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February 15, 2007

Kyler Wells
Legal Counsel, Corporate Finance
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario, M5H-3S8

Dear Mr. Wells:

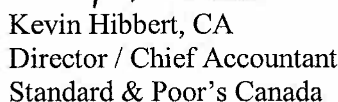
RE: Request for comments on proposed amendments to NP 41-201 "Income trust and Other Indirect Offerings"

Standard & Poor's appreciates the opportunity to share its thoughts on the proposed amendments to NP 41-201. We continue to believe that NP 41-201 in its current form, when viewed in conjunction with the various other staff notices and national policies pertaining to income trust reporting, provides sufficient and appropriate reporting guidance. The proposed amendments to NP 41-201, however, will clarify the existing guidelines by adding a slightly more prescriptive tone to the standards without being overly rules based. The proposed amendments also go a long way in consolidating the CSA's views on income trust reporting under one authoritative document. The principles based approach taken by the CSA, while susceptible to liberal interpretations by some in the income trust space, is our preferred approach to a heavily rules based one. While taking steps to enhance the reporting and disclosure requirements of NP 41-201, we would also encourage the CSA to establish an equal level of resolve in the area of enforcement in order to demonstrate to the capital markets the CSA's commitment to ensuring that the precepts of NP 41-201 are faithfully adhered to by all income trusts.

Although we believe that a principles based approach to financial reporting guidance is the most appropriate strategy, we also believe that there is some merit to increased specificity as it pertains to guidance around key concepts such as distributable cash. In this regard, it would appear that the Canadian Performance Reporting Board's (CPRB) draft interpretive release could be a useful supplement to NP 41-201 as amended. However, we do have certain conceptual and technical concerns regarding the way in which the CPRB defines and quantifies distributable cash. We expressed our concerns to the CPRB in a recent comment letter. The salient points of our comments can be found in the addendum below.

We hope that our thoughts prove valuable to your decision making process.

Sincerely,



Kevin Hibbert, CA
Director / Chief Accountant
Standard & Poor's Canada

Cc: David Wilson, Chair, Ontario Securities Commission
John Carchrae, Chief Accountant, Ontario Securities Commission
Tom Connell, Managing Director, Standard & Poor's Canada

Distributable Cash & "Productive Capacity" Reporting:

- **The CPRB distributable cash calculation is heavy on analytics and ideals and ostensibly requires CFOs to function as analysts rather than in their proper role as reporters of financial results:**

It is Standard & Poor's opinion that the CPRB's distributable cash framework implicitly attempts to present a distributable cash figure that is sustainable for investors or that would at the very least, not jeopardize the income trust's ability to continue as a successful going concern. However, we believe this is outside of the scope of accounting standard setters and should be left to individual investors and analysts to assess with the help of robust, in-depth disclosures by management. A distributable cash figure should be presented in it's most basic form which revolves solely around presenting what was actually generated and available for distribution to investors during the current period. A significant amount of robust disclosures can supplement this basic, to the point distributable cash figure, enabling the investor or analyst to draw their own conclusions around the prudence of management's distribution policies in the context of their own perceptions of sustainability and variability of reported distributable cash.

- **The CPRB requires provisions to be included within the distributable cash calculation for certain material <u>future</u> cash outflows but is silent on how to measure and report <u>current-period</u> material cash outflows within distributable cash:**

The decision whether to include reserves in the distributable cash calculation should be secondary to the more pressing financial reporting issue of income trusts incurring actual cash outflows for current-period sustaining capital expenditures and current-period contractual obligations, without making a corresponding reduction to reported distributable cash figures to reflect the fact that the cash has been spent. Many oil and gas trusts for instance do not include current-period sustaining capital expenditure outflows within their distributable cash calculation--significantly overstating what was actually available for distribution at the time. In an example from the telecom sector, Bell Alliant Regional Communications did not include pension contributions within their distributable cash calculation in 2006, overstating the amount of cash generated and available at the time of distribution. Finally, many REITs have a provision for future sustaining capital expenditures within their distributable cash calculations, but do not report to unitholders what was actually spent in the current period to sustain capital assets.

The notion that income trusts should include a reserve within the distributable cash calculation for future sustaining capital expenditures and contractual commitments is debatable since many of them are capable of funding these material outlays with recurring operating cash flows. If this cannot be done, management will often resort to a sufficiently conservative payout ratio (N.B.: even after making adjustments to address certain reporting distortion effects, we find that some trusts still have fairly conservative payout ratios that could be used to address the outflows mentioned by the CPRB. Peyto Energy Trust is a good example). Consequently, it would be unnecessary for those income trusts to specifically reserve for future commitments that they would otherwise be able to address with recurring operating cash flows at that time, or through a conservative payout ratio. Granted, we are in agreement with the CPRB proposal to require disclosure of the reasons for the existence (or non-existence) of reserves.

We believe that accounting-based measures are meant to depict economic realities, not mandate them--which is what the reserve requirement of the CPRB implicitly entails. Furthermore, if management does not intend to have a physical reserve of cash to address the accounting-based

reserve presentation within the distributable cash calculation, or to economically restrict itself from making distributions in excess of distributable cash (net of the accounting-based reserve) then the reserve requirement could effectively mislead investors into thinking that there is a physical reserve of cash underlying the accounting-based reserve when such cash build-ups might not exist.

Notwithstanding the aforementioned, if management does decide to include an accounting-based reserve in the distributable cash calculation that is indicative of the cash they have actually put aside, or economically plan to hold back, we would like to see a reconciliation between the reserved funds and the actual cash outflow at the time the cash disbursement occurs. We believe that this would provide valuable insight into the adequacy and prudence of management's reserves in retrospect. Especially since the CPRB plan allows normalizing of the productive capacity amounts, the use of significant judgment, and is primarily based on management's own definition of productive capacity--which might not be in lines with an investors observations of the income trusts economic actions.

- **Distributable cash is a theoretical construct under the CPRB's reporting methodology for productive capacity:**

Although we agree with substantially all the sustaining capital expenditure and contractual commitment disclosure proposals of the CPRB--and the CSA for that matter, we believe that the numeric impact on distributable cash calculations should be limited to:

i) Actual sustaining capital expenditure and contractual commitment outflows that occurred during the period that were measurable under GAAP; and

ii) actual cash reserves made by management, or policies adopted by management to economically restrict itself from making distributions in excess of reported distributable cash levels (net of the accounting-based reserve).

We do not support any smoothing or normalizing techniques (including the omission of cash inflows or outflows from discontinued operations) as this would render the distributable cash and related payout figures theoretical concoctions that add little value to the original stated investor objectives the CPRB is attempting to address. If anything, volatility and "lumpiness" of sustaining capital expenditures and legal commitments (including one-off's like cash inflows and outflows from discontinued operations) will underscore to investors the risks and rewards inherent within the cash flows of the income trusts they invest in. This would be similar to how fair value accounting for financial instruments allows investors to appreciate the latent effects of financial instruments and risk management techniques (or the lack thereof) on the balance sheet and income statement of companies they invest in.

Availability Of Distributable Cash:

- **The CPRB definition and calculation of distributable cash is silent on the material reporting distortions evident in using consolidated operating cash flow figures as the starting point to a distributable cash calculation:**

Because consolidation accounting presents the operating entity's cash flows in the aggregate with that of the reporting income trust, it often results in material reporting distortions since the income trust will be consolidating the operating entity's operating cash flows but might not be receiving it in it's entirety. This can occur for instance, if the operating entity has restrictive covenants that prevent it from making certain distribution amounts to the income trust, if capital expenditure initiatives exist at the operating entity level that will be funded internally, or if there are minority interest holders at the operating entity level that are entitled to a portion of the operating cash flows that were consolidated by the income trust.

The overwhelming majority of income trusts use the indirect method of preparing their cash flow statements, which will require them to adjust net income for certain non-cash items such as "minority interest income" in order to get to a GAAP consolidated operating cash figure. The add back of minority interest, however, effectively grosses-up the operating cash flow figure to a level that is neither indicative of the unitholders true entitlements to operating cash flows, or to what was actually available to unitholders at the time of distribution. The actual cash distributions received by the income trust are eliminated on consolidation and hence, visible only under the financing section of the operating entity's cash flow statement. Operating entity financial statements are rarely disclosed by income trusts despite the implicit requirement to do so within NP 41-201 which means that investors and analysts are often left wondering what portion of consolidated operating cash flows were actually received by the income trust at the time of distribution.

We believe that a non-consolidated operating cash flow figure is more meaningful and less susceptible to reporting distortions around the notion of cash availability. For example, a few income trusts such as Enbridge Income Trust (Enbridge) will mention in their MD&A's, the material reporting distortion evident in the consolidated GAAP operating cash flow figure. Rather than using proportionately consolidated operating cash flows from their joint ventures as the starting point to their distributable cash calculation, Enbridge uses the equity-method of accounting instead to ensure that only the cash actually received from the joint venture is reported to investors as being "distributable".

Additional Matters:

- **Financing any non-accretive cash outlay with debt or units is consequential to future distributable cash levels:**

At Standard & Poor's we make no distinction between income trusts that finance distributions with debt or units, and income trusts that finance sustaining capital expenditures with debt or units. This is because unitholder distributions as well as sustaining capital expenditure requirements are material cash outflows that are non-accretive in nature--resulting in incremental distributable cash declines over time if financed with debt or units. The decline in future distributable cash occurs as incremental costs of capital are applied to the financial risk profile of the trust with no corresponding accretion of cash flows. With this in mind, it is not enough to require disclosure of the source of financing for distributions. What would be valuable is a reconciliation of the GAAP operating cash flows generated by the income trust's operating entity, to the amount of current-period sustaining capital expenditures incurred and unitholder distributions made. An income trust with strong enough business risk and financial risk characteristics should be able to fund both of these non-accretive outlays with operating cash flows--preserving the incremental future level of distributable cash in the process. This fact is crucial to highlight for investors. To the extent that additional contractual cash outlays occur for things such as pension contributions or amortizing debt, it would be beneficial to include those outflows within the reconciliation as well.

- **Financial reporting practices of corporate reporters should also be considered:**

At Standard & Poor's we believe that the financial reporting risks evident within the income trust space are no different than in the corporate space. What differs is the response to those risks by investors when reviewing the results of an income trust versus that of a corporation. There is a misconception held by many investors that cash flow figures presented by income trusts are absolute numbers, immune to financial reporting distortion, unlike the supposed accounting influenced earnings figures of corporations. Clearly, this is not the case. We believe that authoritative bodies such as the CPAB and the CSA in conjunction with various market participants have gone to significant lengths to manage investor perceptions through improved reporting and disclosure standards. Going forward, it would be valuable to make use of the lessons learned from this experience while turning attention to the financial reporting practices of corporations. This will ensure that income trusts are not unfairly singled out, and more importantly, ensure that corporate reporting is not given the implicit "thumbs up" by authoritative bodies by virtue of their silence to that sectors financial reporting issues.

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