Ontario Energy Board
Accounting Procedures Handbook
Frequently Asked Questions
October 2009

INDEX

INDEX Continued

New accounts approved for recording incremental costs incurred in relation to transition to International Financial Reporting Standards (IFRS):

Q.1 For a distributor that <u>does not</u> have a Board-approved amount designated for one-time administrative incremental IFRS transition costs already included for recovery in its distribution rates, what account should be used to record these costs for potential future recovery?

A.1 The Board has approved a deferral account for a distributor to record one-time administrative incremental IFRS transition costs, which are not already approved and included for recovery in distribution rates. In such circumstances, the incremental costs (see Q.3 below) will be recorded in a new and separate sub-account of account **1508, Other Regulatory Assets, "Sub-account Deferred IFRS Transition Costs"**, in the Uniform System of Accounts.

Interest carrying charges, calculated on the monthly opening principal balance of this sub-account at the Board's prescribed interest rates, are applicable to amounts recorded in this sub- account. The offsetting credit interest amount is recorded in account 4405, Interest and Dividend Income.

In the distributor's next cost of service rate application immediately after the IFRS transition period, the balance in this sub-account should be included for review and disposition.

Q.2 For a distributor that <u>does</u> have a Board-approved amount designated for one-time administrative incremental IFRS transition costs already included for recovery in its distribution rates, what account should be used to record these costs for potential future recovery?

A.2 The Board has approved a variance account for a distributor to use in such circumstances. The account will reflect the variance between the amounts recovered in distribution rates at approved rates and the actual incurred one-time administrative incremental IFRS transition costs. A separate sub-account of account **1508, Other Regulatory Assets, "Sub-account IFRS Transition Costs Variance"**, is to be used exclusively for this purpose. The distributor will record the actual incurred one-time administrative incremental IFRS transition costs in this sub-account (see Q.3 below). In addition, the amounts recovered in distribution rates will be recorded as credits in this same sub-account. These recoveries are not recorded as credits in the 4000-4499 series of revenue and other income accounts.

Interest carrying charges, calculated on the monthly opening principal balance of this sub-account at the Board's prescribed interest rates, are applicable to amounts recorded in this sub- account. The offsetting credit interest amount is recorded in account 4405, Interest and Dividend Income, or debit interest amount is recorded in account 6035, Other Interest Expense.

In the distributor's next cost of service rate application immediately after the IFRS transition period, the balance in this sub-account should be included for review and disposition.

Q.3 Which incremental IFRS transition costs qualify for recording in the sub-accounts referred to in the answers to questions 1 and 2 above?

A.3 The costs authorized for recording in the deferral or variance account referenced in the answers to questions 1 and 2 above shall be incremental one-time administrative costs caused by the transition of accounting policies, procedures, systems and processes to IFRS. The incremental costs eligible for inclusion in these accounts may include professional accounting and legal fees, salaries, wages and benefits of staff added to support the transition to IFRS and associated staff training and development costs.

These accounts are exclusively for necessary, incremental transition costs and shall <u>not</u> include ongoing IFRS compliance costs or impacts arising from adopting accounting policy changes that reflect changes in the timing of the recognition of income. The incremental costs in these accounts shall <u>not</u> include costs related to system upgrades, or replacements or changes where IFRS was not the major reason for conversion. In addition, incremental IFRS costs shall <u>not</u> include capital assets or expenditures.

The costs recorded in these accounts 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 considered for approval for recovery in rates.

The transition to IFRS is effective for fiscal year-ends beginning on or after January 1, 2011. Accordingly, incremental transition costs incurred after the beginning of the year of adoption are expected to be minimal.

New sub-accounts of account 1595 for the approved disposition of deferral and variance account balances in the 2009 rate setting process:

Q.4 For deferral and variance account balances approved for recovery in 2009 (e.g., as part of the 2009 EDR rebasing applications, IRM applications process or Board reviews), should new sub-accounts of account 1595 be used to record the approved account balances and the associated recoveries collected (or amounts refunded) in rates?

A.4 Yes. The Board in 2008 approved sub-accounts of account 1595, Disposition and Recovery of Regulatory Balances Control Account, to record the deferral and variance account balances approved in 2008 and the associated rate recoveries. For deferral and variance account balances approved in 2009, the Board has approved **"Sub-account Principal Balances Approved for Disposition in 2009."** Distributors will record in this sub-account of account 1595 the approved principal account balances and amounts recovered (or refunds) in rates through regulatory asset or deferral and variance accounts rate riders.

On the transfer of each approved deferral or variance account balance to account 1595, a separation of the principal and interest balances is required for recording purposes. The distributor will record the principal balances in "Sub-account Principal Balances Approved for Disposition in 2009" (as indicated above) and the cumulative carrying charge account balances in a new and separate sub-account of account 1595 **"Sub-account Carrying Charges Approved for Disposition in 2009."** No additional carrying charges will be applied or added to these carrying charge balances (i.e., no interest on interest is applicable).

In addition, a new and separate sub-account of account 1595 **"Sub-account Carrying Charges on 2009 Net Principal Account Balances"**, will be used to record the carrying charges calculated on the opening monthly net principal balance (i.e., transferred account principal balances less recoveries) recorded in "Sub-account Principal Balances Approved for Disposition in 2009." The offsetting credit interest amount is recorded in account 4405, Interest and Dividend Income, and debit interest amount is recorded in account 6035, Other Interest Expense.

The above three new sub-accounts of account 1595 are effective on May 1, 2009.

Q.5 Please summarize the accounting procedures for the new sub-accounts of account 1595?

A.5 In summary, the accounting procedures for the deferral and variance account balances approved for disposition in 2009 are as follow:

1. The principal account balances will be transferred and recorded in "Sub-account Principal Balances Approved for Disposition in 2009."
   - Journal entries for these transfers are posted to this account on the date when the account balances were approved for recovery or refund in rates, which generally is the start of the rate year (e.g., May 1) for most distributors.
   - The offsetting entries will go to the specific deferral or variance account for which the principal amount was approved.
   - Rate recoveries (or refunds) amounts in a rate rider are also recorded in this sub-account.
   - Interest carrying charges apply to the net principal balances in this sub-account (see item 3 below).

2. The interest carrying charge account balances will be transferred and recorded in "Sub-account Carrying Charges Approved for Disposition in 2009."
   - Journal entries for these transfers are posted to this account on the date when the account balances were approved for recovery or refund in rates, which generally is the start of the rate year (e.g., May 1) for most

distributors.
- The offsetting entries will go to the specific deferral or variance account for which the interest amount was approved.
- No interest carrying charge will apply to this sub-account.

3. Interest carrying charges will accrue and be recorded in “Sub-account Carrying Charges on 2009 Net Principal Account Balances.”
   - The carrying charges are calculated on the opening monthly net principal balance of “Sub-account Principal Balances Approved for Disposition in 2009” (i.e., transferred account principal balances less recoveries/refunds) at the Board-prescribed interest rates.
   - The offsetting credit interest amount is recorded in account 4405, Interest and Dividend Income, or debit interest amount is recorded in account 6035, Other Interest Expense.

Q.6 How should the recovery of the approved account balances collected (or refunded) in a rate rider be applied to the new sub-accounts of account 1595?

A.6 In terms of the application of the rate rider recoveries to the balances in these sub-accounts, the amounts recovered (or refunded) should be applied to the balances in the sequence of the items 1 to 3 shown above in A.5.

For example, amounts collected in a rate rider(s) to recover a net debit balance of approved accounts will be applied to the sub-account balances in order of priority, as follows:
1. The cumulative principal balance transferred to and recorded in “Sub-account Principal Balances Approved for Disposition in 2009”
2. The cumulative carrying charge balance transferred to and recorded in “Sub-account Carrying Charges Approved for Disposition in 2009” and,
3. The accrued carrying charges recorded in “Sub-account Carrying Charges on 2009 Net Principal Account Balances.”

In the situation where a rate rider(s) continues to generate recoveries (or refunds) after all sub-account balances shown above have been settled, these “additional” recoveries (or refunds) should be recorded in “Sub-account Principal Balances Approved for Disposition in 2009” and carrying charges on this balance should continue to be recorded in “Sub-account Carrying Charges on 2009 Net Principal Account Balances.”

Upon completion of the recovery (or refund) period and the provision of audited financial statements to support the underlying residual balance in the sub-account(s), the distributor should include the residual balance in the sub-account(s) in its next rate application, for review and disposition. Any final settlement adjustment of the residual balance in the sub-account(s) should be recorded in the sub-account(s) to which the settlement relates so that its balance is drawn down to zero.

New approved deferral and variance accounts arising from the requirements of *Green Energy and Green Economy Act:*

Q.7 Has the Board approved deferral accounts for distributors spending in relation to distribution system planning under *Green Energy and Green Economy Act*?

A.7 On June 16, 2009, the Board issued Guidelines: Deemed Conditions of Licence: Distribution System Planning (G-2009-0087). As part of these guidelines, the Board has established four new deferral accounts in the Uniform System of Accounts that electricity distributors may use to begin recording capital investments and expenses incurred in relation to qualifying projects undertaken to accommodate renewable generation or towards the development a smart grid.

The four approved accounts are as follows:

- Account 1531, Renewable Connection Capital Deferral Account
- Account 1532, Renewable Connection OM&A Deferral Account
- Account 1534, Smart Grid Capital Deferral Account
- Account 1535, Smart Grid OM&A Deferral Account

Q.8 What costs can be recorded regarding distribution system planning in the deferral accounts?

A.8 The guidelines (G-2009-0087) at Section II.A provide details regarding the qualifying expenditures that can be recorded in the four approved accounts. Appendix A provides the set up of, the categories of capital expenditures or expenses that can be included in and the reporting requirements for the four deferral accounts. For reference, the web link to the guidelines is provided below.

http://www.oeb.gov.on.ca/OEB/_Documents/EB-2009-0087/Dx_System_Planning_Guidelines_20090616.pdf

Q.9 Has the Board issued accounting guidance for distributors that own and operate generation facilities?

A.9 On September 15, 2009, the Board issued Guidelines G-2009-0300, entitled "Regulatory and Accounting Treatments for Distributor-Owned Generation." These guidelines provide regulatory and accounting guidance on this subject. For reference, the web link to the guidelines is provided below.

http://www.oeb.gov.on.ca/OEB/_Documents/Regulatory/Guidelines_reg_accounting_treatments_G-2009-0300.pdf

Q.10 What is the accounting treatment and accounts for distributors that own and operate generation facilities?

A.10 Guidelines G-2009-0300 indicate that the statutory framework does not currently give the Board the power to include generation assets in rate base, nor to permit rate recovery for any associated operations and maintenance expenses for distributors. Consequently, the accounting treatment requires the segregation and recording of the generation activities in specified accounts. A distributor need to follow the specified accounting procedures to ensure that information reported for rate setting purposes does not include the assets, liabilities, shareholders' equity, revenues and expense associated with its non-rate regulated generation activities. Details on the accounting procedures are provided in the guidelines.

The specified accounts to record generation activities in Uniform System of Accounts are as follows:

- Account 2075, Non-Utility Property Owned or Under Capital Leases, Sub-account Generation Facility Assets.
- Account 2285, Obligations Under Capital Leases-Current, Sub-account Generation Facility Liabilities.
- Account 2325, Obligations Under Capital Lease-Non-Current, Sub-account Generation Facility Liabilities.
- Account 3075, Non-Utility Shareholders' Equity, Sub-account Generation Facilities. Account 3075 is a control new account.
- Account 4375, Revenues from Non-Utility Operations, Sub-account Generation Facility Revenues.
- Account 4380, Expenses from Non-Utility Operations, Sub-account Generation Facility Expenses

Clarifications on the accounting treatment for accounts 1588 RSVA power and 1588 RSVA power, Sub-account Global Adjustment:

Q.11 Regarding IESO charge type 146, how is the distributor to determine the RPP and non-RPP Portions of the Global Adjustment to be reflected in account 1588, RSVApower, and 1588 RSVApower, "Sub-account Global Adjustment"?

A.11 The IESO charge type 146 for the Global Adjustment comprises the total kWhs consumption of the distributor (including embedded generation) and hence the distributor must determine the appropriate splits. The distributor determines the RPP and non-RPP "portions" of the Global Adjustment and files the RPP portion of the Global Adjustment with the IESO on forms, such as former Form 1598 and successor forms.

The charge type 146 "portions" the distributor submits to the IESO should be used as the basis of the accounting entries for the RPP portion posted to account 4705, Power Purchased, and the non-RPP portion posted to 4705, Power Purchased, "Sub-account Global Adjustment." Ultimately, the amounts recorded in these two expense accounts are reflected in the variances recorded in account 1588, RSVApower, and 1588 RSVApower, "Sub-account Global Adjustment."

Q.12 Distributors apply for the "recovery" of the RPP Portion of Global Adjustment amounts included in Charge Type 146, through their IESO filings (e.g. Form 1598). How should the adjustments arising from true ups be reflected in the RSVAs?

A.12 Electricity commodity power related adjustments to IESO charges (filed via forms with the IESO) are reflected in charge type 142. Charge type 142 is the difference between RPP rates and the cost of power including the Global Adjustment. Accordingly, charge type 142 includes true-up adjustments for both the cost of power purchase attributable to RPP customers included in charge type 101 and the global adjustment attributable to RPP customers included in charge type 146.

Since the distributor will recover through charge type 142 the global adjustment portion attributable to the RPP customers paid on the IESO settlement invoices, a journal entry for the charge type 142 amount should be posted to account 4705, Power Purchased. As a result, this journal entry would have an offsetting effect on the global adjustment (attributable to the RPP customers) amount that was included and paid under charge type 146 also posted to account 4705 (as discussed in A.11 above).

It should be noted that any ongoing variance related to charge types 101 and 146 attributable to RPP customers, will be of a temporal nature as ongoing true-ups continue to be submitted to the IESO and recovered through charge type 142.

Q.13 Can you please clarify whether the RSVAs included in RRR quarterly reports are required to be on an accrual basis or are they required to be on a cash basis? If the cash basis is consistently used on the quarterly reporting to the Board, then the Q4 2.1.1 reporting will never agree to the 2.1.7 reporting as the 2.1.7 information is the trial balance supporting the audited financial statements, which is on the accrual basis?

A.13 The APH in Article 490 (pages 10 and 11) states that the method (billed or accrual) chosen by the distributor shall be consistently applied on an ongoing basis to all RSVAs. Consequently, all quarterly (2.1.1) and annual reporting (2.1.7) are required to be reported under the same method. For example, if a distributor uses the cash basis for RSVAs in its Q4 2.1.1 reporting, the distributor should also use the cash basis for RSVAs reported in the trial balance under 2.1.7.

In the circumstance where the audited financial statements are presented under the accrual method because the distributor interprets that “GAAP financial statements do not allow the cash method”, but reports the RSVAs in the trial balance (2.1.7) on a cash basis for regulatory purposes, the distributor is required to map and reconcile the 2.1.7 trial balance (accounts reported on a cash basis) to the financial statements.

Q.14 Q4 2.1.1 accounts information may be reported using preliminary unbilled revenue figures whereas the 2.1.7 trial balance may be reported on the audited year-end figures. The reporting deadline for distributors with December year ends of January 31 for Q4 2.1.1 has made it such that unbilled revenue is typically not finalized by this time and a preliminary estimate is used. How should distributors deal with reporting different values in the Q4 and annual reporting?

A.14. The Board recognizes that there is a risk that reporting of the Q4 2.1.1 information may be superseded by information reported several months later in 2.1.7 in relation to deferral and variance accounts. Ultimately, however, the two reportings should represent the same information to the Board. At the time the distributor reports 2.1.7 (on or before April 30) the distributor should amend its 2.1.1 reporting in the RRR (via the OEB e-filing services), if there are differences.

A current RRR proposed amendment would extend the 2.1.1 reporting due date from one month to two months after quarter end. If this proposal is approved, the Q4 2.1.1 reporting due date is expected to reduce the risk of differences between the 2.1.1 and 2.1.7 reporting. Under any accounting model, estimates are required at period end in order to close the books of account promptly. Recognizing that distributors have billing cycles of varying durations, it is nonetheless important for distributors to have accurate quarter end estimates in order to support legislative requirements for the Board to review certain balances on a quarterly basis.

For retrospective or prior period adjustments, the distributor should also consider the recoverability of “adjusting” amounts in future rates before making these adjustments. This consideration is applicable to situations where the Board has already approved the disposition of the account balance in rates (e.g. deferral account on a final basis) or has already approved the account balance in rates for a specified time-period (e.g., an RSVA balance as of a specified fiscal-year end).

Accounting guidance provided for various other items and accounts:

Q.15 Does the Canadian Institute of Chartered Accountants (CICA) Handbook, new Section 3031, Inventory, change the accounting treatment of major spare parts and equipment?

A.15 The Accounting Procedures Handbook (APH) provides regulatory accounting guidance on inventory in Article 420 consistent with the requirements in previous CICA Handbook Section 3030, Inventory. The new CICA Handbook Section 3031, Inventory, does not change the fundamental accounting guidance in the APH for electricity distributors (aside from items such as measurement of inventories, etc.). The APH guidance continues to align with the general guidance provided in Section 3031.

An accounting recommendation in Article 510 (page 10) provides guidance to ensure that spare transformers and meters are not treated as “inventory” which is typically classified as a current asset on the balance sheet as if it were goods available for resale. The article specifies five conditions, if met, requires spare transformers and meters to be accounted for as property, plant and equipment (PP&E) in capital assets. The five conditions are: not intended for resale; cannot be classified as inventory in accordance with CICA Handbook; have a longer period of future benefit than do inventory items; form an integral part of the original distribution plant by enhancing the system reliability of the original distribution plant; and, consistency with regulatory treatment.

By analogy, these five conditions are also applicable to other material spare equipment and parts to ascertain whether these items should be capitalized in PP&E. Accordingly, the APH treatment requires all major spare parts and equipment specifically designated as standby for field service to be capitalized in PP&E and amortized.

In summary, the regulatory accounting guidance is as follows:

1. Spare meters and transformers designated as major spares or standby assets are to be classified as property, plant and equipment (PP&E) and amortized when available for use. This is not a change to Board requirements or past practice;
2. Other designated asset items that meet the definition of major spares or standby assets in accordance with the APH five-part test in Article 510 (at page 10) are also classified in PP&E and amortized when available for use. This is not a change in Board requirements but may be a change for some distributors that applied this treatment only to meters and transformers; and,
3. Any inventory items that will eventually be capital but are not major spares or standby assets at the period end should be classified as inventory until placed in service at which time they would be classified in PP&E and amortized. For example, classifying materials purchased to expand a subdivision or as part of an asset replacement program are initially recognized as inventory until they are transferred to Construction Work In Progress or directly to in-service PP&E in anticipation of their ultimate inclusion in the cost of in-service plant. This is not a change to Board requirements.

Q.16 The Canadian Institute of Chartered Accountants (CICA) Handbook, Section 3465, Income Taxes, was amended such that rate-regulated companies are required to recognize future income tax liabilities and assets. Does this change from the taxes payable method to the liability method mean that regulated companies will have to record a regulatory asset on the balance sheet reflecting a future tax liability (or vice versa)?

A.16 The Accounting Procedures Handbook (APH) specifies that a utility can choose to report taxes on a future income taxes basis (even when the taxes payable method was in effect for rate-regulated entities) and that such treatment has no bearing on what the utility chooses to apply for in distribution rates. Article 440 at page 2, states: "…the method of accounting for future income taxes will not affect the manner in which just and reasonable rates are approved by the Board and the accounts provided in the Uniform System of Accounts (USoA) are provided only for the convenience of the electric utility."

The USoA provides accounts for the electric utility to recognize future income taxes in accordance with CICA Handbook Section 3465—Income Taxes, as follows:

- 2296, Future Income Taxes – Current;
- 2350, Future Income Taxes – Non-Current; and
- 6115, Provision for Future Income Taxes.

The Board does not prescribe financial reporting requirements for financial statement purposes. Consequently, the reporting of income taxes in financial statements, whether based on the taxes payable or the future income taxes method, is for the distributor to decide in accordance with CICA Handbook requirements.

Q.17 We have received our bill from Hydro One for charges related to the new Sub-Transmission and regulatory assets implemented on Feb 1, 2009 (per Rate Order EB-2007-0681). Previously, as an embedded distributor, we were billed for RTSR network, connection and LV charges, which we recorded in the appropriate RSVA related charge accounts 4714, 4716 and 4750, respectively.

There are two new charges in the Tariff of Rates and Charges: a Service Charge to be applied to each delivery point including a smart meter charge and a new facility charge for connection to Common ST Lines. In addition, there is a Regulatory Asset Recovery – Rider #3 (i.e., Rider 3A, General, and Rider 3B, WMS). Can you please advise as to which accounts these charges should be recorded?

A.17 The Board's Decision and Order (EB-2007-0681) included the approval of a new Sub-Transmission class, and related fixed and variable charges for Hydro One sub-transmission services. These charges for the sub-transmission class were reflected previously under the LV charge, which was in effect until April 30, 2008.

1. The "Service Charge" is the sub-transmission fixed rate charge component for each meter point. This charge is recorded in account 4750, LV Charges.

2. The “Facility charge for connection to Common ST Lines” is the sub-transmission variable or volumetric charge component (depending on the applicable kV). This charge is recorded in account 4750, LV Charges.

These two new charges are to be reflected in the variance recorded in account 1550, LV Variance Account.

Regarding “Regulatory Asset Recovery 2008 – Rider #3”, the Board approved a net credit balance of $77 million for several deferral and variance accounts as indicated on pages 45 and 47 of the Decision. For Rider 3A, several deferral and variance account balances were approved for disposition totaling a net credit amount of $2.5 million. For Rider 3B, a credit amount of $74.5 million was approved for the disposition for the 1580, RSVA wms, account balance. The distributor should consider how best to allocate or redistribute the rate rider 3A amount to its own accounts. An approach the distributor could use to record the rate rider 3A amount in its related accounts is to break out the rider amount into separate charge/bill components in relation to each account.

For example, each of Hydro One’s deferral and variance account balance is divided by the total account balance approved for Hydro One under rate rider 3A. For each account, the derived amount is then calculated as a percentage of the total approved balance. The rate rider 3A amount charge to the distributor is then multiplied by the account’s percentage to arrive at an amount to be recorded in the particular account (e.g., charge/billed accounts related accounts 1584 RSVAnw and 1586 RSVAcn). The distributor will need to consult the Hydro One rate application and decision to obtain the account balances information to perform such calculations.

Rate rider 3B relates only to wholesale market service (WMS) charges, which although a credit amount should be recorded in account 4708, Charges– WMS. This amount is to be reflected in the variance recorded in account 1580, RSVAwms.

Q.18 In our June 2009 invoice received from Hydro One included a new 'capital rate relief rider' (Rider 5A) charge. Is there any accounting guidance on how to treat this charge?

A.18 The new incremental capital ("Rider 5") charge arises from an incremental capital module approved for Hydro One (EB-2008-0187), which was effective on May 1, 2009 but was implemented on June 1, 2009. The Board has approved a sub-account of account **1508, Other Regulatory Assets, "Sub-account Incremental Capital Charges"**, for distributors to record the charges arising from the capital rate relief rider. Interest carrying charges, calculated on the monthly opening principle balance of this sub-account at the Board's prescribed interest rates, are applicable for amounts recorded in this sub- account. The distributor should include the balance in this sub-account for review and disposition as part of its next cost of service rate application.