

1 Q. **Volume II, Exhibit 11: Depreciation Study**

2 The Depreciation Study describes Hydro’s accounting policy to capitalize site
3 preparation costs, including costs of removal, to the cost of the new asset in
4 replacement projects. Concentric Advisors state, in relation to the collection of
5 these removal costs, “Delaying collection until such costs are incurred results in a
6 charge to customers for plant from which they did not receive service and, as a
7 result of the delay in recovery, also results in higher revenue requirements related
8 to cost of removal.” Please explain how Hydro’s current policy conforms to the
9 principle of intergenerational equity. (Volume II (1st Revision), Exhibit 11:
10 Depreciation Study,
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14 A. This response has been provided by Concentric Advisors.

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16 The manner in which a regulated utility recovers the total service value of an asset
17 in service is a company policy decision which requires the balancing of a number of
18 important considerations. The utility must balance the considerations of regulatory
19 concepts such as generational equity concerns and appropriateness and fairness of
20 customer tolls. At the same time, the regulated utility must ensure that the
21 accounting standards under which it reports are followed, which can result in
22 additional sets of accounting ledgers (for financial disclosure and regulatory
23 reporting); the cost of which must be considered in the development of the
24 company policy.

1 The proposed Hydro policy is best reviewed in two parts. Firstly, the collection for
2 net salvage through depreciation rates for the retirement of assets not being
3 replaced in identical spots within the system, complies with the regulatory
4 principles of generational equity. The total costs of investment (including the
5 estimated costs of retirement) are borne by the users of the Hydro system who are
6 gaining the benefit of having the asset provide utility service. In this circumstance,
7 the net salvage that is collected through depreciation rates complies with the
8 regulatory concepts of generational equity but not with IAS 16. However, the
9 development of specific depreciation rates within the depreciation study for rates
10 that are specific to the recovery of the deemed original cost of investment and
11 separate depreciation rates for the recovery of costs of retirement provide a
12 reasonable method for the utility to report these costs as a regulatory asset under
13 IFRS 14, negating the need for an additional set of accounting ledgers, while still
14 meeting the regulatory principles. It is also noted that the continuation of the
15 current policy of charging cost of removal to income when an asset is not replaced
16 in the same spot is definitely not consistent with the regulatory concept of
17 generational equity.

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19 Secondly, the capitalization of the site preparation costs are clearly a component of
20 the Measurement of Cost standards in IAS 16 of IFRS when there is a specific
21 requirement for site preparation to provide an ability for the installation of the new
22 asset. As such, the Hydro policy to capitalize the costs of retirement for a retired
23 asset when it is being replaced in the exact same spot is a requirement to comply
24 with IAS 16. Given that the compliance with IAS requires a modification to the
25 original cost of the replacement asset, reliance on IFRS 14 (as done in the
26 circumstance of the replacement asset not being in the exact spot as the original
27 asset) is not practicable for site preparation costs. When it is considered that the

1 site preparation costs are specifically required in order for the replacement asset to
2 provide utility service to future customers, it is reasonable from a generational
3 equity point of view to include the site preparation costs (including the removal of
4 retired assets) when it is specifically required for the installation of the replacement
5 asset.