Preliminary 2011 Revenue Requirements

Appendix B

Accounting Changes

Accounting Changes

This section discusses the developments and implementation of accounting guidance under Canadian Generally Accepted Accounting Principles (“GAAP”) and International Financial Reporting Standards (“IFRS”).

A) Changes to GAAP

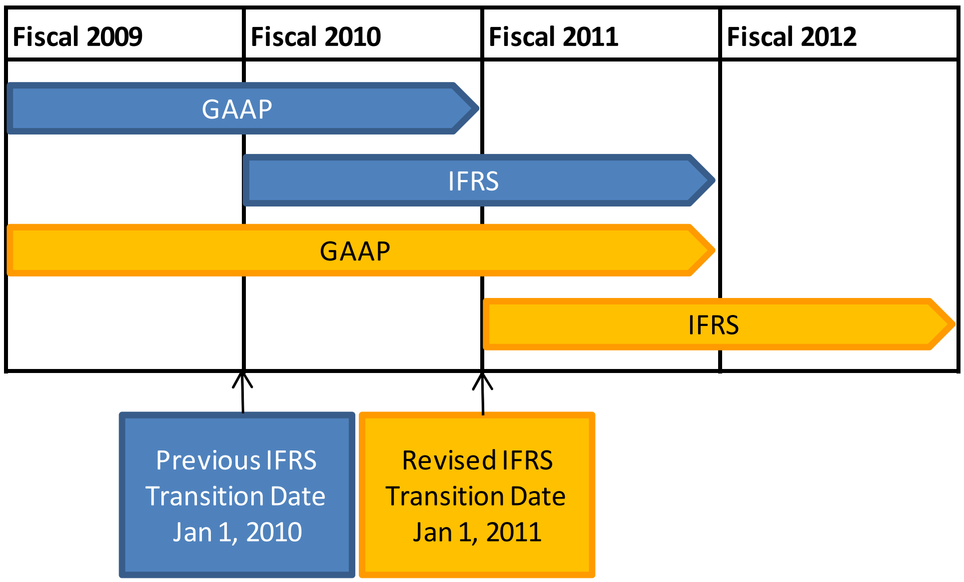
With the intent to facilitate global capital flows and bring greater clarity and consistency to financial reporting in the global marketplace, in February 2008 the Canadian Accounting Standards Board (“AcSB”) confirmed that IFRS would replace GAAP in 2011 for all publicly accountable enterprises in Canada; a classification which includes FortisBC. As a result of the transition to IFRS, there have been no new Canadian accounting standards issued during 2010.

Revised IFRS Transition Date

In September 2010, the AcSB issued a Decision Summary allowing entities with rate-regulated activities to defer the adoption of IFRS until January 1, 2012. This deferral option was meant to give entities with rate-regulated activities sufficient time to meet the requirements of IFRS given the uncertainty surrounding the results of a rate-regulated project carried on by the International Accounting Standards Board (“IASB”) throughout 2010, which would otherwise be FortisBC’s year of IFRS transition. The IASB project on rate-regulated activities is discussed in further detail in Section B below.

FortisBC is intending to elect to defer the adoption of IFRS in the Company’s external financial statements until 2012 with a transition date of January 1, 2011.

Previously, the Company’s January 1, 2011 IFRS adoption date would have required the restatement, for comparative purposes, of amounts reported by the Company for the year ended December 31, 2010, and of amounts reported on the Company’s opening IFRS balance sheet as at the transition date of January 1, 2010. As a result of the September 2010 AcSB Decision Summary, FortisBC’s revised IFRS adoption date will be January 1, 2012 with a transition date of January 1, 2011. A diagram outlining the current and revised transition dates is included below.



B) IFRS

Accounting for Rate-regulated Activities under IFRS

In accordance with GAAP, many entities with rate-regulated activities recognize assets and liabilities arising from the effects of regulation. Currently, IFRS is silent on rate-regulated activities. As a result, entities with rate-regulated activities in Canada preparing to adopt IFRS for the first time are unclear about:

- Whether the deferred charges, regulatory assets, and regulatory liabilities that currently exist on the balance sheet meet the definition of assets and liabilities under existing IFRS guidance;
- Whether these assets and liabilities should be included in an IFRS opening balance sheet; and
- Whether recognizing similar assets and liabilities will continue subsequent to IFRS adoption.

Largely a result of lobbying by the Canadian rate-regulated industry, the IASB initiated a project on rate-regulated activities and, in July 2009, issued an Exposure Draft (“IASB ED”) addressing the recognition, measurement, and disclosure of regulatory assets and regulatory liabilities. The IASB has redeliberated its proposals throughout 2010 based on comments received from global stakeholders and is still divided on the issue of whether regulatory assets and regulatory liabilities should exist under an IFRS framework. Based on results of the IASB's most recent meeting in September 2010, there is no further clarity on the outcome of the project. As a result, there continues to be uncertainty on whether the Company would be able to recognize existing and future deferred charges, regulatory assets, and regulatory liabilities in external financial statements prepared under IFRS.

Impact of IFRS

IFRS and Canadian standards are similar in terms of their conceptual frameworks, form and conclusions. However, at a more detailed level, companies will need to adopt a number of different accounting, reporting and disclosure practices.

The most significant difference currently identified by the Company between IFRS and GAAP relates to the treatment of regulatory assets and liabilities, which has been discussed in "*Accounting for Rate-regulated Activities Under IFRS*" above. Under GAAP, certain amounts that would otherwise be expensed in the current period may be approved by a regulator to be deferred on the balance sheet as regulatory assets to be collected from customers in future periods. Certain amounts received in rates that will be returned to customers in future periods may be approved by a regulator to be accrued on the balance sheet as regulatory liabilities. Under IFRS, there is currently no equivalent authoritative guidance for rate-regulated accounting that explicitly permits the recognition of regulatory assets or liabilities incurred in the ordinary course of business. For example, under GAAP, deferred charges such as revenue protection costs are deferred in the period incurred if they have been approved by a regulator. Under the current interpretation of IFRS, there would likely be a requirement to expense the majority of these costs. As a result, the transition to IFRS is expected to result in significant earnings volatility in external financial statements, adjustments to retained earnings and related debt covenants, and additional resources and costs to maintain two sets of books once IFRS is implemented.

Deferral of Non-Rate Base Items

Although there continues to be uncertainty on the accounting for rate-regulated activities under IFRS there are still some influential stakeholders (primarily the United States rate-regulated industry) who believe that deferrals created as a result of regulation, at least in North America, do meet the criteria of assets and liabilities under the IFRS framework. Moreover, the United States has indicated their intent to move towards a global set of accounting standards and IFRS is the most obvious choice. Before this transition occurs it is presumed that the issue of accounting for rate regulation (among other topics in varying industries) would be ultimately determined.

Despite the uncertainty facing Canadian first-time adopters, there is a presumption that should the Company be able to recognize any type of regulatory deferral, whether under a new or existing IFRS standard, there will need to be explicit support of cost recovery.

Similar to GAAP, when assessing the recognition of a regulatory asset or liability, an entity would still need to consider the probability that a regulator will allow particular costs. In assessing the probability of recovery, the following factors are generally considered as evidence that a regulatory asset or liability may be recognized:

- Statutes or regulations that specifically provide for the recovery of the cost in rates;
- Formal approval from the regulator specifically authorizing recovery of the cost in rates;
- Previous formal approvals from the regulator allowing recovery for substantially similar costs (precedents) for a specific entity or other entities in the same jurisdiction; and
- Uniform regulatory accounting guidance providing for the accounting treatment of various costs that the regulator typically follows in setting rates.

Request for Approval

FortisBC continues to work on a strategy for integrating IFRS into regulatory accounting. Due to the deferral of IFRS to 2012 with a transition date of January 1, 2011, the Company is requesting specific regulatory approval of IFRS differences in 2011. Upon adoption of IFRS in 2012, should certain IFRS differences not be included in customer rates in the year incurred, specific regulatory approval will be required in order to recognize the regulatory asset or liability in the Company's financial statements for future collection or refund in customer rates.

Due to the constantly changing standard-setting environment in accounting for rate-regulated activities under IFRS, the Company would seek further recourse from the BCUC should there be any unexpected changes in the remainder of 2010 and in 2011.

Summary of Differences

Differences between IFRS and GAAP, other than those recognized in this Appendix, may be identified based on further detailed analysis by the Company, auditor interpretation, the outcome of a final standard on accounting for rate-regulated activities, and other changes in IFRS subsequent to the Company's 2011 Revenue Requirements. The full impacts of transitioning to IFRS are expected to continue to be determined throughout 2011.

If additional differences are determined throughout 2011, the Company is requesting approval for any unanticipated adjustments to be captured in a non-rate base IFRS transitional deferral account in 2011 and the recommendations for recognition and settlement will be proposed in the 2012 Revenue Requirements.

Based on the requirements of IFRS as currently assessed, the Company has identified the following differences between IFRS and GAAP that are not included in rate base and require Commission approval to record these differences to non-rate base deferral accounts for the transition year of 2011:

Ref	Non-Rate Base Deferral Account	BCUC IFRS Paper Reference [1]	BCUC Order	Forecast 2011 ($000s) regulatory asset / (regulatory liability)
(i)	Capitalization of Borrowing Costs	4.2		-
(ii)	Capitalization of Depreciation on Assets Used in Construction	4.3(a)	G-162-09	(1,000)
(iii)	Capitalization of the Current Service Cost Component of Pensions and Employee Future Benefits	4.3(b)		-
(iv)	Cessation of Capitalization When Plant Put Into Service	4.3(c)		-
(v)	Property, Plant and Equipment - Gains and Losses on Disposal of Assets	5.1		-
(vi)	Customer Contributions Amortization Rate and Timing	5.2	G-162-09	-
(vii)	Constructive Obligations	5.3		-
(viii)	Depreciation Changes for Property, Plant & Equipment	7.2		-
(ix)	Depreciation of Major Inspections	7.2		-
(x)	Deferred Income Taxes	8.2	G-37-84 G-193-08 G-162-09	101,089
(xi)	Pension and Employee Future Benefit Costs - Cumulative Unamortized Actuarial Gains and Losses Upon Transition	9.1	G-162-09	37,100
(xii)	Pension and Employee Future Benefit Costs - Actuarial Gains and Losses	9.2		-
(xiii)	Pension and Employee Future Benefit Costs - Past Service Costs [2]	9.3	G-162-09	included in (xi)
(xiv)	Pension and Employee Future Benefit Costs - Return on Plan Assets	9.4		-
(xv)	Pension and Employee Future Benefit Costs - Measurement Date [2]	9.5	G-162-09	included in (xi)
(xvi)	Brilliant Power Purchase Agreement Lease Costs			7,900
(xvii)	Brilliant Terminal Station Capital Lease		G-2-04 G-193-08 G-162-09	5,635
(xviii)	Other Post-Retirement Benefits		G-52-05 G-193-08 G-162-09	3,339
(ix)	Trail Office Building Lease		G-41-93 G-193-08 G-162-09	1,104
(xx)	Asset Retirement Obligation ("ARO")			1,071
(xxi)	Financing Costs Under Effective Interest Method			(800)

Note:

[1] Section references relate to the discussion paper filed with the BCUC in June 2009 titled *IFRS: A Summary of Anticipated Impacts of Transition to IFRS on Rate-Regulated Utilities in British Columbia.*

[2] All differences for Pension and Employee Future Benefits are requested to be grouped into one non-rate base deferral account upon transition.

The above forecasted amounts will likely differ from actual amounts due to factors previously mentioned. The forecasted amounts are intended to provide a sense of magnitude to the readers of this application and are referenced in the following section.

With the exception of IFRS conversion costs of $0.2 million included in the 2010 deferred charge Table 1-B in Tab 4 of the 2011 Revenue Requirements and SAP enhancement costs of $0.4 million as approved in the 2009-1010 Capital Expenditure Plan, the proposed deferral items included in this appendix are excluded from rate base and currently not included in the determination of customer rates for 2011.

In June 2009, FortisBC, along with the other primary regulated utility companies in BC, submitted to the BCUC a discussion paper titled *IFRS: A Summary of Anticipated Impacts of Transition to IFRS on Rate-Regulated Utilities in British Columbia*. The following sections summarize the IFRS changes outlined in the paper and how they apply to FortisBC.

(i) Capitalization of Borrowing Costs

Based on the Company's analysis, the difference between what is capitalized currently as AFUDC and the amount that would otherwise be capitalized under IAS 23, *Borrowing Costs,* is immaterial. Therefore it may be possible to continue with current regulatory practice to capitalize AFUDC on assets that take a substantial period of time to place into use and additional deferrals in this area may not be required. However that determination will likely not be finalized until 2011. The Company is requesting approval for any unanticipated adjustments to be captured in a non-rate base IFRS transitional deferral account in 2011 and the recommendations for recognition and settlement will be proposed in the 2012 Revenue Requirements.

(ii) Capitalization of Depreciation on Assets Used in Construction

IAS 16, *Property, Plant & Equipment*, allows the depreciation of certain assets used in the construction of other assets to be capitalized when the future economic benefits embodied in an asset are absorbed in producing other assets. The Company has identified certain vehicles, tools, and other assets that may be used in constructing other assets. The decrease to depreciation expense as a result of capitalizing depreciation of certain assets is estimated to be approximately $1.0 million in 2011. As a result, continued approval of a non-rate base deferral account is requested, with a recommended settlement of the deferred amount to be proposed in the 2012 Revenue Requirements.

(iii) Capitalization of the Current Service Cost Component of Pensions and Employee Future Benefits

The capitalization of these costs will likely not result in any IFRS differences for FortisBC since the Company already includes an appropriate amount of pension and employee future benefit costs in labour loading rates. However, the Company is requesting approval for any unanticipated adjustments to be captured in a non-rate base IFRS transitional deferral account in 2011 and the recommendations for recognition and settlement will be proposed in the 2012 Revenue Requirements.

(iv) Cessation of Capitalization When Plant Put Into Service

FortisBC does not expect any capitalization differences to result between current practice and the requirements of IFRS between when projects become available for use and put into plant in service. However, the Company is requesting approval for any unanticipated adjustments to be captured in a non-rate base IFRS transitional deferral account in 2011 and the recommendations for recognition and settlement will be proposed in the 2012 Revenue Requirements.

(v) Property, Plant and Equipment - Gains and Losses on Disposal of Assets

According to IAS 16, *Property, Plant and Equipment*, gains and losses on disposal of assets are required to be recognized immediately in income instead of current regulatory practice of being charged to accumulated depreciation. As a result, the Company is requesting continued approval to record losses recognized on disposition or retirement of property, plant & equipment ("PP&E") in rate base and to be unwound through rates over the course of the estimated remaining service life of property, plant & equipment.

In accordance with the Commission's Prior Year Directive, as outlined in BCUC Order G-162-09, the Company has identified losses from the disposal of assets as follows:

Actual (Gains) & Losses on Retirement of Property, Plant & Equipment

	12 Months Ending December 31, 2009	7 Months Ending July 31, 2010
	($000s)	
Hydraulic Production	265	-
Transmission Plant	-	-
Distribution Plant	2,108	746
General Plant	430	34
Total	2,804	780

Note: The Company does not forecast retirements, gains, or losses on disposal of property, plant & equipment.

(vi) Customer Contributions Amortization Rate and Timing

FortisBC's current treatment of customer contributions (Contributions in Aid of Construction, or "CIAC") is to recognize as a credit to PP&E, with amortization of the contributions calculated on the deferred balance at the start of the year and recognized as a reduction in depreciation expense over the life of the related assets. International Financial Reporting Interpretations Committee ("IFRIC") 18, *Transfers of Assets from*

Customers, requires the following treatment of CIAC which differs from current regulatory practice:

- Deferred customer contributions should be recognized as a liability, rather than a credit to PP&E, and amortized to revenue, rather than as a reduction to depreciation, over the life of the related assets,
- Amortization of the deferred customer contributions is required at the rate of the related assets, and in the case of FortisBC this would be the depreciation rate associated with distribution assets. If depreciation rates change for IFRS purposes, there could be a rate change from the 3.0% currently used to amortize CIAC.
- Additions to CIAC throughout the year need to be amortized as incurred rather than on the deferred balance at the start of the year.
- There is the possibility of immediate recognition of certain types of CIAC in revenue in the year received.

There is still some investigation required to determine the appropriate application of the IFRS guidance for CIAC. In addition, the IASB has initiated a project on revenue recognition that is expected to address some of the requirements of accounting for customer contributions. The Company is requesting approval for any unanticipated adjustments to be captured in a non-rate base IFRS transitional deferral account in 2011 and the recommendations for recognition and settlement will be proposed in the 2012 Revenue Requirements.

(vii) Constructive Obligations

Based on current analysis, FortisBC does not believe it has any material constructive obligations that will require recognition under IFRS. The Company is of the view that a constructive obligation, as defined under IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, may exist with respect to decommissioning costs that will be incurred when a major portion of our network reaches the end of its useful life. FortisBC may therefore be required to recognize the present value of that obligation as a provision on the balance sheet in accordance with IAS 37 when an estimate of the timing of decommission can be made. However, because FortisBC's network is essentially operated in perpetuity, the date upon which it will be taken out of service is generally not determinable. Therefore the present value of that obligation should be immaterial.

At this time FortisBC has not forecasted any new legal and constructive obligations to be recorded as a result of scope, recognition or measurement criteria defined under IAS 37 other than the asset retirement obligation recognized under GAAP as explained further in item (XX) below. Therefore, there is not expected to be a significant impact on the Company's transition to IFRS in this area. That determination will not be finalized until 2011 when all related IFRS has been issued and interpreted. The Company is requesting approval for any unanticipated adjustments to be captured in a non-rate base IFRS transitional deferral account in 2011 with the proposed recommendations for recognition and settlement to be addressed in the 2012 Revenue Requirements.

(viii) Depreciation Changes for Property, Plant & Equipment

Depreciation requirements under IAS 16, *Property, Plant and Equipment* appear to have many similarities to current regulatory treatment, with the following exceptions:

- Certain group depreciation practices employed by utilities will need to be reviewed to determine if they comply with IFRS;
- IFRS specifically requires that depreciation of assets commence when an asset is available for use; and
- Accounting for components is more rigorously followed under IFRS, therefore to the extent asset classes include components with different lives that would materially impact depreciation, these components must be separately depreciated.

Depreciation expense in the 2011 Revenue Requirements is based on rates agreed upon in the Negotiated Settlement Agreement ("2006 NSA") for the 2006 Revenue Requirements. FortisBC has engaged an external consultant to conduct an updated depreciation study of its plant assets for IFRS purposes, which is scheduled to be complete by the end of 2010. The Company is requesting approval for any unanticipated adjustments relating to depreciation changes to be captured in a non-rate base IFRS transitional deferral account in 2011 and the recommendations for recognition and settlement will be proposed in the 2012 Revenue Requirements.

(ix) Depreciation of Major Inspections

IAS 16, *Property, Plant & Equipment*, recognizes that a condition of continuing to operate an item of PP&E may be performing regular major inspections regardless of whether parts of the item of PP&E are replaced. In these instances, the cost of the major inspection is depreciated separately over its useful life so that it is fully depreciated before the next major inspection occurs. FortisBC performs routine major inspections on its transmission and distribution network as well as its substations. These major inspections occur several times over the life of the related asset, therefore the depreciation rate of these major inspections is higher than the related asset.

The Company is requesting approval for any unanticipated adjustments relating to depreciation of major inspections to be captured in a non-rate base IFRS transitional deferral account as explained in item (viii) above.

(x) Deferred Income Taxes

FortisBC follows the taxes payable method of accounting for income taxes on regulated earnings in accordance with BCUC Order G-37-84:

> *“The Commission has found that the public interest will best be served with a change to "flow-through" accounting for income tax purposes for the Applicant. The change is to occur effective August 1, 1984. The balance of deferred income taxes on the*

books of the Applicant as at July 31, 1984 will remain and be included in the capital structure as zero cost capital."

In addition, certain regulatory assets and deferred charges are recorded net of their income tax impact, with the offset charged to income tax expense. Under this methodology, customer rates do not include the recovery of deferred income taxes related to temporary timing differences between the tax basis of recording regulated assets and liabilities versus their carrying amounts for accounting purposes, other than for the regulatory assets and deferred charges recorded net of their income tax impacts.

Under GAAP FortisBC is required to record a future income tax liability with a corresponding offset to regulatory assets for amounts expected to be included in approved rates charged to customers in the future. Under IFRS, the measurement concept of the deferred income tax liability is not expected to differ materially under IAS 12, *Income Taxes*.

The future income tax liability arises primarily due to the differences between the depreciation rates approved by the Commission for rate setting purposes compared with the rates of depreciation used for the Company's tax calculation purposes. As a result of FortisBC's current capital expenditure plan, the future income tax liability will continue to increase due to these tax timing differences. The effect of the increasing future income tax liability is evident in the 2011 Revenue Requirements where the effective tax rate is approximately 12.2% compared with the statutory rate of 26.5%. The lower effective tax rate is expected to continue and provide a benefit to current customers over the foreseeable future. The future income tax balance would eventually be paid to CRA in future periods when the Company's timing differences reverse.

The Company is not requesting recovery or inclusion of deferred income taxes in rates in the 2011 Revenue Requirements. As a result, continued approval of a non-rate base deferral account is requested for purposes of 2011 Revenue Requirements in the amount of approximately $101 million, with a recommended treatment to be proposed in the 2012 Revenue Requirements. This deferral account will offset the otherwise recognized expense resulting from the future income tax liability arising on the Company's regulated operations. The nature and requested regulatory approval of this account is consistent with what was granted in Schedule 1A of the 2010 Revenue Requirements Negotiated Settlement Agreement.

(xi) Pension and Employee Future Benefit Costs - Cumulative Unamortized Actuarial Gains and Losses Upon Transition

The transition to IFRS requires entities to recalculate historical amounts following guidance in IAS 19, *Employee Benefits*, or they may elect to recognize all cumulative actuarial gains and losses as part of the pension and other post-retirement benefits asset or liability, with an offsetting entry to retained earnings. Based on discussion with the Company's actuary, retrospectively recalculating the amounts that would have been recognized under IFRS is impracticable. Therefore FortisBC is requesting continued approval for a non-rate base deferral account of approximately $37.1 million to recognize all cumulative actuarial gains and losses on transition in 2011, with a recommended settlement to be proposed in the 2012 Revenue Requirements.

(xii) Pension and Employee Future Benefit Costs - Actuarial Gains and Losses

Under IAS 19, *Employee Benefits*, an entity may elect to use a 'corridor' approach that leaves some actuarial gains and losses unrecognized. This method is generally consistent with GAAP and FortisBC will likely be electing to use this 'corridor' approach to minimize actuarial gains and losses. Should there be any further developments to IAS 19 during 2011, such as the elimination of the 'corridor' approach, the Company requests approval for any unanticipated adjustments to be captured in a non-rate base IFRS transitional deferral account in 2011 with the recommendations for recognition and settlement to be proposed in the 2012 Revenue Requirements..

(xiii) Pension and Employee Future Benefit Costs - Past Service Costs

FortisBC proposes to recognize past service costs in accordance with IFRS, which will generally result in immediate recognition since past service costs would already have vested. The Company's unamortized past service costs will require immediate recognition on January 1, 2011. Therefore, FortisBC is requesting continued approval of a non-rate base deferral account for unamortized past service costs to be included in the non-rate base deferral account for employee future benefits on transition in 2011, as per item (XI), with recommended settlement to be proposed in the 2012 Revenue Requirements.

(xiv) Pension and Employee Future Benefit Costs - Return on Plan Assets

FortisBC currently uses fair value to calculate the return on plan assets, which is the required method under IAS 19, *Employee Benefits*. Therefore, there is not expected to be an impact on the determination of the return on plan assets in the Company's pension expense calculations. However, the Company requests approval for any unanticipated adjustments to be captured in a non-rate base IFRS transitional deferral account in 2011 with the recommendations for recognition and settlement to be proposed in the 2012 Revenue Requirements.

(xv) Pension and Employee Future Benefit Costs - Measurement Date

FortisBC currently measures its defined benefit plans as at September 30, which is three months prior to the balance sheet date of December 31. IAS 19, Employee Benefits requires an entity to measure the present value of the defined benefit obligations, and the fair value of any plan assets, at the balance sheet date. In the determination of pension and other post retirement benefits for 2011 Revenue Requirements, the

Company has continued to base the amounts on a measurement date of September 30. In order to comply with IFRS, the Company will be changing its measurement date to December 31 for the fiscal year beginning January 1, 2011 in order to show the comparative 2011 pension and other post retirement benefits based on a December 31 measurement date. The three month “stub period” from October 1, 2010 to December 31, 2010 will be included as part of the re-measurement of the defined benefit obligations, and the fair value of plan assets, at the transition date of January 1, 2011. Therefore FortisBC is requesting continued approval of a non-rate base deferral account for this stub period to be included in the non-rate base deferral account for employee future benefits on transition in 2011, as per item (XI), with recommended settlement to be proposed in the 2012 Revenue Requirements.

Other Non-Rate Base Deferrals

FortisBC is requesting specific regulatory approval to recognize other non-rate base deferrals that are not included in the determination of customer rates for 2011. This request is similar to the approval granted in Schedule 1A of the 2010 Revenue Requirements Negotiated Settlement Agreement. Based on existing BCUC regulatory orders that provide guidance on settlement, FortisBC has recorded certain items to be recovered from customers in future rates in FortisBC's external financial statements. The continued acceptance of these non-rate base deferral items in 2011 and the approval that the deferrals are based on timing differences and will be collected in future customer rates may provide further support for the items to be recognized as regulatory assets or liabilities in 2011 under both GAAP and IFRS.

(xvi) Brilliant Power Purchase Agreement Lease Costs

FortisBC has concluded that the Brilliant Power Purchase Agreement (“BPPA”) meets the criteria of a leasing arrangement under IFRS interpretive guidance (specifically IFRIC 4, *Determining Whether an Arrangement Contains a Lease*) and qualifies as a finance lease under IAS 17, *Leases*. The substance of the BPPA was determined to be an arrangement that contains a lease because the fulfillment of the BPPA is dependent on the use of a specific asset, the Brilliant Plant, and the arrangement conveys the right to use that asset. The effect on the Company's opening IFRS balance sheet as at January 1, 2011 is the recognition of an asset under finance lease in the amount of approximately $260 million with an offsetting obligation under finance lease for an equivalent amount.

Each year subsequent to initial capitalization, the amount previously determined as power purchases under GAAP will be replaced by depreciation on the finance lease asset and interest on the finance lease obligation under IFRS. Initial calculations indicate that these amounts will differ from the amount paid under the BPPA, and as a result approval of a non-rate base deferral account of approximately $7.9 million is requested for the difference in 2011, with a recommended settlement of the deferred amount to be proposed in the 2012 Revenue Requirements.

(xvii) Brilliant Terminal Station Capital Lease

In 2003, the Company entered into a long-term lease of the Brilliant Terminal Station ("BTS"). Under GAAP, the BTS is required to be recorded as a capital lease. However, for regulatory purposes it is treated as an operating lease in accordance with BCUC Order G-2-04:

> *"The Commission approves for Aquila the variance from GAAP to treat the lease obligation for the Brilliant Terminal Station agreement as an operating lease, rather than a capital lease. Approval is granted to Aquila for the establishment of a deferral account for the Brilliant Terminal Station Expense."*

A timing difference exists between the recovery of the capital cost of the BTS, the cost of financing the BTS Obligation and the related operating costs, and the BTS lease payments made on a cash basis (as an operating lease). Therefore the Company is requesting regulatory approval to continue to recognize the timing differences related to the BTS lease in a non-rate base deferral account in the amount of approximately $5.6 million for 2011.

(xviii) Other Post-Retirement Benefits

In prior years, the Company has not collected in customer rates the full accrual cost of other post-retirement benefits. The regulatory other post-retirement benefits non-rate base deferral represents the deferred portion of the expense relating to other post-retirement benefits that is expected to be recovered from customers in future rates as per BCUC Order No. G-52-05, Appendix A:

> *"The Commission Panel notes that the other post-retirement benefits earned each year that were not expensed have already accumulated into a large future liability that continues to increase. However, full compliance and adoption of Section 3461 of the CICA Handbook in 2005 would result in a large rate increase. The Commission Panel denies the request to continue to record other post retirement benefits on a cash basis. The Commission Panel orders a variance from GAAP to require that the transition from the cash basis to accrual accounting for other post-retirement benefits be phased-in over a three-year period."*

Therefore the Company is requesting regulatory approval to continue to recognize a non-rate base deferral account in the amount of approximately $3.3 million for the other post-retirement benefit timing differences in 2011.

(xix) Trail Office Building Lease

Under a sale-leaseback agreement, on September 29, 1993 the Company began leasing its Trail, BC office building for a term of 30 years. The Company is accounting for the lease as an operating lease. The terms of the agreement require increasing stepped lease payments during the lease term. As per BCUC Order G-41-93, the Company recovers the Trail office lease payments from customers and records the lease costs on a cash basis. Under GAAP, the lease payments are to be levelized. The difference is recorded as a regulatory asset, which represents the deferred portion of the lease payments that is expected to be recovered from customers in future rates as the stepped lease payments increase. Therefore the Company is requesting regulatory approval to continue to recognize a non-rate base deferral account in the amount of approximately $1.1 million for lease timing differences in 2011.

(xx) Asset Retirement Obligation ("ARO")

As a result of receiving an approved extension from Environment Canada to comply with PCB Regulations under the Canadian Environmental Protection Act and as a result of interpretation of the regulation that allowed for estimable costs to be developed, FortisBC has recognized an asset retirement cost in property, plant and equipment and an offsetting ARO liability in the amount of approximately $3.4 million in its external financial statements prepared under GAAP. The ARO relates to the removal costs of Polychlorinated Biphenyls ("PCBs") in station equipment and distribution equipment as determined under Environment Canada PCB Regulations. The Company estimates the undiscounted amount of cash flow required to settle the ARO at approximately $4.2M, which will be incurred between 2011 and 2025.

The PCB removal program has been included in the Company's 2011 Capital Expenditure Plan under the project "PCB Environmental Compliance". This capital project is comprehensive in scope and is meant to cover the expected costs of planning, testing, and removing PCB-contaminated oil over the allowable timeframe. In quantifying and estimating the ARO to recognize, FortisBC only included the costs of disposal of used oil since the costs to replace oil and destroyed equipment are capital in nature and not subject to ARO guidance.

The non-rate base asset relates to the depreciation expense on the capitalized asset retirement cost and the accretion expense on the ARO liability that will be recognized between 2011 and 2025. This non-rate base asset will begin to unwind into regulated rate base when PCB Environmental Compliance costs are capitalized into plant in service and depreciated into customer rates. Therefore, approval of a non-rate base deferral account in the amount of approximately $1.1 million is requested for 2011, with a recommended settlement of the deferred amount to be proposed in the 2012 Revenue Requirements.

(xxi) Financing Costs Under Effective Interest Method

CICA 3855, *Financial Instruments - Recognition and Measurement*, requires financing costs to be amortized using the effective interest method, which applies an effective interest rate to determine the amount of expense to be recorded each period. For regulatory purposes, the Company amortizes financing costs using the straight-line method. The regulatory liability represents the cumulative difference between the two amortization methods which will be refunded to customers over the life of the outstanding debt through future rates. Therefore, approval of a non-rate base deferral account in the amount of approximately $0.8 million is requested for 2011, with a recommended settlement of the deferred amount to be proposed in the 2012 Revenue Requirements.