May 21, 2010

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

Dear Ms. Walli:

Re: IFRS Depreciation Study (EB-2010-0178)

On April 30, 2010, the Board invited industry stakeholders to comment on an Asset Amortization Study prepared by Kinectrics and released by the Board as part of the Board's preparation for the transition to IFRS. Through this letter, *ENWIN* is providing submissions for the Board's consideration.

ENWIN has had the benefit of reviewing a draft of the EDA submission and supports that submission. *ENWIN* offers additional submissions below.

ENWIN notes with interest the statement on page 1 of the Study, which reads:

> "Prior to adoption of International Financial Reporting Standards (IFRS), GAAP in Canada permitted the use of asset service lives specified by the regulator. IFRS (without approval of a standard for Rate-regulated Activities) does not allow for the use of externally mandated depreciation rates. As utilities will adopt IFRS beginning in 2010, the Ontario Energy Board (OEB) is encouraging all distributors to adopt useful life estimates that do not depend on the regulator and are determined by independent asset service life studies."

This statement provides an important reminder of the IFRS limitation on the use of the Study. The Study, commissioned by the regulator, seemingly cannot be used by the regulator to approve or disapprove LDC depreciation rates. However, the Board Report in EB-2008-0408, as quoted in the Board's letter of April 30, 2010 releasing the Study, suggests that the Study will be used by the Board in its "determination of service lives for distribution assets". This seems to imply that the Board intends to indirectly use the Study to approve or disapprove LDC depreciation rates. It would be helpful for the Board to clarify what role the Study will play in setting future rates.

Similarly, in some sections of the Study it states that the useful life estimates will be “required” to be independent of the regulator as a determination by IFRS, in others that it is as a determination by the Board and in other cases that the regulator is “encouraging” this independence. These all have different meanings and implications. *ENWIN* requests that the Board help clarify this matter by stating definitively whether IFRS or the Board have the ultimate say of this issue and, if it is the Board, whether using independently derived rates is a requirement or optional.

Another issue is that the Study actively works off the concept of Useful Life Ranges, which it defines as the asset’s physical life. However, the appropriate measure for accounting depreciation is Estimated Useful Life under both Canadian GAAP (Section 3061) and IFRS (IAS 16). This distinction is important and could have a material impact on the Typical Useful Life and the relevant range of Useful Lives.

The Study’s resulting conclusions in respect of Useful Lives (at page 19) are therefore problematic. The Study asserts that there is a need “For ongoing comparison of the amortization period selected with the actual physical useful life lives based on empirical evidence” and that “The goal going forward is to have accounting and actual physical lives of assets aligned as close as possible.” However, these statements appear to conflict with GAAP Section 3061 and IFRS IAS 16. Under both accounting standards, the focus is on aligning accounting depreciation periods (i.e. amortization periods) with the Estimated Useful Life. It would seem to be a significant departure from accounting standards to use actual physical life as the reference point. The proper reference point is Useful Life.

ENWIN is also concerned that the historical regulated depreciation rates are significantly lower than the Useful Lives identified in this report. In some cases, the historical life is half the Useful Life. Although technological advancements exist, this recommendation appears extremely drastic at this point in time.

Moreover, the basis for this recommendation does not seem reasonable. The historical regulated depreciation rates were developed by Ontario Hydro and *ENWIN*’s expectation is that the expertise of the Ontario Hydro and the pervasive ongoing use of the rates should afford those rates a degree of default legitimacy and that departure from the norm be well defended. The magnitude of any departure should be expected to be moderate unless it is demonstrated that there were major errors in the calculation of historical rates or that major changes have occurred in asset durability. In any event, moving from one set of depreciation rates to a dramatically different set of rates should be a cautious and incremental process.

Related to this point, but also an issue for other reasons, is that the Study is was limited to a survey of only 6 LDCs, that is approximately 8% of LDC. It is not clear whether these LDCs were a random sample, a representative sample, or otherwise. It is not clear whether the sample accounts for the varying climate, geography and other factors that vary widely across the province and among LDCs and which impact asset durability. It is not clear whether maintenance programs or operational requirements that may also vary widely over the years or decades of use at a given LDC let alone among LDCs was taken into account. In short, there does not seem to be an explanation or justification for why this Study should create any sort of default presumption (i.e. "good starting point") in the Board's consideration of any particular LDC's assets or accounting.

The Study should certainly not be used as proposed at page 14:

> "In cases when the amortization period is significantly longer or shorter than the recommended TUL, a utility's auditor and regulator will likely require the utility to justify why its UF values are substantially different form the ones established as a result of the surveys."

This would create a presumption against the LDC evidence based on an unreasonably limited pool of research. The Board should be clear that neither an independent study prepared by a LDC nor the depreciation rates that come out of that study will *ipso facto* be subject to a higher standard before the Board, nor will greater justification be expected to be provided to an LDC's auditor, despite its departure from this Study.

On the topic of Utilization Factors, *ENWIN* notes that the weighing of external factors has been minimized. However, external factors can greatly change the Estimated Useful Life due to obsolescence (e.g. technical, environmental, economic), regulatory changes, accidents, customer demands, road widening, etc.

It is also not clear whether the Study examined the nature and level of componentization within the industry. These variances from LDC-to-LDC would result in differing bases for depreciation. These components may not have been segregated in the Study, though they should be reviewed and addressed.

ENWIN notes that in the Study there are inconsistencies between how components are being analysed. On page 9, the Typical Useful Life is defined using three different scenarios. Different scenarios are used for different components. This will inevitably create significant variances not only between similar components but will also create variances between how LDCs interpret the ranges and apply them.

As a final point, *ENWIN* notes that the Study primarily focuses on distribution assets and not on other assets. With the increasing adoption of technology to facilitate such things as smart grids and with the increasing pressure to provide office space and other assets for the use of administrative staff who engage directly with customers to assist with energy planning and questions, there is a residual need to consider the full scope of the assets that modern LDCs put to use.

Yours very truly,

***ENWIN* Utilities Ltd.**

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