

Q&As

Cloud Computing Implementation Costs Generic Deferral Variance Account

Background

On February 15, 2024 the OEB hosted a webinar and Q&A session related to the [Accounting Order](#) for the establishment of a deferral account to record cloud computing arrangement implementation costs. What follows are the questions and answers discussed during the session.

Category 1: Determining Incremental Costs

1. How should a utility define incremental cloud computing implementation costs?

Incremental costs are costs outside of what is embedded in rates. When amounts are recorded, they should represent impacts that are more than what utilities are already compensated for. These impacts depend on the utility’s specific set of circumstances. Accordingly, utilities may submit a proposal on what their incremental costs are, on a case-by-case basis.

2. Should costs included in capital costs under International Financial Reporting Standards (IFRS) or United States Generally Accepted Accounting Principles (US GAAP) be considered incremental?

Determining incremental costs for the cloud is **not dependent** on whether actual cloud implementation costs are being capitalized or expensed under the relevant sections under IFRS or US GAAP. Note 5 of the Cloud Computing Accounting Order, issued on November 2, 2023, defines the incremental cloud computing implementation costs as follows:

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.

If no amounts in base rates pertain to the system/software that the cloud-based solution is replacing, the capital or operating, maintenance and administrative (OM&A) costs of the cloud computing implementation (under IFRS or US GAAP) can be considered incremental costs and recorded in the cloud computing generic deferral account.

Incremental capital costs should be recorded separately from incremental OM&A cloud implementation costs because revenue requirement impacts are to be calculated on the incremental capital costs pertaining to the cloud solutions when the utilities seek disposition of the costs through an application to the OEB.

3. Is determination of incremental costs affected by explicit approval in the most recent rate decision?

If cloud costs are included in the OM&A forecast that are eventually approved on an envelope basis, they should be considered as part of base rates. As an example, if the OM&A envelope was reduced by a certain percentage in an OEB-approved settlement proposal or an OEB decision and order, the utility's approved cloud cost as part of the overall OM&A envelope should, for the DVA, be reduced proportionately, unless the reduction was explicit in the OEB-approved settlement proposal or the OEB's decision and order.

Category 2: Offsetting Savings

4. What kind of savings does the OEB envision?

Some examples of savings could be but not limited to:

- Equipment savings: When there is equipment related to an on-premises solution, and the utility no longer uses such a solution and/or equipment, the costs related to this would be saved (for example, computer and network hardware, equipment, maintenance, real estate, cooling costs)
- Maintenance costs: Software as a Service (SaaS) vendors can apply software upgrades and changes globally at a reduced cost, versus each licensee making changes locally.

If costs were embedded in the utility's rates in the last rebasing application for the on-premises solution and the utility plans to implement the cloud computing solution for the same system, the incremental cost of the cloud computing solution should be the costs net of the costs of the on-premise solutions that were approved in the utility's rates in the last rebasing application.

Comment by OPG for discussion:

Conceptually there are savings for making the optimal decision between two IT solutions, and the rate-payer benefits from this as the optimal decision was made (i.e., total cost of ownership is lower). It was noted that the ratepayer is benefiting directly from the optimal decision. There are no "savings" to add back to the account as the ratepayer is receiving the benefit.

5. Should savings be recorded in the account to offset the cloud implementation costs if the ratepayer directly benefits from the optimal decision-making by the utility in determining its IT solutions?

Implementation savings can be recorded in the same deferral account where incremental costs are recorded. The OEB will allow flexibility with respect to utilities demonstrating that savings have been thoroughly identified and measured. Until further guidance is provided, utilities may propose alternative approaches to measuring these savings.

Category 3: Timing and Recovery Period

6. Does the effective date (December 1, 2023) relate to the date of the cost incurred, regardless of project start/end date?

The effective date is based on when the costs are incurred (on or after December 1, 2023), regardless of the timing/duration of the project. In this case, some costs of a project are recorded in the account while other incurred costs of the same project are not recorded in the account.

7. How will the OEB determine the period for cost recovery? Will it align with the cloud computing contract or another method?

The period of cost recovery will generally align with the initial term of the computing contract. However, the OEB provides utilities flexibility by allowing them to propose a disposition period when the utilities bring the account for disposition.

Category 4: Eligibility of Costs

8. Can training, data conversion, and business process re-engineering costs be included in the new deferral and variance account as implementation costs?

Typical treatment of Implementation costs when incurred – under IFRS		
Cloud SaaS	Cloud SaaS	On-premise software
Construction of a new interface software owned by customer	Intangible	Intangible
Configuration	Expense	Intangible
Testing	Expense	Intangible
Customization of the hosted software by the cloud provider that is not distinct from the software	Defer/Prepaid	Intangible
Training	Expense	Expense
Data conversion/migration	Expense	Expense
Business process reengineering	Expense	Expense

Table 1 – Typical treatment of Cloud Implementation Costs – Under IFRS

Typical treatment of Implementation costs when incurred – under US GAAP		
Cloud SaaS	ASU 2018-15	Pre-ASU 2018-15
Interfacing (customer’s environment)	Defer	Defer
Configuration	Defer	Expense
Coding	Defer	Expense
Testing	Defer	Expense
Customization of the hosted software	Defer	Expense
Training	Expense	Expense
Data conversion/migration	Expense	Expense
Business process re-engineering	Expense	Expense

Table 2 – Typical treatment of Cloud Implementation Costs – Under US GAAP

Note: under US GAAP, “defer” means expense capitalized implementation costs over the term of the hosting arrangement.

As seen in Tables 1 and 2, while these costs (training, data conversion and business process re-engineering costs) are typically expensed under both IFRS and US GAAP for cloud-based solutions and on-premises solutions, the OEB is of the view that they **can be recorded** in the deferral account, so long as they are incremental. Please refer to Category 1: Determining Incremental Costs for further details.

Utilities should follow the accounting standards used in their audited financial statements to capitalize or expense incremental cloud computing implementation costs. In seeking disposition of the costs, utilities under USGAAP should disclose incremental capital costs of the cloud computing implementation that would not have been able to be capitalized under the IFRS, and any approvals the OEB may have granted to permit such capitalization.

9. Can each go-live for new functionality be treated as an “in-service” checkpoint?

The term “in-service” is not defined in the accounting order. The definition will depend on the utility’s capitalization policy and practice. The utility should follow its capitalization policy and comply with the relevant sections under the IFRS or US GAAP to record cloud implementation costs. The OEB reminds utilities of the “used and useful” regulatory principle and will review the cost recovery requests by utilities in their applications.

10. How should SaaS license fees, which do not meet US GAAP capitalization criteria, be treated during the implementation phase?

Please refer to Question 8.

11. Accounting Order Page 3 states “The deferral account is generally intended to record cloud computing implementation costs when utilities first transition from on-premises to cloud computing solutions.” Can the account be used if the new cloud solution is replacing an older cloud solution?

The accounting order does not prohibit the recording of **incremental** costs of transitioning from cloud-to-cloud in the account. However, this scenario was not contemplated when the account was established when the accounting order was issued in November 2023. The intent of the account was to ensure there was no barrier to selecting a cloud-based system if it was the optimal solution. Circumstances will need to be considered on a case-by-case basis.

Category 5: Materiality

12. Is materiality assessed at the account or project level when seeking disposition of accumulated amounts?

Materiality would be assessed at the project level to ensure the account is only used for **material projects**. The account was established to ensure the rate-setting framework is not a barrier to choosing a cloud-based solution, which would not be expected for immaterial projects. Utilities should keep records pertaining to the incremental costs of each material cloud-based solution in the account.

Follow-up Questions received during the webinar

- a. Do ongoing licensing costs after the implementation period qualify for the scope of the deferral account - since these would be incremental costs and not part of utilities’ underlying rates? If not, this may not incentivize the utilities to move to the cloud-based solution during the incentive period.**

The OEB understands that a Cloud Computing Arrangement (CCA) may or may not include a license. The OEB also acknowledges that when the CCA includes a license, the ongoing licensing costs or access fees may be incremental to the existing envelope. The Accounting Order issued in November 2023, for the generic cloud deferral account, states that one objective of establishing the account is to remove the perceived regulatory barrier to adopting cloud solutions and encourage technology advancement in the industry. If the utility can demonstrate that licensing costs or access fees directly related to a CCA are

incremental, they can be recorded in the Cloud Implementation Deferral Account during the Incentive Rate Mechanism (IRM) period.

Please note that utilities should also identify, track, and record any associated savings related to the ongoing licensing costs in the deferral account. In their applications requesting the disposition of the account balance, utilities should file evidence about the costs and savings for the OEB to review. Upon disposition of its balance, the use of the generic deferral account is no longer expected. However, at their next rebasing rate proceeding, utilities may propose the regulatory treatment for any material cloud implementation costs expected during its rate-setting term including consideration of a new deferral account.

- b. The accounting order states, "*The deferral account is generally intended to record cloud computing implementation costs when utilities first transition from on-premises to cloud computing solutions.*" Are new cloud solutions that were not previously on-premises eligible?**

Please refer to Question 11.

- c. On cost eligibility, does this mean for US GAAP filers we must maintain a parallel set of accounts/record keeping under IFRS to reconcile the differences between the 2 GAAPs?**

US GAAP filers do not need to maintain a parallel set of accounts to reconcile the differences between US GAAP and IFRS. However, these utilities should identify categories and quantum of implementation costs that otherwise cannot be capitalized under IFRS in applications where they request disposition of the account.

- d. What level of detail is the OEB expecting utilities to undertake when calculating offsetting savings? For example, is the OEB expecting utilities to conduct a detailed comparison (separate quotes) of cloud vs. on-premises implementation costs (e.g., SAP on-premises vs. SAP cloud) when selecting a solution? Should ongoing operating costs of cloud vs. on-premises be considered in the savings analysis?**

For the Cloud Implementation Deferral Account, the OEB will provide utilities flexibility in demonstrating savings. However, the OEB does expect utilities to be thorough in identifying and measuring savings. Utilities may propose alternative approaches to measuring these savings.