

1 **IFRS IMPLEMENTATION FOR 2011 TEST YEAR**

2
3 **1.0 INTRODUCTION**

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5 On February 13, 2008, the Canadian Accounting Standards Board (“AcSB”) confirmed
6 that publicly accountable enterprises (“PAEs”) will be required to adopt International
7 Financial Reporting Standards (“IFRS”) for interim and annual reporting purposes for
8 fiscal years beginning January 1, 2011. These standards will replace Canadian generally
9 accepted accounting principles (“CGAAP”) that are overseen by the AcSB. IFRS are set
10 by the International Accounting Standards Board (“IASB”).

11
12 The goal of IFRS is to improve financial reporting by establishing one set of high quality,
13 consistent, comparable and transparent reporting standards. As a result, IFRS is intended
14 to benefit PAEs by providing better access to international capital, funding and
15 investment opportunities.

16
17 Conversion to IFRS on January 1, 2011 is not a choice: it is mandatory for PAEs
18 including Hydro One Distribution. Also, the transition not only affects external financial
19 reporting but impacts all business processes that permeate throughout the entire utility.
20 IFRS is the financial reporting language investors and other stakeholders will require of
21 Hydro One Distribution.

22
23 Hydro One Distribution continues to assess the financial reporting impacts of the
24 adoption of IFRS. At this time, the impact on the future financial position and results of
25 operations cannot be determined. IFRS continues to evolve and most likely there will be
26 changes between today and the ultimate adoption in 2011.

27
28 Hydro One Distribution does not believe that the adoption of IFRS will have a material

1 impact on its reported cash flows. However, there is a risk that IFRS could have a
2 material impact on its consolidated balance sheet and consolidated statements of
3 operations and comprehensive income.

4
5 Hydro One Distribution has determined that the areas with highest potential to impact its
6 reporting are: rate regulated accounting; accounting for fixed assets; payments in lieu of
7 corporate income taxes; employee future benefits; and the initial adoption of IFRS under
8 the provisions of IFRS 1, *First-Time Adoption of IFRS*.

9 10 **2.0 OEB'S IFRS STAKEHOLDER CONSULTATION**

11
12 At the May 4, 2009 Ontario Energy Board ("the Board") IFRS stakeholder consultation,
13 Hydro One supported the proposal by Board staff to adopt IFRS as the default regulatory
14 accounting model. Further, in its comment letter on May 25, 2009, Hydro One reiterated
15 its position that IFRS should be adopted without modification, but made it clear that the
16 Company would adopt any measures the Board thought were necessary to maintain its
17 regulatory objectives, as well as stay within the Board's rate increase threshold. The
18 Company's position has not changed in its support of IFRS. However, the status of rate
19 regulatory accounting under IFRS has changed direction since those proceedings as a
20 result of a June 19, 2009 IASB decision.

21 22 **3.0 RATE REGULATED ACCOUNTING**

23
24 In May 2009, the IASB posted agenda papers on rate regulated accounting and specific
25 IFRS 1 amendments pertaining to rate-regulated operations. On June 19, 2009, the IASB
26 approved a number of staff proposals and authorized staff to proceed with an exposure
27 draft to be released in July 2009, with an expected final standard issued in 2010. The staff
28 proposal approved included:

- 1 • Costs of property, plant and equipment (“PP&E”) and intangible assets, to include
2 both directly attributable costs and other amounts permitted by the regulator, e.g.,
3 indirect overheads;
- 4 • The prospective application of the new standard for regulatory assets and
5 liabilities; and
- 6 • The elimination of the previously proposed IFRS 1 exemption which would have
7 permitted the use of carrying values as deemed costs upon transition to IFRS.

8

9 Based on the June 19, 2009 vote, Hydro One distribution expects that amounts permitted
10 to be recovered by the regulator will continue to be included in the costs of self-
11 constructed assets.

12

13 As a result of these recent developments, Hydro One Distribution has not adjusted its
14 costing of work programs in this application from CGAAP. Instead, the costing of assets
15 for purposes of IFRS in 2011 is assumed to be equivalent to that under CGAAP.

16

17 Depending on the outcome of the IASB project and their final decision, there could still
18 be more changes that Hydro One Distribution may have to make as a result of IFRS. The
19 subject of these changes is addressed in the proposed IFRS Variance Account (see
20 Exhibit F1, Tab 2, Schedule 2).

21

22 **4.0 PROPERTY, PLANT AND EQUIPMENT (“PP&E”)**

23

24 There are differences between IFRS and CGAAP with respect to the accounting for
25 PP&E and intangible assets. Some of the specific differences that apply to Hydro One
26 Distribution are outlined below:

27

1 (a) IFRS references component accounting for depreciation purposes, generally
2 applied on a straight-line basis, which potentially is at a more detailed level than
3 that under CGAAP. Hydro One Distribution has assessed its componentization
4 and determined it to be compliant with IFRS.

5
6 (b) CGAAP permits interest to be capitalized on all assets, and as determined by a
7 regulator. Under current IFRS, only directly attributable borrowing costs are
8 capitalized and only upon qualifying assets.

9
10 (c) IFRS recognizes gains or losses on the disposal of PP&E and intangible assets
11 immediately into income as opposed to the current CGAAP treatment of deferral
12 in accumulated depreciation.

13
14 (d) Under IFRS, the obligation associated with customer contributions received in
15 advance of construction cannot be included as an offset to PP&E. These amounts
16 but must either be deferred as a liability and amortized into income as revenue, or
17 recognized immediately as revenue for financial reporting purposes. Hydro One
18 Distribution proposes to defer customer contributions as a liability and amortize
19 to income.

20
21 For items (b) to (d), the application will depend on the outcomes of the IASB project on
22 rate regulated entities. Based on the proposals approved by the IASB on June 19, 2009,
23 there are no adjustments to PP&E, intangible assets and depreciation in this rate
24 application for IFRS. As a result, we are requesting a rate treatment for PP&E,
25 intangible assets and depreciation consistent with current CGAAP for purposes of IFRS
26 in 2011.

27
28 To the extent that final decisions of the IASB affect the carrying amounts of PP&E and

1 intangible assets, Hydro One Distribution proposes that when these amounts are
2 determined, they be captured as part of the IFRS Variance Account (see Exhibit F1, Tab
3 2, Schedule 2).

4 5 **5.0 IFRS 1**

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7 Under IFRS 1, the Company was to prepare an opening IFRS balance sheet at the date of
8 transition to IFRS that will form the starting point in accounting for transactions and
9 events under IFRS. Disclosure of the effects of these changes in the notes to the first set
10 of interim and annual financial statements is also required after conversion. The general
11 premise of IFRS 1 is that IFRS should be retrospectively applied in the preparation of the
12 opening IFRS balance sheet as if IFRS had always applied.

13
14 As a result of the June 19, 2009 decision, rate-regulated entities including Hydro One
15 Distribution are expected to be able to elect to use carrying values of PP&E and
16 intangible assets at transition to IFRS.

17
18 It is the Company's expectation that given the IASB's project direction to date, the final
19 decision regarding accounting for regulatory assets and liabilities will not require Hydro
20 One Distribution to retrospectively restate PP&E and intangible assets upon adoption of
21 IFRS.

22 23 **6.0 PAYMENT IN LIEU OF CORPORATE TAXES**

24
25 As of January 1, 2009, the Company recognized future income tax assets and liabilities in
26 accordance with the revised section 3465 *Income Taxes* in the CICA Handbook
27 applicable to rate regulated entities. Concurrently, the Company recognized an
28 equivalent regulatory asset. The recognition of these accounts impacted the balance sheet

1 only. As the Company continues to follow the flow through method of accounting for
2 income taxes, there is no impact on the Statement of Operations.

3
4 The current absence of specific guidance in IFRS on the recognition and measurement of
5 regulatory assets or liabilities arising from temporary differences between the flow
6 through method and the liability method of accounting for income taxes (i.e., recovery of
7 future income taxes), may cause a change in recognition of these amounts at the IFRS
8 transition date. It is unclear whether the final IFRS standard on regulatory assets and
9 liabilities from the IASB will permit the Company to continue using the flow through
10 method. As a result of these uncertainties and for purposes of this rate application in
11 respect of IFRS for 2011, the Company has continued to apply the flow through method
12 for the purposes of setting the revenue requirement, consistent with past applications. As
13 such, we are requesting a rate treatment for income taxes consistent with current CGAAP
14 for the purposes of IFRS in 2011. Hydro One Distribution believes that this is a
15 reasonable assumption given the recent developments in the IASB's rate regulated
16 accounting project.

17
18 For financial reporting purposes, the Company will apply rate regulated accounting for
19 differences between the cash and accrual methods, either as a regulatory asset or liability.
20 Any differences in accounting resulting from changes in direction in this project would
21 be captured in the proposed IFRS variance account.

22 23 **7.0 EMPLOYEE FUTURE BENEFITS**

24
25 Under current CGAAP, Hydro One Distribution currently does not recognize any pension
26 related balance sheet accounts, as the Company uses the cash basis of accounting for
27 these transactions. Such accounts would represent the cumulative difference between the
28 Company's pension contributions accounted for on a cash basis, and the costs that would

1 be recognized on an accrual basis under CGAAP. No amount is currently recognized for
2 the related regulatory liability. Further, the Company follows the cash basis of
3 accounting for its pension costs. The current absence of specific guidance on the
4 recognition of regulatory assets or liabilities under IFRS means that any regulatory
5 account balances would not be recognized if the Company is required to adopt the accrual
6 basis for purposes of its Statement of Operations. It is unclear whether the final standard
7 on regulatory assets and liabilities from the IASB will permit the Company to continue
8 following the cash basis of accounting for pension costs. As a result of these
9 uncertainties and for the purposes of this rate application in respect of IFRS for 2011, the
10 Company has continued to apply the cash method of accounting for pensions for
11 purposes of setting the revenue requirement, consistent with past applications. As such,
12 we are requesting a rate treatment for pension consistent with current CGAAP for the
13 purposes of IFRS in 2011. We believe that this is a reasonable assumption given the
14 recent developments in the IASB's rate regulated accounting project.

15
16 For financial reporting purposes, the Company will apply rate regulated accounting to
17 differences between the cash and accrual methods, either as a regulatory asset or liability.
18 Any differences in accounting resulting from changes in direction in this project would
19 be captured in the proposed IFRS variance account.

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21 **8.0 CONCLUSION**

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23 The Company continues to assess the impacts of adopting IFRS. Recent developments
24 at the IASB level since the Board's IFRS stakeholder consultation have caused Hydro
25 One Distribution to re-examine the impacts of IFRS going forward. At this time, Hydro
26 One Distribution believes there will be no change to the costing of work as a result of
27 IFRS given the positive direction of the IASB's rate regulatory accounting project. To
28 the extent unanticipated changes in accounting result after the proposals have been

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Exhibit A

Tab 13

Schedule 1

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- 1 published, Hydro One Distribution would envision such impacts being captured in the
- 2 proposed IFRS variance account.