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**Susan Frank**

Vice President and Chief Regulatory Officer  
Regulatory Affairs

BY COURIER

May 21, 2010

Ms. Kirsten Walli  
Secretary  
Ontario Energy Board  
Suite 2700, 2300 Yonge Street  
P.O. Box 2319  
Toronto, ON.  
M4P 1E4

Dear Ms. Walli:

**EB-2010-0178 – “Depreciation Study for Electricity Distributors – Transition to International Financial Reporting Standards (IFRS)”**

Attached are three (3) paper copies of Hydro One Networks’ comments on the Kinectrics Inc. draft Depreciation Study for Electricity Distributors that was issued for comment on April 30, 2010.

I have also attached proof of successful submission of these comments through the Board's Regulatory Electronic Submission System.

Sincerely,

ORIGINAL SIGNED BY SUSAN FRANK

Susan Frank

**HYDRO ONE COMMENTS ON DRAFT REPORT:  
DEPRECIATION STUDY FOR ELECTRICITY DISTRIBUTORS -  
TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS  
(IFRS)**

Hydro One Inc. (“Hydro One”) is pleased to provide comments on the draft industry depreciation/amortization study performed by Kinectrics Inc. (“Kinectrics”) and issued for comment by the Board on April 30, 2010.

Background and General Comment

In its EB-2008-0408 report on the adoption of IFRS, the Board undertook to sponsor a common industry depreciation study to provide some guidance to Distributors that are setting initial IFRS-compliant asset service lives. The study was meant to be used by Distributors that do not use the services of an external depreciation expert to recommend service lives. Provision of this industry guidance was expected to result in more consistency and cost efficiencies as it would avoid the necessity of each Distributor to engage its own external depreciation consultant.

Kinectrics’ draft study provides useful information that we expect will provide relevant assistance to those Distributors that do not opt to sponsor their own external depreciation studies. The report’s proposed typical useful lives (“TULs”) and related minimum and maximum service life ranges will be useful tools, particularly for smaller Distributors with no experience of conducting their own depreciation reviews. The proposed lives are primarily based on a professional engineering assessment of physical service life expectations, as one would expect given the absence of detailed historical retirement data. Distributors should assess local factors to determine any deviations from the TULs. We expect that the actual service lives that emerge from the application of this guidance will represent an improvement over the service life assumptions that are currently mandated by the Distribution Accounting Procedures Handbook.

Application to Hydro One Inc

Hydro One will not apply the Kinectrics recommendations for our property, plant and equipment or intangible assets. The regulated businesses owned and operated by Hydro One Networks Inc. (“Networks”) and by Hydro One Remote Communities Inc., have historically sponsored and filed depreciation studies performed by an independent external expert. Hydro One’s other regulated distribution business, Hydro One Brampton Networks Inc., has also sponsored an initial depreciation review to develop IFRS-compliant service life assumptions to be used following its January 1, 2011 adoption of IFRS.

Hydro One carries out external depreciation reviews because external review provides for high quality and independent regulatory support for an expense category that is very material to our revenue requirement. The use of an external consultant was initially ordered by the Board in Networks’ Distribution and Transmission transitional rate orders for 2000 and 2001.

The fact that depreciation service life recommendations are made by an expert external consultant provides additional assurance to our external auditors and, indirectly, to other financial statement users

that the depreciation expense and related asset carrying values included in our external financial reports are appropriate. As we are a public securities filer, it is critical that all management estimates that impact the balance sheet or income statement are credible. External expert review supports the assertion that the service life estimates we apply in arriving at reported depreciation expense appropriately reflect expected asset useful lives. Our service life estimates have historically incorporated physical life assumptions as well as other expected forces of retirement such as: technical, economic, social or environmental obsolescence; the impact of government policy decisions; upgrades for changes in service quality or increased load; storms, catastrophes and accidents; and miscellaneous external factors. In addition, in some cases, asset component service lives applied should be limited by related agreement or contract terms or by the service lives of the facilities in which the components are installed. It is our experience that many of these non-physical external factors have a significant impact on the accounting life of asset components.

Accuracy of service life assumptions becomes even more important under IFRS as group depreciation can no longer be applied. Actual depreciation methods and service lives will now have a direct impact on asset component net book values. Under IFRS, a gain or loss will be reported in the income statement whenever a depreciable component with remaining net book value is derecognized from the balance sheet. Once IFRS is adopted, asset service lives will directly impact the income statement in two ways; through depreciation expense levels and through the measurement of component gains and losses on sale or retirement. Given the importance of depreciation estimates, we expect to continue to engage the services of an independent depreciation consultant for all of our regulated businesses, including those that are technically out of scope for the Kinectrics study (e.g. transmission and remote diesel generation assets).

It is useful to note that our existing and historic asset componentization is significantly more detailed than that assumed in the draft report. We maintain defined plant retirement units that are used as criteria for determining when asset sub-components should be retired and recapitalized when assets are removed and replaced. Our granular asset componentization and our use of defined retirement units has a direct impact on ensuring that we are as accurate as possible in estimating the accounting life of our assets.

Finally, we have not needed to make significant changes to our asset componentization or plant retirement unit definitions in moving from Canadian generally accepted accounting principles (“CGAAP”) to IFRS. As such, we generally have strong continuity between our asset records and underlying asset service life assumptions previously used for CGAAP and those that will be used as we transition from CGAAP to IFRS.

### Going Forward

We expect that the Board will need to periodically refresh the guidance provided in the draft report to ensure that relevant guidance is available for future application by smaller Distributors. This could result from new service life intelligence gathered through actual retirement experience. In addition, future external events may have the effect of changing service life assumptions for the industry as a whole. Examples in past years would include the Province’s smart meter initiative, which had a service life impact on conventional meters, and recent federal PCB mitigation requirements, which could have had impacts on the service lives of distribution transformers and other electrical equipment.

## Timing of Implementation of Depreciation Changes

Management has an obligation under IFRS to actively annually review and attest to the continued adequacy of depreciation methods and service life assumptions. In the past, under CGAAP-based regulatory accounting, the implementation date for any service life changes resulting from external events, such as major government decisions or newly completed external depreciation reviews, could be deferred until the impact of those changes was effective in rates. This is no longer the case. Under IFRS, such service life changes will now need to be implemented for external reporting purposes as soon as they are known.

Since the Board will be basing its regulatory service lives on the IFRS service lives used for external reporting purposes, it should consider how it will handle this timing issue. We suggest that a variance account be established for the impact on approved revenue requirement of any changes in depreciation rates so the same rates are applied both for external reporting and regulatory purposes. To minimize differences between the external financial statements and regulatory reporting, the variance account could hold the revenue requirement impact of depreciation changes between the date of implementation for financial reporting purposes and the date that the change is effective in rates. The impact of service life changes, such as those attributable to a new external depreciation study or a major external event like those described above for smart meters, would be held in this variance account until disposed of through a future rate application. This treatment would be analogous to the existing regulatory treatment accorded to Hydro One Networks' distribution and transmission businesses for changes in statutory tax rates.