# Briefing Note

**Office of the Provincial Controller Division**

IFRS-US GAAP Differences for OPG and Hydro One

Background
The 2016-17 third quarter update included a commitment to adopt IFRS for purposes of consolidating OPG and Hydro One beginning with the 2017 Budget document.

> In addition, beginning in the *2017 Budget*, the reported revenues related to electricity sector business enterprises will reflect a change in the basis of consolidation from Generally Accepted Accounting Principles in the United States (US GAAP) to International Financial Reporting Standards (IFRS) effective April 1, 2016, consistent with the Auditor General's recommendation. The impact of this change is not expected to be significant for 2016–17.

The 2017 Budget document will include an interim update for fiscal 2016-17, and forecasts for 2017-18, 2018-19 and 2019-20, with more detailed information provided for 2017-18.

IFRS-US GAAP Differences
IFRS-US GAAP differences for both OPG and Hydro One were identified for purposes of the preparation of the 2015-16 public accounts. The impact of the differences on the 2015-16 annual deficit were not material to the financial statements and the impact was disclosed in a note to the financial statements. There were a number of differences identified, but the only difference that is currently expected to be significant to the financial statements over the period of the 2017 Budget is the accounting for Asset Retirement Obligations (AROs) for OPG. OPG recognizes AROs for fixed asset removal and nuclear waste management, discounted for the time value of money.

The primary differences in accounting for AROs are (i) the requirement under IFRS to annually update the discount rate used to determine the present value of the expected future cash flows and (ii) a difference in treatment of certain lifecycle costs that are capitalized and amortized under US GAAP, but expensed under IFRS. A more detailed description of the difference is included in the appendix to this note.

Current Approach for 2017 Budget

The estimates currently available regarding the difference between US GAAP and IFRS on OPG's AROs are noted below. These estimates are being updated by OPG and will be provided to OPCD by March 31, 2017.

**Commented [HK(1]:** Can we please change this to when a revised estimate will be available for inclusion in the budget. For example can we have a revised estimate for numbers lock next week?

| | 2016-17 | 2017-18 | 2018-19 | 2019-20 |
|---|---|---|---|---|
| Decrease in income from GBEs | $75M | $425M | $525M | $675M |
| Included in current version of "Balance Scenario" as of March 21, 2017 | Yes | Yes | No | No |

**Risks/Impacts of Current Approach**

Accountability – The decision to adopt IFRS for purposes of consolidating OPG and Hydro One was announced in February 2017 with the release of the third quarter update. Specific reference was made to the 2017 Budget. Adopting the impact for the current fiscal year and 2017-18 only in the 2017 Budget is not aligned with the commitment made in the third quarter update.

**Commented [HK(2]:** Need to add from an accountability perspective where the numbers will show in the budget for 2018-19 and beyond.

Consistency -- The inclusion of the best estimates of the IFRS-US GAAP differences for only 2016-17 and 2017-18 and exclusion for later years is not internally consistent. The estimate for each year is calculated based on a series of assumptions including the costs expected to be incurred and the future discount rates.

Accuracy -- OPG is in the process of updating the IFRS-US GAAP differences for 2017-18 and the future out years (they have confirmed that the estimate for 2016-17 remains at approximately $75M). While it is not known how accurate the current estimates are, in connection with the receipt of updated information, OPCD will determine what sensitivity analysis can be completed on the out years (e.g. the impact of an x basis point change in the discount rate.)

Pre-election report -- The proposed treatment for the 2017 Budget will not be available to use in the pre-election report. Management issues a Statement of Responsibility with the report, the 2011 version of which included the following statement:

> *The financial estimates in this report have been prepared in accordance with generally accepted accounting principles recommended by the Canadian Institute of Chartered Accountants. The accounting policies are consistent with those used by the Ministry of Finance in preparing the Public Accounts of Ontario.*

Similar representations are made to the Auditor General in connection with the OAG's report on the pre-election report.

**OPCD's Recommendation**

The treatment of the IFRS-US GAAP differences should be included in the 2017 Budget, in each year, on a consistent basis based on revised estimates provided at the end of March.

**Commented [HK(3]:** Last year, OFA didn't take on some sort of forecast from OPG – we should be aware what that was and how it is impacting this year's plan.

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**Date:** March 21, 2017

**Appendix** -- IFRS Nuclear Asset Retirement Obligation Narrative
(excerpt from 2015-16 IFRS-US GAAP Specified Procedures Report)

OPG recognizes asset retirement obligations (AROs) for fixed asset removal and nuclear waste management, discounted for the time value of money.

Under US GAAP, the nuclear ARO is initially recorded at the estimated fair value, which is based on a discounted value of the expected costs to be paid. In addition to accretion expense, the liability is increased by the present value of the incremental cost portion for the nuclear waste generated each year, with the corresponding amounts charged to operating expenses. Changes in the liability resulting from changes in assumptions or estimates that impact the amount or timing of the cash flows are recorded as an adjustment to the liability with the resulting change capitalized as part of the carrying amount of nuclear asset retirement cost (ARC). The liability is not remeasured due to changes in discount rates. Periodic revisions to either the timing or amount of the estimate of undiscounted cash flows underlying the liability balance are treated as separate tranches of the liability. Upward revisions to the estimated cash flows are discounted using the current discount rate. Downward revisions to the estimated cash flows are discounted using historical discount rates reflected in the liability.

Under IFRS, IAS 37, Provisions, Contingent Liabilities and Contingent Assets provides that the provision for a liability should be the best estimate of the expenditure that would be required to settle the obligation as of the balance sheet date. Certain lifecycle costs related to nuclear fixed asset removal and nuclear waste management recognized in OPG's ARO and ARC under legacy Canadian GAAP and US GAAP are not immediately recognized in the ARO and ARC under IFRS and instead are recognized in the ARO at their present value as incremental period expenses over time.

Unlike US GAAP, the ARO is remeasured at each reporting period using a current discount rate under IFRS. The discount rate applied by OPG to measure the nuclear ARO under IFRS reflects the long operating cycle of the nuclear generating assets and related decommissioning and nuclear waste management programs and the maturities of associated commitments, and has been calculated as a simple average of a series of data for the 30-year Ontario bond over a period of 20 years. The 20-year period is based on the 15-year period preceding the most recent comprehensive review of the underlying assumptions and baseline cost estimates for the nuclear ARO undertaken in conjunction with the Ontario Nuclear Funds Agreement (ONFA) reference plan update process, and 5-year period following such reassessment, to coincide with a typical period covered by an approved ONFA reference plan.

Changes in the liability resulting from changes in underlying assumptions or estimates that impact the amount or timing of the cash flows, as well as from changes in discount rates, are recorded as an adjustment to the liability under IFRS. Changes in the liability result in a change to the related carrying amount of nuclear ARC to the extent the adjustment falls under the scope of IFRIC 1, Changes in Existing Decommissioning, Restoration and Similar Liabilities. Other changes to the liability are recorded in operating expenses under IFRS.

On transition to IFRS, OPG recorded adjustments to remove certain lifecycle costs from the nuclear ARO and related ARC that are recognized as incremental period expenses over time. OPG also remeasured the nuclear ARO using a single current discount rate determined under the approach described above and applied the IFRS 1, First-time Adoption of IFRS exemption to estimate the corresponding adjustment to ARC.

OPG recognizes regulatory debits and regulatory credits under IFRS 14, Regulatory Deferral Accounts in respect of nuclear ARO costs, at transition and on an ongoing basis, including when there are changes in assumptions and estimates.

OPG recognizes regulatory debits to the extent that expenses recognized under IFRS in respect of the nuclear ARO are in excess of those previously recovered through regulated prices established by the Ontario Energy Board for OPG’s rate regulated generating facilities, to the extent that these amounts are expected to be included in future revenue through future regulated prices. Regulatory credits are recognized if amounts have been included in revenue through regulated prices in respect of ARO-related expenses that have not yet been recognized under IFRS.

On transition to IFRS, OPG recognized a net increase in deferred income tax assets associated with the adjustments to the nuclear ARO and ARC balances and the regulatory debits and regulatory credits described above. OPG also recognized an offsetting net increase to the regulatory credit balance related to deferred income taxes, to the extent these income taxes that are expected to be reflected in future regulated prices are charged to customers.