IFRS IRM Working Group
Board Staff Proposals for Discussion
January 20, 2011

The recommendations below are provided as a starting point for discussion, and do not necessarily represent Board staff's final views on the issues.

Issues arising on transition to IFRS

1. Does the Board policy provide sufficient guidance as to when to begin to use modified IFRS in a rates application for a rebasing year that precedes an IRM rate setting period? If not, what additional guidance is required?

Staff submits that Board policy provides sufficient guidance, and no additional guidance is required.

References:

- November 8, 2010 Amendment to Board Policy
- Report of the Board: Transition to International Financial Reporting Standards ("Board Report") p. 29 - 32

Alternatives:

2. What, if any, additional guidance does the Board need to provide as to how to recognize accounting changes between CGAAP and modified IFRS in an IRM application? Examples of problem areas include calculations for off-ramps, Z-factors, deferral and variance accounts, and the incremental capital module.

Note: Earnings sharing calculation covered by Board Report.

For electricity distributors who rebased under CGAAP and are filing an IRM application in which the distributor:

- **seeks an adjustment through**
  - **a Z-factor,**
  - **incremental capital module (ICM),**
  - **off-ramp (IRM2),**
  - **LRAM or SSM,**
- **reports deferral and variance account balances above the preset disposition threshold,**
- **calculates annual tax adjustment rates, or**
- **reports an instance of ROE exceeding the deadband (IRM3),**

Staff recommends that the financial information supporting this aspect of the application must be provided under CGAAP. In addition, for those distributors who have adopted IFRS for financial reporting and are therefore reporting to the Board (RRR) under modified IFRS, a reconciliation of the financial information mentioned above to the last annual RRR reporting under modified IFRS is required. Where the distributor has adopted IFRS for financing reporting but has not yet made an annual RRR filing under modified IFRS, the financial information mentioned above must be provided in both CGAAP and modified IFRS, and a reconciliation provided between the two accounting standards.

Example of where distributor has adopted IFRS for financial reporting, but has not yet made an annual RRR filing under modified IFRS: Distributor rebased in 2010 under CGAAP. In 2012 the distributor adopts IFRS for financial reporting. First modified IFRS RRR filing is due March 2013. However, in fall 2012, the distributor seeks an adjustment under the ICM. Financial information supporting the ICM application must be provided in both CGAAP and modified IFRS, with a reconciliation between the two.

References:
- Chapter 3 of the Filing Requirements for Transmission and Distribution Applications updated July 9, 2010
- November 8, 2010 Amendment to Board Policy section 9.1.2, 9.1.3, 9.1.4 and 9.2.2
- Board Report p. 29 - 31

Alternatives:

3. What level of audit assurance should the Board require for reconciliation of CGAAP to modified IFRS in IRM applications for calculations affected by changes in accounting policy (e.g. off-ramps, Z-factors, deferral and variance accounts, incremental capital module)?

Staff recommends that the Board require assurance provided by an external auditor to the “review level of assurance” specified in the CICA Handbook.

References:
- Board Report Appendix 2, section 10.5
- CICA Handbook Section 8100

Alternatives:

4. Should any discrepancy between costs reported for regulatory purposes and those recovered through rates during an IRM period that arise from changes in accounting for capital or operating costs, prompted by the adoption of modified IFRS, be recovered from or refunded to ratepayers? If yes, on what basis?

Note: It may be that the Board has already decided this issue as issue 8.4 in the Board's Report.
When considering this issue, please also consider proposed issue 15.

Staff proposes that in general, any such discrepancy, if properly calculated, should be recoverable from, or refundable to, ratepayers, subject to the materiality threshold.

Staff recommends that a deferral account be established to be used during an IRM period, in which the utility records any discrepancy between costs reported for regulatory purposes and those recovered through rates arising from the adoption of modified IFRS. This account would contain only those discrepancies not covered by the accounts relating to opening balance sheet differences (issues 5 and 6), the account relating to retirements (issue 10) and any utility-specific IFRS-related accounts established by the Board. Staff proposes that disposition of the amounts in the account would be considered by the Board in the next cost of service application, and staff further recommends that the account be closed at that time.

Staff recommends that a materiality threshold be established for recovery, refund or use of the deferral account by electricity distributors, and that the threshold be the threshold prescribed by the Board for Z-factors for IRM3 applications.

Note: A materiality threshold is proposed to avoid the effort involved in recording and making determinations of small differences.

Could have one general materiality threshold for electricity distributors for each deferral account proposed, rather than repeating for each issue (4, 5, 6, 10).
Do we need a materiality threshold for others?

References:

- Board Report pages 26, 28
- Chapter 3 of the Filing Requirements for Transmission and Distribution Applications updated July 9, 2010, pages 12 - 13

Alternatives:

5. On the transition date to modified IFRS, a financial difference may arise between the modified IFRS opening balance sheet and the CGAAP opening balance sheet, due to the adjustment of rate base (PP&E) items upon transition to modified IFRS. Should this difference, if properly calculated, generally be recoverable from or refundable to ratepayers? If so, what mechanism should be used to recover or refund this difference? Is a deferral account necessary to avoid the amount being out of period? Should a materiality threshold be established for the use of the mechanism?

Staff proposes that in general, any such difference, if properly calculated, should be recoverable from, or refundable to, ratepayers, subject to the materiality threshold.

Staff recommends that where a utility is filing a cost of service application, the applicant should propose a method for recovery or refund in its application.

Staff recommends that a deferral account be established for those utilities under an IRM period when the transition occurs, in which the utility records any financial difference between the modified IFRS opening balance sheet and the CGAAP opening balance sheet values due to the adjustment of rate base (PP&E) items. Disposition of the amounts in the account would be considered by the Board in the next cost of service application, and staff further recommends that the account be closed at that time.

Staff recommends that a materiality threshold be established for recovery, refund or use of the deferral account by electricity distributors, and that the threshold be the threshold prescribed by the Board for Z-factors for IRM3 applications.

Note: is the "financial difference" that would be recorded a difference in depreciation expense?

References:

- Chapter 3 of the Filing Requirements for Transmission and Distribution Applications updated July 9, 2010, pages 12 - 13

Alternatives:

6. There may be non-rate base items affected by the opening balance sheet adjustment upon transition to modified IFRS. Where financial differences occur, should these differences, if properly calculated, generally be recoverable from or refundable to ratepayers? If yes, is a generic mechanism necessary, or should affected utilities apply individually for a suitable mechanism? If a generic mechanism is necessary, what mechanism should that be? Should a materiality threshold be established for the use of the mechanism?

Staff proposes that in general, any such difference, if properly calculated, should be recoverable from, or refundable to, ratepayers, subject to the materiality threshold.

Staff recommends that where a utility is filing a cost of service application, the applicant should propose a method for recovery or refund in its application.

Staff recommends that a deferral account be established for those utilities under an IRM period when the transition occurs, in which the utility records any financial difference between the modified IFRS opening balance sheet and the CGAAP opening balance sheet values due to the adjustment of non-rate base items. Disposition of the amounts in the account would be considered by the Board in the next cost of service application, and staff further recommends that the account be closed at that time.

Staff recommends that a materiality threshold be established for recovery, refund or use of the deferral account by electricity distributors, and that the threshold be the threshold prescribed by the Board for Z-factors for IRM3 applications.

References:

- Chapter 3 of the Filing Requirements for Transmission and Distribution Applications updated July 9, 2010, pages 12 - 13

Alternatives:

7. Are there special implications associated with IFRS-related corporations tax or PILs impact during an IRM period for which additional IFRS transition related guidance is required from the Board?

Staff reports that no special implications requiring guidance have been identified.

Alternatives:

Issues arising after adoption of modified IFRS

8. Should the Board grant a generic deferral account, for utilities that have rebased under modified IFRS, for the impacts of changes resulting from new IFRS standards or changes in existing IFRS standards arising during an IRM regime?

Staff recommends that the Board not grant a generic deferral account for these impacts at this time. Any utility that anticipates a large impact arising from a change in IFRS standards may apply to the Board for an appropriate mechanism to deal with the impact. In addition, if the Board becomes aware that a change in standards will create a large impact on Ontario utilities, the Board can consider whether to create a generic account at that time. ,

Staff notes that the deferral accounts approved for Hydro One were created during an application using a two year test period, and were limited to a period of one year.

Wording of Hydro One Transmission decision: "The Impact for Changes in IFRS Account is approved to record the impact on revenue requirement of changes in IFRS arising between those IFRS standards in force at the date of the company's application and those in force at the time of their next application…"

Wording of Hydro One Distribution decision: "The Board will approve the creation of the IFRS deferral account to capture the aggregate impact on the 2011 revenue requirement resulting from any changes to existing IFRS standards and changes in the interpretation of such standards. The granting of this account is, in part, in recognition of the fact that this application by Hydro One covers a two year period.

References:

- Board Report pages 10 -11
- EB-2010-0002 Decision of the Board Hydro One Transmission
- EB-2009-0096 Decision of the Board Hydro One Distribution

Alternatives:

9. Should the Board grant a generic variance account, for utilities that have rebased under modified IFRS, to capture any differences arising in depreciation or amortization expense caused by changes in estimated useful life of in-service PP&E or certain intangible assets in either an IRM or cost of service regime?

Staff recommends that no such generic account be established at this time. At this point, there is no certainty that any changes will be material. If any

utility anticipates material impacts from annual adjustments to service lives, that utility can apply to the Board for a variance account or other appropriate mechanism. If in the future, there appear to be similar material adjustments for many utilities, the Board could establish a generic account at that time.

References:

- Board Report pages 20 - 22

Alternatives:

10. A utility may experience gains or losses for financial reporting purposes under IFRS from retirements of PP&E in a pool of like assets. Should these differences, if properly calculated, generally be recoverable from or refundable to ratepayers? If yes, by what mechanism should it be recovered or refunded? Is a deferral account necessary to avoid the amount being out of period? Should a materiality threshold be established for the use of the mechanism?

Staff proposes that in general, any such differences, if properly calculated, should be recoverable from, or refundable to, ratepayers, subject to the materiality threshold.

Staff recommends that the Board establish a generic deferral account to capture any differences arising from these retirements, which shall be maintained only until the next cost of service application for the utility. If, at the time of the cost of service application, the utility is experiencing uncertainty regarding the estimates of future gains and losses from retirements to be reflected in its revenue requirement, the utility can seek a variance account as part of its rate application.

Staff recommends that a materiality threshold be established for recovery, refund or use of the deferral account by electricity distributors, and that the threshold be the threshold prescribed by the Board for Z-factors for IRM3 applications.

References:

- Board Report page 19
- Chapter 3 of the Filing Requirements for Transmission and Distribution Applications updated July 9, 2010, pages 12 - 13

Alternatives:

11. Should the Board permit rate applications or RRR reporting using USGAAP?

Staff recommends that the Board not permit filings under USGAAP. It is important for utility regulation in Ontario that financial information be universal and standardized for all utilities.

Alternative 1: In accordance with the second sentence of principle 5 of the Board's Report, 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.

Alternative 2: The Board will require all electricity utilities and agencies (including OPG) to file rate applications and perform RRR reporting using modified IFRS, except those utilities who are not required to adopt IFRS for financial reporting purposes due to their not-for-profit status. For gas utilities, the Board will require Enbridge Gas Distribution Inc. and Union Gas Limited to file rate applications and report to the Board using the same accounting standard, as approved by the Board (e.g. modified IFRS or USGAAP). It is important for utility regulation in Ontario that utilities within an energy sector report financial information on a common basis.

If one of the alternatives is chosen, all references to IFRS or modified IFRS in these recommendations shall be read as including any other accounting standard approved by the Board for regulatory purposes, unless otherwise indicated.

References:

- Board Report page 5

12. The Board Report in issue 10.4 states "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". Does this mean that a reconciliation from modified IFRS, as reported under RRR, to CGAAP must be performed and filed each year of an IRM period? Or is a reconciliation for the first year of RRR reporting under modified IFRS sufficient? What level of audit assurance should the Board require for this reconciliation?

Staff recommends that the reconciliation in section 10.4 of the Board's Report not be required every year of an IRM period. Rather, staff recommends that a reconciliation between CGAAP and modified IFRS be performed and filed with the RRR annual performance filing for the first year in which modified IFRS is used for regulatory accounting. Staff

recommends that the Board require assurance provided by an external auditor to the "review level of assurance" specified in the CICA Handbook.

References:
- Board Report pages 33 – 34
- CICA Handbook Section 8100

Alternatives:

Other potential recommendations

13. Should the Board in some forum consider how to deal with irreconcilable disparities between the actual value of rate base and net book value of PP&E in audited financial statements?

Staff asks working group members for examples. Is this a concern for all utilities?

References:
- Board Report page 19

Alternatives:

14. Should the Board in some forum consider what adjustments need to be made to the IRM regime itself, if adjustments may be made during an IRM period due to the transition to IFRS?

The Working Group recommends that the Board consider the adjustments proposed relating to the adoption of modified IFRS for regulatory filings and the implications of those adjustments when it reviews the incentive regulation methodology for electricity distributors, or considers incentive regulation plans presented by other utilities. It may be that the Board will need to consider whether these adjustments can be made in isolation during an IRM period.

Proposed new issue: 15. Should the Board grant a generic deferral account for utilities that will rebase under CGAAP in 2012 to capture any impacts to revenue requirement resulting from the implementation of (modified) IFRS in 2012?

Note: Is this issue covered by revised issue 4? Should it replace issue 4?