposed that the Board require utilities to adhere to IFRS accounting requirements for PP&E related items for regulatory purposes, with certain noted exceptions. The Board accepts this basic statement, and has reached conclusions on specific items as set out below.

### 1. Borrowing costs applied to PP&E

The staff proposal read as follows:

> IFRS requires utilities to capitalize carrying charges associated with Construction Work in Progress (CWIP) using actual interest cost incurred as opposed to amounts calculated at rates prescribed by the regulator. On or before the date for adoption of IFRS, the Board will discontinue publication of market based rates for applying borrowing costs to CWIP. For regulatory rate making and reporting the Board will use the values calculated in accordance with IFRS to determine capitalized carrying charges on CWIP.

The Board notes that several participants questioned whether actual borrowing costs should be used for rate setting purposes where the debt is held by an affiliate of the distributor.

The Board will continue to publish interest rates for CWIP as it does now. Where incurred debt is acquired on an arm’s length basis, the actual borrowing cost should be used for determining the amount of carrying charges to be capitalized to CWIP for rate making during the period, in accordance with IFRS. Where incurred debt is not acquired on an arm’s length basis, the actual borrowing cost may be used for rate making, provided that the interest rate is no greater than the Board’s published rates. Otherwise, the applicant should use the Board’s published rates.

## 2. Customer contributions received for PP&E

The staff proposal on this topic read as follows:

> IFRS requires customer contributions to be recorded as revenue or deferred revenue (depending on the circumstances) instead of as an offset to capital cost. For regulatory reporting and rate making purposes the amount of customer contributions will be treated as deferred revenue to be included as an offset to rate base and amortized to income over the life of the facility to which it relates. This reclassification is necessary to preserve continuity of the rate base.

Generally participants agreed with the approach proposed. However, a number of participants representing ratepayers pointed out that componentization rules and the need for a regular review of depreciation rates may cause complexities in ensuring that the amortization of the contributions offsets depreciation in the same fashion as at present. In particular, they note that the amortization period for the contributions associated with assets for which the service life has been adjusted will itself require adjustment in order to remain revenue-neutral.

The Board regards the matter of matching changes to the amortization period for unamortized customer contributions to the remaining service life of the assets to be a matter of internal bookkeeping that is the responsibility of the utilities and will be checked by their external auditors. Distributors should confirm in the introduction to their first rates application after the IFRS transition that the amortization period is being adjusted on an ongoing basis.

## 3. Asset reclassifications from PP&E to intangible assets

The staff proposal for asset reclassifications read:

> IFRS requires certain assets to be recorded as intangible assets (e.g. computer software and land rights) that were previously included in PP&E. Utilities shall include such intangible assets in rate base and the amortization expense in depreciation expense for determining the revenue requirement. This reclassification is also necessary to preserve continuity of the rate base.

Most participants agreed with this proposal. However SEC submitted that there was insufficient data at this time to know whether a revenue requirement impact could occur, and the decision on the issue should be deferred until such data was available.

The Board anticipates that where these intangible asset costs are material, they will already have service lives attributed to them in their current classification within PP&E. Accordingly, the Board is not persuaded that their reclassification will have any impact on a utility’s revenue requirement. In any case, should such impact occur, it will be addressed in utility rate applications, along with any other rate impacts of implementing IFRS. The Board therefore accepts staff’s proposal.

## 4. Asset retirement obligations

Staff proposed no specific treatment of asset retirement obligations, but suggested that these costs be separately identified. The proposal read as follows:

> IFRS requires that asset retirement obligations include estimates of the cost of certain obligations not required under existing accounting requirements, and revaluation of those obligations during the lives of the assets. For rate setting and reporting purposes, utilities shall identify separately the depreciation expense associated with amortizing the asset retirement cost and the accretion expense associated with the amortization of the asset retirement obligation. This will allow the Board to assess these costs independently of other amortization costs to determine the portion, if any, of these costs that should be recovered in revenue requirement.

A general consensus emerged among participants that asset retirement obligations should be addressed by the Board on a utility-specific basis. The Board agrees. It may be that the need for, or desirability of, a generic approach will emerge as the Board has an opportunity to review the information related to these costs in utility rate applications.

## 5. Gains and losses on disposition of assets

The staff proposal on this issue read as follows:

> Where a utility for financial reporting purposes under IFRS has accounted for the amount of gain or loss on the retirement of assets in a pool of like assets as a charge or credit to income, for reporting and rate application filings the utility shall reclassify such gains and losses as depreciation expense and disclose the amount separately. Where a utility for financial reporting purposes under IFRS has reported a gain or loss on disposition of individual assets, such amounts should be identified separately in rate filings for review by the Board (as at present).

There was general agreement with this proposal. BOMA & LPMA raised the question of whether a significant deviation between rate base and net book value would accumulate over time. This could be a particular problem for distributors whose rates are set based on an incentive regulation mechanism (“IRM”).

The Board notes that complexities will likely arise on a number of issues related to the co-ordination of IRM and the transition to and continuation of IFRS accounting requirements. Several participants proposed the creation of a Board staff-led stakeholder working group to identify any issues that arise relating to IFRS and the IRM regime. The Board supports this suggestion, and will organize such a working group at the appropriate time.

**6. Treatment of asset impairment**

There was general agreement with the staff proposal related to asset impairment, which read as follows:

> Where for financial reporting purposes under IFRS a utility has recorded an asset impairment loss, for rate application filings such losses shall be reclassified to PP&E and identified separately to allow consideration of whether and how such amounts are to be reflected in rates.

The Board accepts this proposal.

## *Depreciation*

> ***Issue 4.1*: Should the Board set parameters for depreciation accounting for regulatory purposes (E.g., depreciation methods, the level at which sub-componentization should be applied to specified asset classes)?**
>
> ***Issue 4.2*: Should the Board set the parameters for electricity distributors to establish their own depreciation rates rather than continue to use depreciation rates historically approved by the Board (co-ordination of depreciation studies may be possible)?**

Because IFRS does not currently recognize industry-specific accounting applicable to regulated enterprises, utilities in Ontario that have relied upon the Board to establish certain aspects of depreciation accounting will now be required to apply the accounting requirements of IFRS for financial reporting. Under IFRS, a review of useful life, depreciation methods and residual values is required to be conducted annually. Many of the municipally-owned electric utilities in Ontario have not conducted depreciation studies or reviewed the useful lives of their assets in many years, and rely on depreciation rates and methods that pre-date regulation of those utilities by the Board.

Board staff proposed that utilities continue to use the straight line method of depreciation for regulatory accounting purposes, and this was supported by participants.

> 4.1 Utilities should continue to use the straight line method of depreciation.

The Board agrees with this proposal.

However, staff did not propose that the Board set parameters for depreciation accounting for regulatory purposes, and issues such as the level of componentization required under IFRS remained unresolved during the consultation.

Under issue 4.2, staff proposed a depreciation study that would address such issues. The proposal read:

> 4.2 The Board will facilitate a joint depreciation study for electrical distribution utilities. The aim of the study will be to determine depreciation methodologies and rates that will be applied to all electrical distribution utilities for the purpose of setting rates and regulatory reporting. The study must give due weight to the IFRS requirements regarding depreciation, including componentization. Until the study is completed and the resulting depreciation rates are modified or adopted by the Board, electrical utilities will continue to use their present depreciation rates.
>
> Any electrical utility retains the option of demonstrating, through a well-founded depreciation study, that the Board should approve specific depreciation methodologies and rates for that utility.
>
> Gas utilities may submit a utility-specific depreciation study, which should include their proposed treatment of items unique to the gas industry (e.g., cushion gas).

Several participants pointed out that the results of a joint depreciation study would likely be useful but insufficient to satisfy the requirements under IFRS for individual consideration of depreciation rates by each utility. Utility specific work would still have to be done. Further, unless the study was repeated annually, the annual review requirement under IFRS would not be satisfied. The common view seemed to be that while such a study would be useful in establishing a common starting point for utilities and increasing consistency in depreciation rates for regulatory purposes, it would not completely solve the problem utilities face with IFRS compliance for financial reporting purposes.

While utilities remain solely responsible for complying with financial reporting requirements, the Board notes that a generic depreciation study could assist utilities with IFRS compliance in addition to providing considerable regulatory benefits. The study should provide a good starting point for the determination of service lives for distribution assets that may be both acceptable to the Board and useful for financial reporting purposes. Distributors will remain responsible for review and updates of the service lives for their particular assets for financial reporting and regulatory requirements.

The Board will undertake a depreciation study for electricity distributors. Until the study is completed and the resulting asset service lives are modified or adopted by the Board, electricity distributors may continue to use their present service lives for rate setting purposes. Some electricity distributors may choose to undertake a distributor-specific depreciation study or to participate in a study undertaken by a group of distributors rather than await the outcome of the Board study, and produce the results in their rate applications.

The Board agrees with the proposal that gas distributors continue to provide distributor-specific depreciation studies.

Two participants raised the question of whether depreciation rate changes should be factored into rates during the period that a utility's rates are set under an IRM. This matter may be considered by the working group considering IRM and IFRS co-ordination (to be created as discussed above) if the issue arises.

## Other Issues

***Issue 5.1:*** **What changes to existing regulatory accounting and rate treatments should the Board require for other items?**

- **Inventory valuation (based on lower of cost and net realizable value)**
- **Payments in lieu of corporate income taxes ("PILs")**
- **Pensions and employee future benefit costs**

### Inventory valuation

With respect to inventory valuation, the Board staff proposal read as follows:

> For gas utilities, the Board will continue the current practice of recording the difference between the actual purchase price of gas inventory and the weighted average cost of gas (forecast purchase price approved by the Board) in a variance account (PGVA) for future collection or refund to customers when approved by the Board.

The ratepayer participants in general agreed with the staff proposal. EGD indicated that it was still evaluating the issue and would advise the Board of its position well in advance of the January 1, 2011 effective date for IFRS. Union indicated that it would follow IFRS in valuing gas inventory for rate setting as well as for financial reporting. This would mean that the inventory would be valued at the lower of cost and net realizable value. Purchased gas cost variances would be recorded at the point of sale rather that at the point of purchase. Union did not anticipate that this approach would have any material impact on rates.

It appears that the gas utilities do not require guidance on this issue at this time. The Board will expect the gas utilities to bring forward proposals for inventory valuation in their rates cases, and provide sufficient evidence to justify their proposals. The Board encourages gas distributors to work together to develop a common solution.

### PILs

The staff proposal on PILs read as follows:

> For electricity distributors, the Board will continue with the current practice of

> using estimated taxes (the tax or PILs proxy) to be included in the revenue requirement for rate-setting purposes.
>
> For gas utilities, the Board will continue with the current practice for the inclusion of an estimated tax recovery in rates.
>
> Tax or PILs related costs as incurred in the future may be recovered in rates when approved in a future rate proceeding.

The majority of participants agreed with the staff proposal. OPG, EGD and Union proposed that the Board approve a regulatory future income tax deferral account to enable utilities to record the future income taxes recoverable on their IFRS balance sheet. The Board's policy on the recovery of future income taxes has not changed, and no amendment to regulatory accounting appears to be required to support the transition to IFRS. The Board does not consider it necessary to approve a deferral account for the purpose of addressing this issue.

The Electricity Distributors Association ("EDA") asked that the Board approve a true-up mechanism to capture the income tax or PILs effect that might arise from changes in accounting on the adoption of IFRS. A difference could arise if the amount of taxes on income included in approved revenue requirement were determined differently under IFRS, for example, under different capitalization accounting. The EDA acknowledged that this effect, if any, would differ among distributors, would affect only distributors whose rates are set under an IRM, and would arise during a brief period beginning with IFRS implementation and ending with the next scheduled rebasing. The EDA also noted that adopting IFRS could affect amounts paid by distributors to the government and suggested that the true-up mechanism should provide for this effect as well.

The Board considers that the IFRS-related PILs impact during an IRM period is no different that what might occur with any other cost component that might be affected by IFRS during an IRM regime. Accordingly, to the extent that it is necessary to do so, this issue can be considered in the IFRS-IRM working group mentioned in the section of this report dealing with PP&E issues. With regard to the difference between the amounts included in rates and the amount paid to taxation authorities, consistent with its intention to deal primarily with IFRS transition issues in this Report, the Board is not prepared to enunciate additional policy on the treatment of any such differences in this Report.

## Pension and other post-employment benefit costs

Staff proposed no change to the Board's approach to pension and other post-employment benefit costs. The proposal (under the title "pensions and employee future benefit costs") read:

> For gas utilities, the Board will continue to review pensions and employee future benefit costs in the utilities' rate applications.

> For electrical utilities, the current practice approved by the Board will continue for pensions and employee future benefit costs. Any changes to current practice may be sought through an application to the Board.

The majority of participants agreed with the approach of considering these costs in utility-specific rate applications. SEC pointed out, however, that regulatory efficiency and consistency would be achieved by considering the issues in a generic proceeding. The Board is not convinced of the merits of a generic proceeding at this time. It appears that the issues are not the same for all utilities. Utilities have a choice on first time adoption of IFRS as to the treatment of unamortized actuarial gains and losses. The Board therefore accepts staff's proposal. The Board may revisit the need for, or desirability of, a more generic approach in relation to this issue should circumstances warrant.

Union and Toronto Hydro Electric System Ltd., supported by OPG, proposed a new deferral account to record unamortized actuarial losses for recovery in future rates. The Board is not prepared to establish such a deferral account on the basis of the information obtained through this consultation. Any utility that believes such an account is necessary should apply for the establishment of the account, supported by evidence demonstrating its necessity.

# Impacts

## *Rate Impacts*

> **Issue 7.1: Compared to rates established under current regulatory accounting, what are the direction and estimated magnitude of rate impacts created by establishing rates on the basis of various IFRS accounting option?**
>
> ***Issue 7.2:* Should a mechanism be developed to phase-in or otherwise mitigate the rate impacts, if any, of adopting IFRS?**
>
> ***Issue 7.3:* Should rate increase thresholds be set?**

Board staff and participants in the consultation submitted that potential revenue requirement impacts, if any, from adoption of modified IFRS will vary from distributor to distributor. The Board agrees, and will require distributors to specifically identify financial differences and any revenue requirement impacts that result from adoption of modified IFRS requirements in the distributor's first cost of service application after adoption. Revenue requirement impacts of any change in capitalization policy must be specifically and separately quantified.

Mechanisms to mitigate any rate impacts, and rate impact mitigation thresholds were discussed in the consultation. There was general agreement among participants that rate mitigation mechanisms currently used by the Board, such as deferral accounts and rate riders, could be used to reduce any impacts resulting from IFRS-related costs that the Board permits to be recovered through rates. Similarly, there was general agreement that IFRS-related costs would be considered as part of general cost increases forming the aggregate rate impact of any particular rate application.

Although the Board agrees that rate impacts should be considered in aggregate to determine the significance of the cumulative effect, the Board will require distributors to provide specific information regarding the individual cost drivers making up the aggregate impact.

The Board will require a proposal for a rate mitigation mechanism if the impact is material and mitigation appears to be required.

## *Utility and Shareholder Impacts*

The issues list in the consultation identified three types of potential impacts from IFRS adoption that could affect revenue requirement and therefore rates of utilities:

- One-time administrative costs of transition,
- Ongoing administrative costs for IFRS and regulatory reporting, and
- Impacts arising from the timing of the recognition in rates of expenses.

As well the list included a question concerning suggestions on how to minimize IFRS implementation costs.

The issues list read as follows:

> ***Issue 8.1:*** **Should the administrative costs (e.g., new systems, special audits, consulting) to transition to IFRS be recovered from ratepayers? On what basis?**
>
> ***Issue 8.2:*** **Should incremental on-going compliance costs be recovered from ratepayers? On what basis (z-factor treatment? threshold amounts?)?**
>
> ***Issue 8.3:*** **How can the Board encourage minimization of IFRS implementation costs?[3]**
>
> ***Issue 8.4:*** **Should any proposed increases in revenue requirement that may arise from changes in accounting for rate base and operating costs prompted by the adoption of modified IFRS be recovered from ratepayers? If yes, on what basis?**

### Administrative costs (One-time transition)

There was general agreement among participants in the consultation that the first two types of costs, prudently incurred administrative costs directly related to IFRS transition and to ongoing compliance, would be recoverable from ratepayers on the same basis as other administrative costs. However, the portion of the staff proposal describing how those costs would be recovered provoked considerable debate. That portion of the proposals under issues 8.1 and 8.2 read:

> This [right to recover such costs] applies to utilities filing for rates on a cost of service basis and to utilities on an incentive rate mechanism. Where the utility incurs incremental costs related to transition to IFRS [and incremental ongoing

[3] The Board concluded that no specific additional policy statement is required on this issue (see discussion on page 28).

> costs] during a period for which rates have already been set, and for which the Board did not consider such costs, the utility may record in a Board-approved deferral account such incremental costs incurred after January 1, 2009 for consideration by the Board at the next cost of service proceeding. The Board, in determining the disposition of the account, will consider the criteria of causation, materiality and prudence.

CME submitted that no new deferral accounts should be introduced during the course of an IRM, either retroactively or prospectively, and utilities operating under an IRM regime should be required to work within the parameters of that mechanism to obtain cost relief. BOMA & LPMA submitted that deferral accounts should be established, but that amounts in the account should not be recoverable unless they were sufficiently material to meet the Z-factor materially threshold. BOMA & LPMA further pointed out that for those utilities where the Board has already approved IFRS related costs, the account should be a variance account to track the differences between the actual costs incurred and those embedded in rates.

Nearly all participants submitted that the staff proposal that the deferral account record costs starting only at January 1, 2009 was unfair. Some utilities incurred IFRS related costs prior to that date, including costs to participate in the Board-initiated meetings referred to in the introduction to this Report. Some utilities and the EDA sought the establishment of IFRS deferral accounts in 2008, and were told to wait for the results of this consultation.

SEC proposed the use of a Board-determined IFRS transition allowance, amortized over a three year period and collected through a rate rider, to avoid any potential problem of retroactivity. SEC acknowledged that determination of the amount of the allowance could be problematic, however, in the absence of data supporting an expected cost of transition.

The Board will establish a deferral account for distributors for incremental one-time administrative costs related to the transition to IFRS. This account is exclusively for necessary, incremental transition costs and is not to include the other two types of costs listed at the beginning of this section: ongoing compliance costs or impacts on revenue requirement arising from changes in the timing of the recognition of expenses.

The Board will not restrict the IFRS transition costs account by establishing a fixed start date for amounts to be recorded. However, the Board cautions distributors that the amounts in the account will be subject to a prudence review before disposition. The criteria of materiality, causation and prudence will be considered at the time of proposed disposition. Only costs that are clearly driven by the necessity of transitioning to IFRS and are genuinely incremental to costs that would have been otherwise incurred will be recoverable in rates. Any distributor that has IFRS related costs already approved in rates must record, in a variance account, the variances between the previously approved costs and actual costs of transitioning to IFRS.

### Administrative costs (Ongoing)

The Board declines to establish a deferral account for ongoing compliance costs related to IFRS. Distributors who are filing a cost of service application for rates should forecast ongoing compliance costs as part of the rate application. Distributors under an IRM are expected to work within the general provisions of that mechanism.

### Impacts resulting from changes in accounting

The recovery of the third type of costs, impacts on revenue requirement that may arise from changes in rate base and operating costs determinants, driven by changes in the timing of the recognition of expenses from the adoption of modified IFRS, was resisted by several ratepayer participants. Staff had proposed in its opening statement in the stakeholder conference that both increases and decreases to revenue requirement, as a result of changes in accounting rules, should be passed through to ratepayers. Staff submitted that any undue rate impacts could be mitigated.

The Board is of the view that the cost consequences of changes in accounting for rate base and operating costs may be sought to be included in revenue requirement in a similar fashion to cost consequences arising from other events. Recovery from customers of such costs would be subject to testing for accuracy and prudence, as well as rate mitigation mechanisms as necessary. Accordingly, the Board will not establish a deferral account to record increases or decreases in costs resulting from the accounting changes. Distributors under an IRM have options to address unexpected and material cost increases if necessary.

The Board notes two complexities outlined by VECC in its submission on this issue: the need to ensure that distributors report both positive and negative differences at the time of rebasing, and the possible discrepancy between costs reported for regulatory purposes and those recovered through rates during an IRM period. Any incremental difficulties arising from the adoption of modified IFRS for regulatory purposes may need to be considered by the IFRS – IRM working group mentioned in the section of this Report dealing with PP&E issues.

### Minimization of IFRS related costs

Board staff proposed some suggestions for discussion regarding ways the Board could encourage minimization of IFRS implementation costs. As indicated above, the Board will undertake a joint depreciation study, and encourages distributors to share their knowledge and experience to simplify the transition to IFRS as much as is feasible.

Several participants addressed the suggestion of establishing a threshold test for transition costs. Transition costs above the threshold would be subject to increased scrutiny before being passed through to ratepayers. Although such a benchmark might be useful in encouraging distributors to minimize costs, and in assessing costs

presented for recovery in rates, the Board does not have the data at this time to set a numerical threshold. Distributors will need to exercise business judgement to ensure expenses are prudent. Evidence will be required to demonstrate that IFRS spending is meeting the functional requirements of transition through a well planned and executed initiative.

## Filing and Reporting Requirements

### *Filing Requirements for Rate Applications*

> ***Issue 9.1*: What are the filing requirements for rate applications for entities regulated by the Board during and after the transition to IFRS?**
>
> ***Issue 9.2:* What financial filings should the Board require for use in cost of service rate applications for historical and test years subsequent to 2009?**
>
> ***Issue 9.3:* Would the Board prescribe any specific rate making measures in its incentive regulation mechanisms to take account of the adoption of IFRS?**
>
> ***Issue 9.4:* Should rate applications under an incentive regulation mechanism be required to include a reconciliation of reported annual performance to the same financial reporting standard as that upon which the incentive framework was approved?**

In this consultation Board staff proposed a series of requirements for filings for rate applications for electricity and gas distributors that respond to the needs of each sector, rather than in the sequence of the issues.

The staff proposals have recognized the need for comparative information to show the differences between current CGAAP regulatory accounting and regulatory accounting based on IFRS (modified IFRS). Staff noted that 2010 is a year in which companies required to transition to IFRS in 2011 would be required to maintain their accounts for financial reporting based on both systems of accounting. The proposals therefore used 2010 as a “pivot” year in which rate application filings could include both accounting systems.

The fundamental consideration in setting rate application filing requirements is that the regulator must have sufficient information to properly set rates. This means that the Board must have filings in both CGAAP and modified IFRS for at least one year over the transition to IFRS, with comparative analysis and a demonstration of revenue requirement impacts resulting from the transition. In addition, the Board needs the most recent year of actual results presented in the same accounting system as that used to forecast the revenue requirement for the test year. In some circumstances,

the Board's need for complete and accurate information dictates that more than one year must be filed using both systems.

**Electricity distributors**

The Board's rate application filing requirements for electricity distributors require that the following years of data be filed for cost of service applications:

- the test year forecasts,
- the preceding or "bridge" year which is a mix of actual results and forecasts, and
- three prior years of actual historical results, or the number of years necessary to provide actuals back to and including the most recent Board-approved test year, but not less than three years.

During the transition to modified IFRS regulatory accounting, one of these years may coincide with a year for which audited financial statements are prepared under CGAAP, under IFRS, or both. One practical matter that must be kept in mind is that distributors are filing their rate applications with the Board approximately six months before the start of the test year for which rates are sought.

The Board agrees with the staff proposal that electricity distributors making cost of service applications in the summer of 2009 for 2010 rates should file using existing CGAAP based regulatory accounting. The proposal also suggested that such applicants could also file modified IFRS financial data if they so choose, with reconciliations between CGAAP results and modified IFRS results. The Board does not intend to preclude such filings, but believes that modified IFRS-based information provided before the end of 2009 would likely be of little value, given the uncertainties remaining regarding IFRS requirements and their interpretation. The provision of such an early modified IFRS filing would not relieve the distributor of the requirements for filing in later years described below.

For electricity distributors filing cost of service applications in mid-2010 for 2011 rates, staff proposed that the 2009 and 2010 information be filed in CGAAP, and the 2011 information be filed in CGAAP and modified IFRS. The CLD suggested that the 2010 information could be presented in both systems, with 2011 presented only in modified IFRS. Neither of these alternatives is acceptable to the Board.

Distributors filing cost of service applications for 2011 rates have no complete year of actual results available under modified IFRS at the time of filing. In addition, the Board acknowledges that not all distributors may be ready to file a complete and accurate application under modified IFRS in mid-2010. The Board will require electricity distributors filing for 2011 rates to provide the required actual years, the 2010 bridge year and the 2011 forecasts in CGAAP based format. An electricity distributor may choose to present modified IFRS based forecasts for 2010 and 2011, if the distributor prefers to have rates set on the basis of modified IFRS. If the distributor is seeking rates based on modified IFRS accounting, the distributor must identify

financial differences and resulting revenue requirement impacts arising from the adoption of modified IFRS accounting.

Those distributors filing cost of service applications in 2011 for 2012 rates will have actual results in both CGAAP and IFRS for the 2010 historical year. These distributors must file the 2010 information in both systems, and provide 2011 and 2012 information in modified IFRS. The historical years required prior to 2010 may be provided in CGAAP only. In addition, the distributor must identify financial differences and resulting revenue requirement impacts arising from the adoption of modified IFRS accounting.

For distributors filing cost of service applications for rates to be implemented subsequent to 2012, the Board anticipates that those distributors will be required to provide results for one year, probably 2010, in both accounting systems, and identify financial differences and resulting revenue requirement impacts arising from the adoption of modified IFRS accounting. However, the Board may need to revisit this requirement once more information about IFRS accounting and its potential revenue requirement impact is known.

### Gas distributors with earnings sharing mechanisms in place

EGD and Union are both scheduled to apply in 2012 for 2013 rates through a rebasing cost of service application. During the period of the IRM under which the companies are currently operating, an earnings sharing mechanism is in place. Earnings under the IRM are reported annually, and sharing is triggered by earnings above a certain threshold. Staff proposed that these distributors continue to report earnings under CGAAP until rebasing, and that forecasts for the test year be provided in both CGAAP and modified IFRS. Neither distributor agreed completely with the staff proposal.

Union proposed to make an application to the Board in the first half of 2011 providing results for 2010 under both CGAAP and modified IFRS. The purpose of the application would be to seek Board approval of the implications of converting to modified IFRS and to include the resulting impacts in rates, as well as to reset the earnings sharing mechanism so that the results could be reported under modified IFRS in subsequent years. The 2013 rebasing application would include historical information from 2011 in both CGAAP and modified IFRS, while the 2012 and 2013 bridge and test years would be filed under modified IFRS only.

EGD's thinking evolved during the consultation. In its May 25th written submission, EGD proposed that it continue to report under CGAAP until the end of 2012, and report under modified IFRS beginning in 2011 and continuing into the 2013 test year. In its reply submission, EGD indicated that it found merit in Union's proposal to apply during the IRM term to have the Board address financial differences and revenue requirement impacts rather than waiting until the rebasing application.

Each of these proposals means that the Board's requirement for comparative filings for at least one year is satisfied and the Board will have actual results (for 2011) in the same accounting system as the 2013 test year. In addition, as recommended by staff

and supported by participants, the Board will require that the gas distributors provide a detailed comparative analysis identifying financial differences and resulting revenue requirement impacts arising from the adoption of modified IFRS accounting.

The Board is not convinced that reporting for the earnings sharing mechanism can be adjusted before rebasing to allow reliable reporting to occur under modified IFRS. At this time, the Board will require EGD and Union to continue to provide annual results for the existing earning sharing mechanism under CGAAP. It is open to the gas distributors to apply to have this reporting converted to modified IFRS. However, they will bear the burden of convincing the Board that accuracy, comparability and fairness can be achieved despite the conversion.

### Other distributors

Staff proposed that gas distributors without an earnings sharing mechanism in place[4] follow the same rate application requirements as electricity distributors.

As noted earlier in this Report, one of the guiding principles adopted by the Board is that the Board would not require modified IFRS filing and reporting from the limited number of utilities (gas or electricity) that are not otherwise required to adopt IFRS for financial reporting purposes.

The Board does not accept the staff proposal. The Board does not consider the presence or absence of an earnings sharing mechanism to be the determining factor of whether or not to apply IFRS.

The Board will not require rate applications from any electricity distributor or natural gas utility it regulates that is not required to adopt IFRS for financial reporting purposes to be filed using modified IFRS. Some of these distributors may choose to adopt IFRS for external financial reporting however, and if this is the case, they should make that choice known to the Board and follow the filing requirements prescribed above for electricity distributors.

## *Reporting and Record Keeping Requirements (RRR)*

> ***Issue 10.1*: What changes are required to financial reporting requirements for entities regulated by the Board during and after the transition to IFRS?**
>
> ***Issue 10.2*: Should the Board require all rate-regulated entities to report information to the Board using IFRS beginning January 1, 2011, regardless of whether they are otherwise required to use IFRS?**

[4] Currently Natural Resource Gas

> ***Issue 10.3*: Should the Board require all rate-regulated entities to continue to report information to the OEB using CGAAP until December 31, 2010 (regardless of early adoption by the utility)?**
>
> ***Issue 10.4*: Should the RRR include requirements for reconciliations between IFRS and regulatory accounting information?**
>
> ***Issue 10.5*: 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?**
>
> ***Issue 10.6*: Should the periodic reporting to the Board by utilities under incentive regulation include a reconciliation of reported annual performance to the same basis of accounting as that upon which the incentive framework was approved?**

Utilities regulated by the Board are required to report certain financial and operating information quarterly and also provide their audited financial statements annually.

### Regulatory reporting

Board staff proposed that all electricity distributors and gas utilities report their financial results to the Board using modified IFRS beginning January 1, 2011, regardless of whether they are otherwise required to use IFRS for financial reporting. The Board has determined that it would not require modified IFRS filing and reporting from distributors that are not otherwise required to adopt IFRS for financial reporting purposes. The Board therefore does not accept the staff proposal, and will not require regulatory reporting from such distributors to be filed using modified IFRS. Some of these distributors may choose to adopt IFRS for external financial reporting however, and if this is the case, they should make that choice known to the Board and will be required to follow the reporting requirements prescribed below.

The Board will require, consistent with the staff proposal, that all utilities continue to report their financial results using CGAAP for financial year ends up to and including December 31, 2010.

### Reconciliations

Staff proposed the following reconciliation requirements be included as part of the RRR:

> The RRR will require reconciliations between financial reporting under IFRS and regulatory accounting information as follows:
>
> For fiscal year 2010, reconciliations between:
>
> - IFRS for financial reporting and modified IFRS for regulatory accounting (i.e. financial accounting based on IFRS, with the modifications and

exceptions for regulatory accounting identified by the Board in this consultation)
- CGAAP results and modified IFRS.

For fiscal years subsequent to 2010, reconciliations between IFRS for financial reporting and modified IFRS.

In general, participants agreed with this proposal and the Board accepts it.

In addition, it was proposed and generally agreed that utilities under incentive regulation should include in their report of annual performance a reconciliation of reported annual performance to the same basis of accounting as that upon which the incentive framework was approved. The Board also accepts this proposal.

**Supplementary audit assurance**

Once IFRS is implemented for financial reporting, differences will exist between utilities' audited financial statements and the modified IFRS financial results they report for regulatory purposes. The Board uses audited financial statements to evaluate and validate reported financial results, and to assess and test the accuracy of rate application filings. Audited financial statements are therefore an important tool in regulation of Ontario distributors.

Board staff proposed that an audit be required as follows:

> The RRR will include a requirement for supplementary audit assurance regarding regulatory accounting values reported on an annual basis where they differ from IFRS reported values in audited financial statements and that are not otherwise audited. The supplementary audit assurance will involve a full audit of regulatory accounting values by a third party auditor in accordance with attest audit requirements. The auditor will be required to express an opinion on the financial information in accordance with a predetermined standard.

Several participants objected to this requirement describing it as an extra requirement, and suggested that the reconciliation between IFRS and modified IFRS values referred to in the preceding section should be sufficient.

The Board notes that regulatory accounts have been subject to audit in virtually all cases as part of the expression of an audit opinion under CGAAP because such accounts are considered to be within CGAAP. The Board intends to continue its reliance on audited financial information for regulatory purposes, and the modified IFRS values would otherwise not be subject to audit because, at the present time, they are not considered to be within IFRS. Accordingly, to maintain the same level of assurance as currently provided, the Board will require supplementary audit assurance provided in accordance with generally accepted auditing standards. The supplementary audit will be required to include an audit of any deferral or variance account balances recorded by the utility.

# Appendix 1: IFRS Consultation – List of Issues

## A. Scope

This consultation examines the effects of the adoption of International Financial Reporting Standards ("IFRS") on regulatory accounting and rate making, to identify necessary changes to the Board's filing and reporting requirements and rate setting methodologies. It includes changes in Canadian GAAP related to the implementation of IFRS. This consultation will not include a discussion of changes to filing requirements and rate setting methodologies that are not driven by the adoption of IFRS.

This consultation will not include a discussion of the financial risk profile of utilities, and how the adoption of IFRS may affect that risk profile.

## B. Principles

1.1 In considering the issues listed below, what principles should the Board use to guide the determination of the preferred alternative? Examples of key questions:

- How much difference between IFRS and regulatory accounting is sustainable in the long term?
- To what degree should avoidance of harm to ratepayers prevail over other considerations?
- To what degree should avoidance of harm to utilities prevail over other considerations?

## C. Major points of departure between existing regulatory accounting and rate making as compared to IFRS

### 2. Regulatory Assets and Liabilities

2.1 Should the Board continue to use deferral and variance accounts in the event that they are not recognized under IFRS?

2.2 Should the Board approve definitions for deferral and variance accounts if the Board retains their use for regulatory purposes?

### 3. Property, Plant and Equipment

3.1 For the purpose of first-time adoption of IFRS, should the Board require historic cost (NBV) or the IFRS adoption requirements (fair value or retrospective restatement)

to be used as the basis for setting opening rate base values and reporting to the Board?

3.2 After adoption, what should be the basis for reporting PP&E for regulatory purposes (e.g. historical acquisition cost, fair value)?

3.3 Should the Board require PP&E to conform to IFRS capitalization requirements (e.g. capitalize less indirect overhead and administration cost)?

3.4 What changes to existing regulatory or rate making treatments should the Board require for other PP&E related items as a result of the adoption of IFRS?

- Borrowing costs applied to PP&E (as opposed to deemed interest or AFUDC)
- Customer contributions received for PP&E
- Asset reclassifications from PPE to intangible assets (e.g., computer software and land rights).
- Asset retirement obligations
- Gains and losses on disposition of assets
- Treatment of asset impairment

**4. Depreciation**

4.1 Should the Board set parameters for depreciation accounting for regulatory purposes (e.g. depreciation methods, the level at which sub-componentization should be applied to specified asset classes)?

4.2 Should the Board set the parameters for electricity distributors to establish their own depreciation rates rather than continue to use depreciation rates historically provided by the Board (co-ordination of depreciation studies may be possible)?

**5. Other Issues**

5.1 What changes to existing regulatory accounting and rate treatments should the Board require for other items?

- Inventory valuation (based on lower of cost and net realizable value)
- Payments in lieu of corporate income taxes
- Pensions and employee future benefit costs

## D. External Uncertainties

### 6. Decisions of Accounting Standard-Setting Bodies

6.1 What are the potential implications on the Baord's decisions of the questions now before accounting standards-setting bodies? These uncertainties include:

- Potential exemption from the requirement for retrospective or fair value restatement of PP&E (International Accounting Standards Board)
- Recognition of regulatory assets and liabilities, e.g., deferral and variance accounts (International Accounting Standards Board)
- Whether accounting standards will require municipal and provincial government-owned distributors (government business enterprises) to adopt IFRS (Public Sector Accounting Board – Canada)
- Other developments from accounting standard-setting bodies

## E. Impacts

### 7. Rate Impact

7.1 Compared to rates established under current regulatory accounting, what are the direction and estimated magnitude of rate impacts created by establishing rates on the basis of various IFRS accounting options?

7.2 Should a mechanism be developed to phase-in or otherwise mitigate the rate impacts, if any, of adopting IFRS?

7.3 Should rate increase thresholds be set?

### 8. Utility and Shareholder Impact

8.1 Should the administrative costs (e.g. new systems, special audits, consulting) to transition to IFRS be recovered from ratepayers? On what basis?

8.2 Should incremental on-going compliance costs be recovered from ratepayers? On what basis (z-factor treatment? threshold amounts?)?

8.3 How can the Board encourage minimization of IFRS implementation costs?

8.4 Should any proposed increases in revenue requirement that may arise from changes in accounting for rate base and operating costs prompted by the adoption of modified IFRS be recovered from ratepayers? If yes, on what basis?

## F. Filing and Reporting Requirements

### 9. Filing Guidelines for Rate Applications

9.1 What are the filing requirements for rate applications for entities regulated by the Board during and after the transition to IFRS?

9.2 What financial filings should the Board require for use in cost of service rate applications for historical and test years subsequent to 2009?

9.3 Should the Board prescribe any specific rate making measures in its incentive regulation mechanisms to take account of the adoption of IFRS?

9.4 Should rate applications under an incentive regulation mechanism be required to include a reconciliation of reported annual performance to the same financial reporting standard as that upon which the incentive framework was approved?

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

10.1 What changes are required to financial reporting requirements for entities regulated by the Board during and after the transition to IFRS?

10.2 Should the Board require all rate-regulated entities to report information to the Board using IFRS beginning January 1, 2011, regardless of whether they are otherwise required to use IFRS?

10.3 Should the Board require all rate-regulated entities to continue to report information to the OEB using Canadian GAAP until December 31, 2010 (regardless of early adoption by the utility)?

10.4 Should the RRR include requirements for reconciliations between financial reporting under IFRS and regulatory accounting information?

10.5 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?

10.6 Should the periodic reporting to the Board by utilities under incentive regulation include a reconciliation of reported annual performance to the same basis of accounting as that upon which the incentive framework was approved?

# Appendix 2: Summary of Board Policy

## 1. Principles

1.1 The methodologies used by the Board to establish just and reasonable rates have not always been the same as those used for external financial reporting purposes. The Board has and will retain the authority to establish regulatory accounting and regulatory reporting requirements. While IFRS accounting requirements are an important consideration in determining regulatory requirements, the objective of just and reasonable rates will continue to be the primary driver of such requirements.

1.2 Future regulatory accounting and regulatory reporting requirements established by the Board will continue to be based on sound regulatory principles. These principles include fairness, minimizing intergenerational inequity and minimizing rate volatility.

1.3 Future regulatory accounting and regulatory reporting requirements established by the Board will, in taking into account IFRS requirements, balance the effects on both customers and shareholders.

1.4 Future regulatory accounting and regulatory reporting requirements established by the Board will be aligned with IFRS requirements as long as that alignment is not inconsistent with sound regulatory rate making principles.

1.5 Future regulatory accounting and regulatory reporting requirements established by the Board will be universal and standardized for all utilities, while recognizing that utility-specific issues can be addressed through a utility's applications. The Board will not require modified IFRS filing and reporting requirements for utilities that are not otherwise required to adopt IFRS for financial reporting purposes.

## Major Points of Departure between Existing Regulatory Accounting and Rate Making as Compared to IFRS

### 2. Regulatory Assets and Liabilities

2.1 The Board will continue to use deferral and variance accounts for rate making in appropriate circumstances, whether or not these accounts are recognized under IFRS.

2.2 The Board will continue to apply the existing approach in the use and establishment of deferral and variance accounts at this time. The Board may consider the review and adjustment of its existing approach when the rulings from the International Accounting Standards Board are received and the interpretation of IFRS becomes clearer.

### 3. Property, Plant and Equipment

3.1 The Board will require regulated net book value to be used as the basis for setting opening rate base values and reporting to the Board at the time of the first report to the Board or rate application for periods subsequent to the adoption of IFRS. To establish continuity of historic cost, the statement of opening value for regulated net book value includes providing gross capital cost and accumulated depreciation, subject to additional breakout of amounts as necessary to support the regulatory accounting requirements stated below.

3.2 The Board will require the use of historical acquisition cost as the basis for reporting PP&E for regulatory purposes.

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.

3.4 The Board will require utilities to adhere to IFRS accounting requirements for items related to PP&E for rate application filings and for reporting to the Board after the date of adoption of IFRS, except where specifically noted below.

- Borrowing costs applied to PP&E (as opposed to deemed interest or AFUDC)

  The Board will continue to publish interest rates for CWIP as it does now. Where incurred debt is acquired on an arms length basis, the actual borrowing cost should be used for determining the amount of carrying charges to be capitalized to CWIP for rate making during the period, in accordance with IFRS. Where incurred debt is not acquired on an arm's length basis, the actual borrowing cost may be used for rate making, provided that the interest rate is no greater than the Board's published rates. Otherwise, the distributor should use the Board's published rates.

- Customer contributions received for PP&E

  For regulatory reporting and rate making purposes, customer contributions will be treated as deferred revenue to be included as an offset to rate base and amortized to income over the life of the facilities to which they relate. Distributors should confirm in the introduction to their first rates application after the IFRS transition that the amortization period is being adjusted on an ongoing basis.

- Asset reclassifications from PPE to intangible assets

  Where IFRS requires certain assets to be recorded as intangible assets that were previously included in PP&E (e.g. computer software and land rights), utilities shall include such intangible assets in rate base and the amortization expense in depreciation expense for determining revenue requirement.

- Asset retirement obligations

  Utilities shall identify separately in their rate applications the depreciation expense associated with amortizing asset retirement costs and the accretion expense associated with the amortization of the asset retirement obligations. The Board will assess these costs independently of other amortization costs to determine the portion, if any, of these costs that should be recovered in revenue requirement.

- Gains and losses on disposition of assets

  Where a utility for financial reporting purposes under IFRS has accounted for the amount of gain or loss on the retirement of assets in a pool of like assets as a charge or credit to income, for reporting and rate application filings the utility shall reclassify such gains and losses as depreciation expense and disclose the amount separately. Where a utility for financial reporting purposes under IFRS has reported a gain or loss on disposition of individual assets, such amounts should be identified separately in rate filings for review by the Board.

- Treatment of asset impairment

  Where for financial reporting purposes under IFRS a utility has recorded an asset impairment loss, for rate application filings such losses shall be reclassified to PP&E and identified separately to allow consideration of whether and how such amounts are to be reflected in rates.

## 4. Depreciation

4.1 Utilities should continue to use the straight line method of depreciation for regulatory accounting purposes.

4.2 The Board will undertake a depreciation study for electricity distributors. Until the study is completed and the resulting asset service lives are modified or adopted by the Board, electricity distributors may continue to use their existing service lives for rate setting purposes.

Any electricity distributor retains the option of demonstrating, through a well-founded depreciation study, that the Board should approve specific depreciation methodologies and rates for that distributor.

Gas utilities may submit a utility-specific depreciation study, which should include their proposed treatment of items unique to the gas industry.

### 5. Other Issues

5.1 Inventory valuation

The Board expects the gas utilities to bring forward proposals for inventory valuation in their rates cases, and provide sufficient evidence to justify their proposals.

5.2 PILs

For electrical utilities, the Board will continue with the current practice of using estimated taxes (the tax or the PILs proxy) in revenue requirement for rate-setting purposes. Similarly, for gas utilities, the Board will continue with the current practice of using estimated taxes for rate setting. Tax or PILs related costs as incurred in the future may be recovered in rates when approved in a future rate proceeding.

5.3 Pension and other post-employment benefit costs

For gas utilities, the Board will continue to review pension and other post-employment benefit costs in the utilities' rate applications.

For electrical utilities, the current practice approved by the Board will continue for pension and other post-employment benefit costs. Any changes to current practice may be sought through an application to the Board.

## 6. External Uncertainties

6.1 The Board is proceeding with this consultation on the intersection of regulatory accounting and IFRS in the absence of final decisions from accounting standard-setting bodies, as it believes that distributors need early guidance on the Board's regulatory accounting and rate application filing requirements. The Board's approach may need to be modified if an unanticipated ruling is received.

## Impacts

### 7. Rate impacts

7.1 Distributors must specifically identify financial differences and any resulting revenue requirement impacts that result from the adoption of IFRS requirements in the distributor's first cost of service application after adoption. Revenue requirement impacts of any change in capitalization policy must be specifically and separately quantified.

7.2 Rate impacts should be considered in aggregate to determine the significance of the cumulative effect. Distributors must provide specific information regarding the individual cost drivers making up the aggregate impact.

7.3 Utilities must provide a proposal for a rate mitigation mechanism if the impact is material and mitigation appears to be required.

### 8. Utility and shareholder impacts

8.1 Prudently incurred incremental administrative costs directly related to the ongoing compliance with IFRS will be recovered from ratepayers on the same basis as other current operating costs.

8.2 The Board will establish a deferral account for distributors for incremental one-time administrative costs related to the transition to IFRS. This account is exclusively for necessary, incremental transition costs, and is not to include ongoing compliance costs or impacts on revenue requirement arising from changes in the timing of the recognition of expenses. Any distributor that has IFRS related costs already approved in rates must record in a variance account the variances between the previously approved costs and actual costs of transitioning to IFRS. The Board, in determining the disposition of these accounts, will consider the criteria of causation, materiality and prudence.

8.3 Not used.

8.4 The cost consequences of changes in accounting for rate base and operating costs may be sought to be included in revenue requirement in a similar fashion to cost consequences arising from other events. Recovery from customers of such costs will be subject to the usual testing for accuracy and prudence, and rate mitigation mechanisms as necessary.

## Filing and Reporting Requirements

### 9. Filing Requirements for Rate Applications

*Note*: Policy statements in this section are organized by sector, not by issue.

*9.1 Electricity distributors*

9.1.1 Electricity distributors making cost of service applications in 2009 for 2010 rates should file using existing CGAAP based regulatory accounting. Such applicants may also file modified IFRS financial data if they so choose, with reconciliations between CGAAP results and modified IFRS results.

9.1.2 Electricity distributors filing cost of service applications for 2011 rates must provide the required actual years, the 2010 bridge year and the 2011 forecasts in CGAAP based format. An electricity distributor may choose to present modified IFRS based forecasts for 2010 and 2011, if the distributor seeks to have rates set on the basis of modified IFRS. If the distributor is seeking rates based on modified IFRS

accounting, the distributor must identify financial differences and resulting revenue requirement impacts arising from the adoption of modified IFRS accounting.

9.1.3 Electricity distributors filing cost of service applications for 2012 rates must file 2010 information in both CGAAP and modified IFRS, and provide 2011 and 2012 information in modified IFRS. The historical years required prior to 2010 may be provided in CGAAP only. In addition, the distributor must identify financial differences and resulting revenue requirement impacts arising from the adoption of modified IFRS accounting.

9.1.4 Electricity distributors filing for rates to be implemented subsequent to 2012 are expected to be required to provide results for 2010 in both CGAAP and modified IFRS, and identify financial differences and resulting revenue requirement impacts arising from the adoption of modified IFRS accounting. Once a distributor has received an order from the Board with rates approved based on modified IFRS, succeeding applications filings are expected to be made in accordance with modified IFRS.

*9.2 Gas utilities*

9.2.1 Gas utilities must provide the following information in rate applications for 2013 rates at a minimum.

- Historical year actual information (up to and including 2011) presented in CGAAP-based accounting.
- Actual results for 2011 presented using modified IFRS.
- 2012 actuals and forecasts and 2013 forecasts presented using modified IFRS, and
- a detailed comparative analysis identifying financial differences and resulting revenue requirement impacts arising from the adoption of modified IFRS accounting.

9.2.2 With respect to reporting for the earnings sharing mechanism, annual results under this mechanism must continue to be provided under the same basis of accounting as that under which the earnings sharing mechanism was approved (CGAAP).

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

10.1 The Board will require all electricity distributors and gas utilities that are required to adopt IFRS by accounting standard setting bodies to report information to the Board using modified IFRS for regulatory accounting values and IFRS for audited financial statements beginning January 1, 2011. For those few utilities not required to adopt IFRS for financial reporting, the Board will require that they report information to the Board using the form of generally accepted accounting principles approved by their external auditors as being applicable to them as regulated utilities.

10.2 The Board will require all electricity distributors and gas utilities to continue to

report information to the Board using Canadian GAAP until December 31, 2010.

10.3 The RRR will require reconciliations between financial reporting under IFRS and regulatory accounting information as follows:

For fiscal year 2010, reconciliations between:

- IFRS for financial reporting and modified IFRS for regulatory accounting (i.e. financial accounting based on IFRS, with the modifications and exceptions for regulatory accounting identified by the Board in this consultation)
- CGAAP results and modified IFRS.

For fiscal years subsequent to 2010, reconciliations between IFRS for financial reporting and modified IFRS.

10.4 Utilities under incentive regulation are required to include in their annual RRR filing a reconciliation of reported annual performance to the same basis of accounting as that upon which the incentive framework was approved.

10.5 The RRR will include a requirement for supplementary audit assurance regarding regulatory accounting values reported on an annual basis where they differ from IFRS reported values in audited financial statements and that are not otherwise audited, including for example deferral and variance accounts. The supplementary audit assurance will involve audit of regulatory accounting values by a third party auditor in accordance with generally accepted auditing standards.