ONTARIO POWER GENERATION

700 University Avenue, Toronto, Ontario M5G 3X6

August 29, 2013

Mr. Hans Hoogervorst
Chairman of the International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Mr. Hoogervorst,

Re: Exposure Draft ED/2013/5 Regulatory Deferral Accounts

Ontario Power Generation Inc. (OPG) is encouraged by the Exposure Draft on Regulatory Deferral Accounts (ED or interim Standard). We appreciate the urgency with which the International Accounting Standards Board (IASB) has endeavoured to address the concerns of utilities that have not adopted International Financial Reporting Standards (IFRS). OPG is generally supportive of the draft interim Standard, as allowing regulated entities to recognize regulatory balances is critical to the usefulness of their financial statements. The draft interim Standard enables utilities to continue to recognize regulatory balances in their financial statements until the IASB has completed its comprehensive rate-regulated accounting project. The interim Standard aims to accommodate first time adopters, without causing undue changes to existing IFRS preparers. We acknowledge that the technical discussions regarding regulatory assets and liabilities are not within the scope of this interim Standard and that substantial work is still required to complete the longer-term rate-regulated accounting project.

There is a particular concern with the interim Standard that OPG would like to highlight: The presentation of net movements in regulatory deferral accounts is restricted to the Statement of Profit. Under the interim Standard, changes to regulatory deferral accounts, including changes related to pension and other post-employment benefits (OPEB), cannot be recorded in other comprehensive income. This may result in a mismatch between profit and other comprehensive income. For example, an unfavourable change in assumptions, such as a change in discount rate or change in fund returns, which results in higher pension and OPEB liabilities, would give rise to increased profit under the draft interim Standard. This is because such increases in obligations are generally recognized in other comprehensive income under IAS 19, *Employee Benefits*, while the increase to the deferral account regulatory debit balance would be included in profit. We have provided a recommendation in our detailed comments to address this.

It is also recommended that the IASB consider an additional disclosure requirement so that entities are required to provide a description for material regulatory balances, as this would enable users to better understand the nature of the deferral account balances. This type of disclosure is important because the proposed standard may create two types of balances in a regulated entity's financial statements that are similar in nature. The two types of balances could arise as a result of first applying other IFRS Standards, and then applying the interim Standard for incremental amounts.

OPG is of the opinion that regulatory balances best reflect the economics of rate-regulated utilities. Therefore, the inclusion of regulatory assets and liabilities in a regulated entity's financial statement is critical for stakeholder assessment of a utility's financial position and performance.

OPG is a Canadian-based electricity generation company, with approximately 10,000 employees, whose principal business is the generation of electricity in Ontario. OPG's focus is on the efficient production of electricity from nuclear, hydroelectric and thermal generating assets. OPG receives regulated prices for electricity generated from most of its baseload hydroelectric facilities and all of the nuclear facilities it operates (Regulated Facilities). OPG's regulated prices for electricity generated from the Regulated Facilities are determined by the Ontario Energy Board (OEB), an administrative tribunal responsible for the regulation and supervision of the electricity and natural gas industries. The OEB receives authorization to set regulated prices for the Regulated Facilities pursuant to a regulation passed by the Province of Ontario.

Thank you for the opportunity to comment on this interim Standard.

Yours sincerely,

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Question 1

The Exposure Draft proposes to restrict the scope to those first-time adopters of IFRS that recognised regulatory deferral account balances in their financial statements in accordance with their previous GAAP.

Is the scope restriction appropriate? Why or why not?

The scope of the interim Standard is appropriate given that it aims to accommodate first time adopters without causing undue changes to existing IFRS preparers. The interim Standard enables first time adopters to maintain regulatory balances in their financial statements until the IASB has completed its comprehensive rate-regulated accounting project.

Question 2

The Exposure Draft proposes two criteria that must be met for regulatory deferral accounts to be within the scope of the proposed interim Standard. These criteria require that:

(a) an authorised body (the rate regulator) restricts the price that the entity can charge its customers for the goods or services that the entity provides, and that price binds the customers; and

(b) the price established by regulation (the rate) is designed to recover the entity's allowable costs of providing the regulated goods or services (see paragraphs 7–8 and BC33–BC34).

Are the scope criteria for regulatory deferral accounts appropriate? Why or why not?

The scope criteria are appropriate as they establish an identifiable causal effect that links the regulatory deferral account balances to the rate-setting process. The scope criteria set out in the interim Standard are generally comparable to those within US GAAP under Accounting Standards Codification topic 980.

Question 3

The Exposure Draft proposes that if an entity is eligible to adopt the [draft] interim Standard it is permitted, but not required, to apply it. If an eligible entity chooses to apply it, the entity must apply the requirements to all of the rate-regulated activities and resulting regulatory deferral account balances within the scope. If an eligible entity chooses not to adopt the [draft] interim Standard, it would derecognise any regulatory deferral account balances that would not be permitted to be recognised in accordance with other Standards and the *Conceptual Framework* (see paragraphs 6, BC11 and BC49).

Do you agree that adoption of the [draft] interim Standard should be optional for entities within its scope? If not, why not?

An entity should have the option of applying the interim Standard upon initial adoption of IFRS, consistent with other first time adoption exemptions. Given the on-going longer-term project, it would be best for an entity to assess if the application of the interim Standard will enhance comparability and transparency, and more appropriately, reflect its financial position by meeting the information needs of stakeholders.

Question 4

The Exposure Draft proposes to permit an entity within its scope to continue to apply its previous GAAP accounting policies for the recognition, measurement and impairment of regulatory deferral account balances. An entity that has rate-regulated activities but does not, immediately prior to the application of this [draft] interim Standard, recognise regulatory deferral account balances shall not start to do so (see paragraphs 14–15 and BC47–BC48).

Do you agree that entities that currently do not recognise regulatory deferral account balances should not be permitted to start to do so? If not, why not?

This is consistent with the premise of the Standard, which allows entities that currently have regulatory assets and liabilities to continue to recognize them upon initial adoption of IFRS. Entities that did not have an accounting policy to recognize regulatory balances under their previous GAAP prior to the adoption of the interim Standard should not commence recognizing such balances pending the completion of the longer-term project.

Question 5

The Exposure Draft proposes that, in the absence of any specific exemption or exception contained within the [draft] interim Standard, other Standards shall apply to regulatory deferral account balances in the same way as they apply to assets and liabilities that are recognised in accordance with other Standards (see paragraphs 16–17, Appendix B and paragraph BC51).

Is the approach to the general application of other Standards to the regulatory deferral account balances appropriate? Why or why not?

OPG agrees that, in the absence of any specific exemption, or exceptions contained within the interim Standard, other Standards shall apply and not be modified, as the interim Standard is expected to minimize the impact on existing preparers of IFRS.

Question 6

The Exposure Draft proposes that an entity should apply the requirements of all other Standards before applying the requirements of this [draft] interim Standard. In addition, the Exposure Draft proposes that the incremental amounts that are recognised as regulatory deferral account balances and movements in those balances should then be isolated by presenting them separately from the assets, liabilities, income and expenses that are recognised in accordance with other Standards (see paragraphs 6, 18–21 and BC55–BC62).

Is this separate presentation approach appropriate? Why or why not?

As described in the scoping section of the proposed Standard, the draft interim Standard is only applicable to the incremental amounts that would not otherwise be recognized as assets and liabilities under the current IFRS. Assets and liabilities are required to be recognized and measured first by applying other Standards and the *Conceptual Framework for Financial Reporting.* This could result in two types of balances in a regulated entity's financial statements that will be collected through rates, but are presented separately on the financial statement, and measured on a different basis. The interim Standard and its basis of conclusion explained the reason for this decision, noting this potential complexity.

Given this potential issue, we believe it would be prudent to require additional disclosures to enable users to understand the nature of material regulatory balances. Therefore, in addition to the proposed disclosure requirements, it is recommended that the interim Standard include a requirement to provide a description of material regulatory balances to identify the nature of the regulatory accounts.

Question 7

The Exposure Draft proposes disclosure requirements to enable users of financial statements to understand the nature and financial effects of rate regulation on the entity's activities and to identify and explain the amounts of the regulatory deferral account balances that are recognised in the financial statements (see paragraphs 22–33 and BC65).

Do the proposed disclosure requirements provide decision-useful information? Why or why not? Please identify any disclosure requirements that you think should be removed from, or added to, the [draft] interim Standard.

As discussed in Question 6, it is suggested that a description of material regulatory deferral accounts be included in the notes to the financial statements. Overall, the proposed disclosure requirements as drafted in the Standard will enable users to identify differences, and address potential concerns regarding comparability between current IFRS issuers and issuers adopting this Standard.

Question 8

The Exposure Draft explicitly refers to materiality and other factors that an entity should consider when deciding how to meet the proposed disclosure requirements (see paragraphs 22–24 and BC63–BC64).

Is this approach appropriate? Why or why not?

It is appropriate and consistent for management to consider materiality and other factors when assessing the level of disclosure required to adequately inform stakeholders.

Question 9

The Exposure Draft does not propose any specific transition requirements because it will initially be applied at the same time as IFRS 1, which sets out the transition requirements and relief available.

Is the transition approach appropriate? Why or why not?

This approach is reasonable as this Standard is only applicable to first-time adopters.

Question 10

Do you have any other comments on the proposals in the Exposure Draft?

As noted in the cover letter, we have a significant concern that the presentation of net movements in regulatory deferral accounts is restricted to the Statement of Profit. Under the interim Standard, changes to regulatory deferral accounts, including changes related to pension and OPEB, cannot be recorded in other comprehensive income. This can result in a mismatch between profit and other comprehensive income. For example, when there is an unfavourable change in assumptions (such as a change in discount rate or fund returns) which results in higher pension and OPEB liabilities, the application of the proposed Standard would give rise to an increase in profit. This is because such increases in obligations are generally recognized in other comprehensive income under IAS 19, *Employee Benefits*, while the increase to the deferral account regulatory debit balance would be included in profit.

To address this, OPG recommends a modification to paragraph 21 of the ED, allowing the net movement in regulatory deferral accounts to be recorded in profit or other comprehensive income, depending on the underlying nature of the transaction. Accordingly, the illustrative example 3 in the exposure draft should include the statement of comprehensive income and there should be a subtotal under the caption "Comprehensive income before regulatory account movements in other comprehensive income".

Given the volatility of the pension and OPEB liabilities, this amendment would prevent the distortion to profit due to changes to the liabilities and the corresponding change in the regulatory balances being recorded in two different sections or statements. Avoiding this distortion will result in a more meaningful measure of financial performance in the Statement of Profit.