



Ontario  
Energy  
Board | Commission  
de l'énergie  
de l'Ontario

BY EMAIL AND WEB POSTING

November 2, 2023

**To: All Licensed Rate-regulated Electricity Distributors  
All Rate-regulated Natural Gas Distributors  
All Licensed Rate-regulated Transmitters  
Ontario Power Generation Inc.  
All Other Interested Parties**

**Re: Accounting Order (003-2023) for the Establishment of a Deferral Account to  
Record Incremental Cloud Computing Arrangement Implementation Costs**

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The OEB is establishing a deferral account relating to incremental cloud computing implementation costs. The applicable carrying charges and/or another type of rate, if any, will be subject to a generic proceeding.

### **Background**

In recent years, cloud computing has gained traction and it is expected to be one of the options utilities consider when assessing technology solutions. As a result, the OEB issued a letter on June 16, 2023 requesting that utilities complete a survey relating to their practice for cloud computing arrangements. The letter also indicated that the OEB retained KPMG to prepare a report (KPMG Report) on cloud computing arrangements for utilities in the regulatory environment. The KPMG Report has now been completed and is attached to this accounting order as Appendix B for information. The KPMG Report includes a summary of the results from the survey, a jurisdictional review, and a discussion of options to consider for the regulatory treatment of cloud computing costs.

In the letter, the OEB noted that the survey will not only help the OEB better understand cloud computing arrangements within the sector but will also assist in deciding whether

further consideration of the appropriate regulatory treatment of cloud computing costs for rate-setting purposes is warranted.

Under the current financial accounting standards (International Financial Reporting Standards (IFRS), U.S. Generally Accepted Accounting Principles (US GAAP) or Accounting Standards for Private Enterprises (ASPE)), costs for cloud computing solutions typically are expensed as incurred, while costs for on-premise solutions are typically capitalized in accordance with the utility's capitalization policy. The current regulatory accounting treatment would result in the capitalized costs for on-premise solutions being included in a utility's rate base and attract a return at the utility's weighted average cost of capital (WACC). Cloud computing solution costs would typically be expensed.<sup>1</sup> If a utility incurs costs to implement cloud computing solutions during the incentive-rate setting period, there would be no opportunity to recover these costs, whereas utilities have the opportunity to recover on-premise capital costs through the OEB's mechanism for incremental capital modules. Furthermore, cloud computing systems are typically in use by utilities for several years to provide service to customers but the costs are currently expensed in the year they occur. If a computing solution goes into service in a rebasing year, operating expenses for that base year may be inflated.<sup>2</sup> The survey results indicated that the current regulatory treatment for cloud computing costs is a perceived barrier to adopting cloud solutions.<sup>3</sup>

In previous Reports of the OEB,<sup>4</sup> the OEB established principles and practices related to regulatory accounting. The OEB considers many of these relevant to the consideration of the approach to cloud computing solutions, including that accounting and regulatory reporting requirements should:

- be based on sound regulatory principles including principles of fairness, minimizing intergenerational inequity and minimizing rate volatility
- balance the effects on both customers and shareholders when taking into account financial accounting requirements
- be primarily driven by the objective of just and reasonable rates

Cloud computing solutions often require significant up-front costs for implementation. The OEB is establishing a generic deferral account, as set out in the attached Appendix

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<sup>1</sup> Some cloud computing arrangement implementation costs may be capitalized under US GAAP.

<sup>2</sup> Operating expenses may be amortized if that is agreed-upon in an approved utility-specific settlement proposal, or if directed to do so by an OEB decision.

<sup>3</sup> KPMG Report, p.30

<sup>4</sup> Report of the OEB, Transition to International Financial Reporting Standards, EB-2008-0408, pp.6-7; Report of the OEB, Regulatory Treatment of Pension and Other Post-Employment Benefits (OPEBs) Costs, EB-2015-0040, September 14, 2017, p.3

A, for incremental implementation costs relating to these cloud computing solutions. The OEB concludes that establishing this generic deferral account will:

- remove the perceived regulatory barrier to adopting cloud solutions and encourage technology advancement in the industry
- encourage optimal planning by allowing cloud computing implementation costs to be recovered outside of a rate rebasing year
- address potential intergenerational inequity concerns by allowing utilities in an extended incentive-rate setting period to request disposition of significant account balances in a non-rate rebasing year, if warranted
- permit utilities to reduce the rate impact to customers from significant one-time cloud computing implementation costs by proposing a disposition period when the utilities bring the account for disposition

The generic deferral account will be effective December 1, 2023 and will record incremental cloud computing implementation costs incurred by utilities and any related offsetting savings, if applicable.<sup>5</sup> The OEB will assess any claimed costs recorded in the account at the time the disposition of the account balances is requested, subject to the applicable criteria for causation, materiality, and prudence. Cloud computing implementation costs recorded in the deferral account and requested for disposition will be subject to review by the OEB in the utility's next rebasing (cost of service or Custom IR) rate proceeding. The OEB will also allow utilities that are in an extended incentive rate-setting period (e.g. under a deferred rebasing period arising from utility consolidations or under Annual Incentive Rate-setting (IR) Index) to request significant account balances for disposition in a non-rate rebasing year to address potential intergenerational inequity concerns, if warranted.

Carrying charges at the OEB's prescribed rates for deferral and variance accounts will apply to the account unless otherwise directed by the OEB. As a part of a first phase of the OEB's generic cost of capital proceeding, expected to launch in early 2024, the OEB will also determine whether carrying charges (and the rate applicable to those carrying charges) and/or another type of rate will apply to the account. The risk profile of cloud computing solutions and on-premise solutions is expected to be included in the scope of that cost of capital proceeding. If the OEB determines that carrying charges other than the prescribed rates will apply to the account, any carrying charges that have accrued will be reversed in favour of the final approach.

The deferral account is generally intended to record cloud computing implementation costs when utilities first transition from on-premise solutions to cloud computing

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<sup>5</sup> To clarify, costs recorded must be incremental to amounts embedded in base rates, if any, regardless of whether the cloud costs are treated as operations or capital costs in base rates.

solutions. At the utility's next rebasing rate proceeding, a utility may propose the regulatory treatment for any material cloud implementation costs expected during its rate-setting term. The proposal could include consideration of a new deferral account or other approaches that take into account the timing and duration of the contract term. Furthermore, the utility's proposal for cloud computing implementation costs is expected to be informed by any results of the generic proceeding related to this issue.

**DATED at Toronto, November 2, 2023**

Yours truly,

Nancy Marconi  
Registrar

## Appendix A

### **Accounting Order (003-2023) for Cloud Computing Implementation Costs**

Electricity distributors and transmitters may establish the following account and sub-account effective December 1, 2023:

- Account 1511 - Incremental Cloud Computing Implementation Costs
  
- Account 1511 - Incremental Cloud Computing Implementation Costs, Sub-account Carrying Charges

Natural gas distributors may establish similar sub-accounts under Account 179 – Other Deferred Charges. This accounting order also applies to Ontario Power Generation Inc.

In the Incremental Cloud Computing Implementation Costs account, utilities may record incremental cloud computing implementation costs incurred and any related offsetting savings, if applicable. Carrying charges will apply at the OEB's prescribed rates for deferral and variance accounts that are published on the OEB's website on a quarterly basis,<sup>6</sup> unless otherwise directed by the OEB.<sup>7</sup>

Utilities are expected to track costs at a sufficiently detailed level or category to assist in a prudence review of the costs incurred.

The OEB will assess any claimed costs recorded in the account at the time the disposition of the account balances is requested, subject to the applicable criteria for causation, materiality, and prudence.<sup>8,9</sup>

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<sup>6</sup> Per the OEB's [Prescribed Interest Rates](#) webpage

<sup>7</sup> Further direction may be provided subsequent to a first phase of the OEB's generic proceeding on cost of capital in which the OEB expects to consider carrying charges related to cloud computing solutions.

<sup>8</sup> Filing Requirements for Electricity Distribution Rate Applications - 2023 Edition for 2024 Rate Applications, Chapter 2 Cost of Service, December 15, 2022, p. 66

<sup>9</sup> Filing Requirements for Natural Gas Rate Applications - Chapter 2 Cost of Service, February 16, 2017, p.38

**Sample Journal Entries for Electricity Distributors and Transmitters.**

Note: Similar sample journal entries would apply for Natural Gas Distributors and Ontario Power Generation Inc.

To record incremental cloud computing implementation costs:

Dr. 1511 Incremental Cloud Computing Implementation Costs

Cr. XXXX OM&A Account(s) associated with cloud costs, as applicable

*To record incremental cloud computing implementation costs incurred and any related offsetting savings, if applicable*

Dr. 1511 Incremental Cloud Computing Implementation Costs, Sub-account Carrying Charges

Cr. 6035 Other Interest Expense

*To record the carrying charges on the net monthly opening balance in Account 1511 - Incremental Cloud Computing Implementation Costs*