

May 21, 2010

Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Via web portal and by courier

Dear Board Secretary:

Re: Board File No. EB-2010-0178; Depreciation Study for Electricity Distributors – Transition to IFRS

The Electricity Distributors Association (EDA) is the voice of Ontario's local distribution companies (LDCs). The EDA represents the interests of the over 80 publicly and privately owned LDCs in Ontario.

The EDA greatly appreciates the Board's initiative to launch a Depreciation Study for assisting LDCs in transition from Canadian GAAP to International Financial Reporting Standards (IFRSs) and the EDA is pleased to provide comments on the Kinectrics' draft report entitled "Asset Amortization Study". The attached submission has been prepared in consultation with members of the EDA Finance Council.

This Depreciation Study Report provides LDCs with a useful tool as they establish LDC specific useful lives for their assets at the time of conversion to IFRS and annually thereafter. The EDA recommends that the study report should only serve as a "guideline" for arriving at initial IFRS-compliant service lives, and the report should neither constrain LDCs with a new set of imposed service lives nor should it constrain LDCs to adhere with the level of componentization identified in the report.

The EDA would like thank the Board for giving the opportunity to provide comments on this important initiative and looks forward to working with Board members and staff in this regard.

Yours truly,

"original signed"

Maurice Tucci
Policy Director, Distribution and Regulation
Attached: EDA submission

EDA's Comments on Kinectrics Inc Depreciation Study - Draft Report

The EDA believes that the generic depreciation study conducted by Kinectrics would only serve as a helpful guideline for those utilities (LDCs) that have not undertaken specific studies on their own. Further, it would provide a good starting point for LDCs, in their transition to IFRS, to determine service lives for their assets.

Going forward, under IFRS, LDCs would be accountable to ensure the depreciation rates in use are properly reflective of the useful lives of their assets. LDCs will also be responsible for periodically adjusting the service lives of their assets for financial reporting and regulatory requirements.

Significance of non-physical external factors in assigning accounting service life for assets

The draft report prepared by Kinectrics Inc. states that “the goal going forward is to have accounting and actual physical lives of assets aligned as close as possible.” The EDA disagrees with this statement.

The accounting service life of an asset is defined as the period of time during which the asset is expected to provide a positive benefit. It begins when the asset starts producing useful benefits and ends when there is no longer a benefit (e.g., system is removed or replaced with an equal or better system). On the other hand, the physical life is defined as the period of time over which the asset may be expected to last physically.

A utility may not wish to keep an asset until the end of its physical life. There may be a point when it becomes uneconomic to continue to use the asset even though there is still some physical life left. The physical asset lives largely reflect the technical expectations of how long an asset can be used in a given way, in a given environment. However, the depreciation study prepared to satisfy accounting requirements should portray the sufficiency of accounting (useful service) life, remaining service life, net salvage value; componentization of assets to a sufficient degree; and expected future conditions not reflected in historical statistics but based on such factors as technological progress and changes in demand.

The accounting and physical lives of assets could be aligned only when the cost of an asset is depreciated over its physical life as opposed to the accounting service life or useful life. However, under IFRS, the cost of an asset is to be depreciated over its useful life but not physical life.

The Typical Useful Lives (TULs) proposed in the draft report appear to have been established largely based on the information from manufacturers; research studies; industry statistics from other jurisdictions; and Kinectrics own engineering experience. Further, most of the utilization factors considered in the draft report are related to physical life factors such as, environmental conditions; mechanical and electrical loading; maintenance conditions and operating practices. The only utilization factor, namely ‘external factors’ is what addresses the non-physical factors such as obsolescence, regulatory changes, and construction activities. The point to note here is

that Kinectrics appears to have laid a lot more emphasis on physical factors than the non-physical factors in assigning TULs, MIN UL, and MAX UL for each of the assets.

For purposes of calculating depreciation, it is the estimated economic life rather than the potential physical life of the fixed asset that is to be used. Therefore, the EDA members believe that many non-physical external factors, besides the physical life factors, play a significant role in assigning the economic life for assets or asset components.

Although in the case of some assets, proposed TULs may reflect a combination of factors such as physical end of life; factors not related to asset performance; and economic factors', the EDA is of the opinion that it is important to lay much more emphasis on non-physical factors.

LDC Input in to Kinectrics Study

The information pulled together for this study from six Ontario LDCs was primarily based on the experience of technical staff of those LDCs. The important and necessary data such as 'actual asset failure information' was not available. The report confirms that most distributors have limited data available on actual asset retirement history and so the utility staff relied on existing age distribution when available, hands-on field experience or budgetary forecasting experience to provide the required information.

The EDA is not convinced that the type of information collected from the sample LDCs can be used to establish hard and fast values for TULs and Min/Max ULs that cannot be deviated, especially due to the small nature of the sample. However, Kinectrics recommendation states: "the (LDC) selected useful lives are not expected to be substantially different from the TULs provided in this report unless it can be demonstrated that a utility operates under an exceptional set of circumstances." The EDA disagrees with this recommendation.

The TULs proposed by Kinectrics are not based on any scientific judgment. The recommended service lives are just the simple averages of the values resulting from Kinectrics research findings and the values obtained from LDC interviews. In addition, the proposed service lives (in the draft report) are based on a specific componentization regime that may not accurately reflect a specific LDC's facts. There may be some commonly found components, which are not componentized in the Kinectrics report, for example, "insulators", that a distributor determines to be significant enough for componentization. LDC will have to consider practicality/materiality when componentizing the assets to suit their specific circumstances. Different levels of asset componentization among LDCs would lead to varied service lives for their assets and components.

Further, the report indicates (page 14) that "the percentage of assets with useful life within the range between MIN UL and MAX UL is equal to 91% for normal distribution (TUL is the same as the mean value). If the useful life distribution is not normal (TUL is not the same as the mean value) the percentage of assets within the range between MIN UL and MAX UL will be less than 91% but more than minimum value of 67%. This statistical analysis in fact suggests that the asset service lives selected by a utility are likely to deviate considerably from the TUL and the range provided in the report.

In view of the above, the EDA believes that the TUL assigned for each asset/component in the draft report should only serve as a reference and should not be treated as the most probable useful value of an asset.

The draft report places the burden of proof on individual LDC to justify why it has deviated from the proposed TUL. The EDA considers that this is not appropriate in view of the non-scientific method used to develop proposed TULs, MIN ULs and MAX ULs; and the potential differences in the level of distributor componentization from what is proposed in the report.

Kinectrics report also provided typical amortization periods used for other non-distribution assets such as office equipment, computers, buildings, vehicles, meters and communication equipment based solely on “industry standards and utility’s practices”. There was no analysis done by Kinectrics in developing amortization periods for non-distribution assets. Therefore, the EDA believes that the information provided in the report should only be expected to facilitate transfer of responsibility to LDCs for determining asset total service lives and not be applied in a manner that restricts LDCs from proposing a different service lives for such non-distribution assets.

Recommendation

In view of the above, the EDA recommends that the study report should only serve as a “guideline” for arriving at initial IFRS-compliant service lives, and the report should neither constrain LDCs with a new set of imposed service lives nor should it constrain LDCs to adhere with the level of componentization identified in the report.

The EDA would like to take this opportunity to request the Board to provide guidance for accounting changes in respect of Uniform System of Accounts (USoA) related to depreciation changes and other IFRS changes by starting the process of amending the regulatory instruments in accordance with the policy outlined in the Board Report (EB-2008-0408; Transition to IFRS). In addition, the EDA suggests that the Board consider launching a Board staff led working group as determined in the Board Report for addressing the impact of changes in depreciation service lives; changes in capitalization; changes in PILs and other IFRS impacts during the IRM period.