



Preliminary 2010 Revenue Requirements

Appendix B

Accounting Changes

1 **Accounting Changes**

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

5 **Changes to GAAP**

6 Effective January 1, 2009, FortisBC adopted the following new accounting standards
7 issued by the Canadian Institute of Chartered Accountants (“CICA”). There is no impact
8 to earnings reported under Canadian GAAP as a result of adopting these new
9 accounting standards since changes to the income statement have been offset through
10 the recognition of regulatory assets and liabilities for external financial reporting
11 purposes. However, the continued recognition of these regulatory assets and liabilities
12 for external financial reporting purposes depend on the future developments of IFRS
13 and the nature of regulatory approval, both of which are discussed in further detail
14 throughout this appendix.

15 **i. Amendments to Section 1100, *Generally Accepted Accounting Principles***

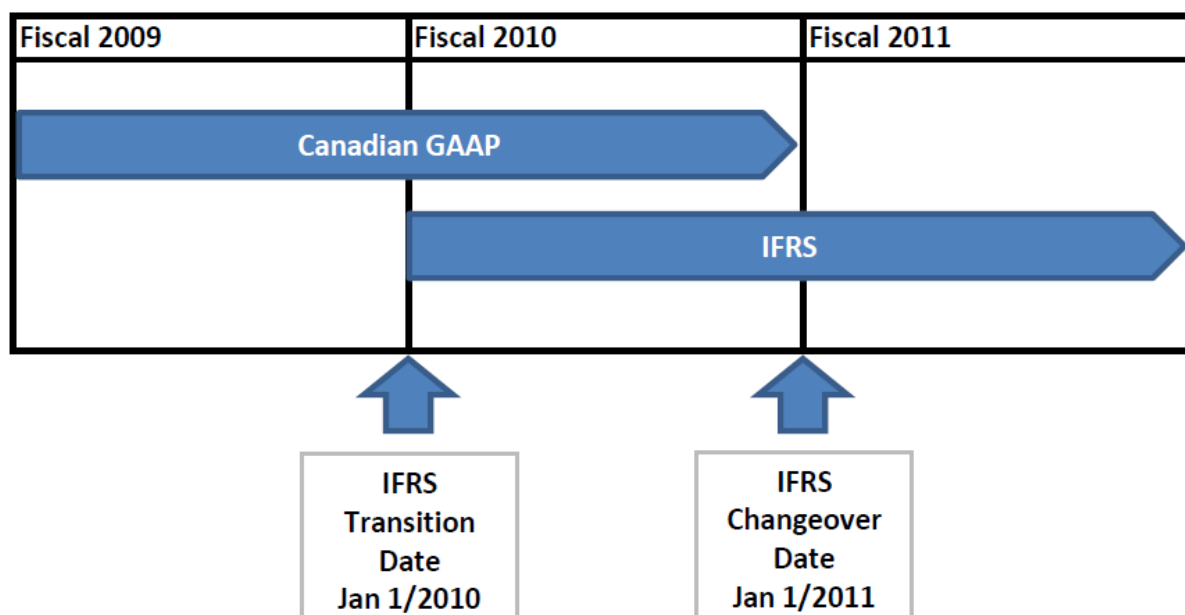
16 The temporary exemption in Section 1100, *Generally Accepted Accounting*
17 *Principles* providing relief to entities subject to rate regulation from the
18 requirement to apply Section 1100 to the recognition and measurement of
19 assets and liabilities arising from rate regulation has been removed. With the
20 removal of the temporary exemption, although some assets and liabilities
21 arising from rate regulation continue to have specific guidance under the
22 CICA Handbook, for those that do not, Section 1100 directs the Company to
23 adopt accounting policies that are developed through the exercise of
24 professional judgment and the application of concepts described in Section
25 1000, *Financial Statement Concepts*. The Company has determined that the
26 regulatory assets and liabilities currently recognized qualify for recognition as
27 assets and liabilities under Section 1000.

ii. Amendments to Section 3465, *Income Taxes*

Section 3465, *Income Taxes* has been amended to require the prospective recognition of future income tax liabilities and assets for rate regulated entities, as well as permitting the recognition of an offsetting regulated asset or liability, for amounts expected to be recovered from or returned to customers in future rates. To date, the Company has not recognized future income taxes for its rate regulated operations as it uses the taxes payable method of accounting for income taxes so that when these amounts become payable, they will be recovered through future rates. As a result, the Company has recorded a deferred income tax liability with a corresponding offset to non-rate base regulatory assets for amounts expected to be included in approved rates charged to customers in the future.

International Financial Reporting Standards

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 Canadian GAAP in 2011 for all publicly accountable enterprises in Canada. In March 2009, the AcSB issued a second Omnibus Exposure Draft confirming that publicly accountable enterprises in Canada, which includes FortisBC, will be required to apply IFRS, in full and without modification, beginning January 1, 2011. The Company’s January 1, 2011 changeover date to IFRS will require 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. A diagram outlining the transition dates is included below.



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

4 The most significant difference currently identified by the Company between IFRS and
 5 GAAP relates to the treatment of regulatory assets and liabilities. Under GAAP, certain
 6 amounts that would otherwise be expensed in the current period are deferred on the
 7 balance sheet as regulatory assets to be collected from customers in future periods.
 8 Certain amounts received in rates that will be returned to customers in future periods
 9 are accrued on the balance sheet as regulatory liabilities. Under IFRS, while there is an
 10 Exposure Draft on *Rate-regulated Activities* which is discussed in the next paragraph,
 11 there is currently no equivalent authoritative guidance for rate-regulated accounting that
 12 explicitly permits the recognition of regulatory assets or liabilities incurred in the ordinary
 13 course of business. For example, under current GAAP, deferred charges such as DSM
 14 costs and revenue protection costs are deferred in the period incurred. There may be a
 15 requirement to expense these costs under IFRS. This transition to new accounting
 16 standards could result in significant earnings volatility, adjustments to retained earnings
 17 and related debt covenants, and additional resources and costs to maintain two sets of
 18 books when IFRS is implemented.

1 **Accounting for Rate-regulated Activities under IFRS**

2 In December 2008, the International Accounting Standards Board (“IASB”) initiated a
3 project on accounting for rate-regulated activities and whether or not rate-regulated
4 entities could or should recognize assets or liabilities as a result of rate-regulation
5 imposed by a regulatory body.

6 On July 23, 2009, the IASB issued an Exposure Draft on *Rate-regulated Activities*.
7 Comments on the Exposure Draft are to be submitted for consideration by the IASB by
8 November 20, 2009. Based on the current project timeline of the IASB, a final standard
9 is expected to be issued in 2010.

10 There is still uncertainty surrounding the interpretation of this Exposure Draft, comments
11 from international stakeholders and accounting firms are yet to be submitted and
12 considered, and the specifics of the final standard on accounting for rate-regulated
13 activities under IFRS is still unknown. However, based on the Exposure Draft as it
14 currently exists, regulatory assets and liabilities may be recognized under IFRS when,
15 as a result of the actions of an independent regulator empowered to set rates, an entity
16 has the right to recover specific previously incurred costs or refund previously collected
17 amounts. While there are still differences that exist between GAAP and IFRS, the
18 ability to record regulatory assets and liabilities, as proposed, may reduce the earnings
19 volatility of FortisBC that may have otherwise resulted under IFRS.

20 One key component of the Exposure Draft relates to the probability of cost recovery.
21 According to the guidance, when assessing the recognition of a regulatory asset or
22 liability an entity needs to determine the probability that a regulator will allow particular
23 costs. In assessing the probability of recovery, the following factors are considered as
24 evidence that a regulatory asset or liability may be recognized:

- 25 • Statutes or regulations that specifically provide for the recovery of the cost in
26 rates;
- 27 • Formal approval from the regulator specifically authorizing recovery of the cost in
28 rates;

- 1 • Previous formal approvals from the regulator allowing recovery for substantially
2 similar costs (precedents) for a specific entity or other entities in the same
3 jurisdiction;
- 4 • Written approval from the regulator (although not a formal approval) approving
5 future recovery in rates; and
- 6 • Uniform regulatory accounting guidance providing for the accounting treatment of
7 various costs that the regulator typically follows in setting rates.

8 Differences between IFRS and GAAP, other than those recognized in this Appendix,
9 may be identified based on further detailed analysis by the Company, auditor
10 interpretation, the outcome of a final standard on accounting for rate-regulated activities,
11 and other changes in IFRS subsequent to the Company's 2010 Revenue Requirements.
12 The full impacts of transitioning to IFRS are expected to continue to be determined
13 throughout 2010 and the Company will communicate these impacts to its stakeholders
14 in its 2011 Revenue Requirements for further discussion and recommendation.

15 Based on the requirements of the Exposure Draft listed above, FortisBC is requesting
16 specific regulatory approval to recognize non-rate base deferral accounts on the
17 transition to IFRS in 2010 as follows:

Ref	Non-Rate Base Deferral Account	BCUC IFRS Paper Reference 5	Approval requested for 2010	Note	BCUC Order	Forecast 2010 (in \$000s) regulatory asset / (regulatory liability)
(I)	Property, Plant and Equipment ("PP&E") - Valuation	3.1 / 3.2	Not at this time	1		
(II)	Overheads Capitalized	4.1	Not at this time	1		
(III)	Capitalization of Borrowing Costs	4.2	Not at this time	1		
(IV)	Capitalization of Depreciation on Assets Used in Construction	4.3(a)	Yes	2		\$ (3,700)
(V)	Capitalization of the Current Service Cost Component of Pensions and Employee Future Benefits	4.3(b)	Not at this time	1		
(VI)	Cessation of Capitalization When Plant Put Into Service	4.3(c)	Not at this time	1		
(VII)	Property, Plant and Equipment - Gains and Losses on Disposal of Assets	5.1	Yes	2		\$ 2,000
(VIII)	Customer Contributions Amortization Rate and Timing	5.2	Yes	2		\$ (510)
(IX)	Constructive and Asset Retirement Obligations ("ARO")	5.3	Not at this time	1		
(X)	Depreciation Changes for Property, Plant & Equipment	7.2	Yes	2		\$ 7,500
(XI)	Depreciation of Major Inspections	7.2	Yes	2		\$ 160
(XII)	Deferred Income Taxes	8.2	Yes	4	G-37-84 G-193-08	\$ 92,050
(XIII)	Pension and Employee Future Benefit Costs - Cumulative Unamortized Actuarial Gains and Losses Upon Transition	9.1	Yes	2,3		\$ 29,890
(XIV)	Pension and Employee Future Benefit Costs - Actuarial Gains and Losses	9.2	Not at this time	1		
(XV)	Pension and Employee Future Benefit Costs - Past Service Costs	9.3	Yes	2,3		included in (XIII)
(XVI)	Pension and Employee Future Benefit Costs - Return on Plan Assets	9.4	Not at this time	1		
(XVII)	Pension and Employee Future Benefit Costs - Measurement Date	9.5	Yes	2,3		included in (XIII)
(XVIII)	Brilliant Terminal Station Capital Lease		Yes	4	G-2-04 G-193-08	\$ 5,090
(XIX)	Other Post-Retirement Benefits		Yes	4	G-52-05 G-193-08	\$ 3,536
(XX)	Trail Office Building Lease		Yes	4	G-41-93 G-193-08	\$ 1,249

Note:

¹ No deferral approval is required at this time, as current regulatory accounting appears consistent with IFRS. However, it will be necessary to finalize during 2010 with possible retroactive deferral recognition required during 2010 (or at a later date) for unanticipated / currently unknown adjustments.

² Recommended settlement will be proposed in the 2011 Revenue Requirements.

³ All differences for Pension and Employee Future Benefits are requested to be grouped into one non-rate base deferral account upon transition.

⁴ Deferral recognition has already been approved by the BCUC through a previous order.

⁵ 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*.

- 1 The above forecast amounts will likely differ from actual amounts due to factors
2 previously mentioned. The forecast amounts are intended to provide a sense of
3 magnitude to the readers of this application and are referenced in the following section.
- 4 The opening IFRS balance sheet date of January 1, 2010 creates some unique
5 challenges as the Company will apply for its 2010 Revenue Requirements consistent
6 with past practice, using GAAP for rate-regulated utilities. However, the Company will
7 also be required to track and recognize its financial performance under IFRS beginning
8 January 1, 2010 in order to be reported as comparative figures in external financial
9 statements in 2011. In order to minimize the impact to retained earnings and related
10 debt covenants, reduce exposure to earnings volatility, and minimize the costs and

1 resources associated with maintaining two sets of books, the Company requests
2 acknowledgment and approval from the regulator of certain non-rate base deferral
3 accounts in 2010 with proposed recommendations for settlements to be addressed in
4 the 2011 Revenue Requirements.

5 With the exception of the IFRS conversion cost included in the deferred charge Table 1-
6 B in Tab 4 of the 2010 Revenue Requirements, the proposed deferral items are
7 excluded from rate base and are not included in the determination of customer rates for
8 2010.

9 In June 2009, FortisBC, along with the other regulated utility companies in BC,
10 submitted to the BCUC a discussion paper titled *IFRS: A Summary of Anticipated*
11 *Impacts of Transition to IFRS on Rate-Regulated Utilities in British Columbia* which is
12 included in Appendix 1 to Appendix B. The following sections summarize FortisBC's
13 approach to each of the IFRS changes that are expected to affect FortisBC.

14 **i. Property, Plant and Equipment ("PP&E") - Valuation**

15 A recently proposed exemption for IFRS 1, *First-time Adoption of IFRS* would
16 allow the use of historical carrying value of PP&E for entities subject to rate
17 regulation as deemed cost on transition if it is otherwise impracticable to restate
18 historical costs for IFRS. However this exemption is not formalized. The recently
19 released Exposure Draft on *Rate-regulated Activities* indicates that rate-regulated
20 entities who hold items of property, plant and equipment in accordance with
21 previous GAAP can elect to use the carrying amount of such an item at the date
22 of transition to IFRS as deemed cost. As a result, the net book value of assets
23 may become the new carrying cost. While there currently may not be any
24 retained earnings adjustments expected as a result of the initial adoption of IFRS
25 as it relates to PP&E, any unanticipated adjustments will be captured in a non-
26 rate base IFRS transitional deferral account in 2010 and the recommendations
27 for recognition and settlement will be proposed in the 2011 Revenue
28 Requirements.

1 **ii. Overheads Capitalized**

2 FortisBC's capitalization of 20 percent of approved operating and maintenance
3 expenses, in accordance with BCUC Order G-58-06, may not entirely qualify as
4 "directly attributable" as described in International Accounting Standard ("IAS")
5 16, *Property, Plant and Equipment*. However, the recently released Exposure
6 Draft on *Rate-regulated Activities* has indicated that certain costs authorized by a
7 regulator to be capitalized as part of the cost of PP&E may continue to be
8 included in the cost of PP&E for IFRS purposes even if some or all of the costs
9 may be better represented as regulatory deferrals. Based on the Exposure Draft
10 as it stands today, current regulatory practice for FortisBC's capitalized overhead
11 may be appropriate and additional deferrals in this area may not be required.
12 That determination will likely not be finalized until 2010, at which time a final
13 IFRS standard on Rate-regulated Activities will have been issued and
14 interpreted. Any unanticipated adjustments will be captured in a non-rate base
15 IFRS transitional deferral account in 2010 and the recommendations for
16 recognition and settlement will be proposed in the 2011 Revenue Requirements.

17 **iii. Capitalization of Borrowing Costs**

18 The recently released Exposure Draft on *Rate-regulated Activities* has indicated
19 that certain costs authorized by a regulator to be capitalized as part of the cost of
20 PP&E may continue to be included in the cost of PP&E for IFRS purposes even if
21 some or all of the costs may be better represented as regulatory deferrals.
22 Therefore it may be possible to continue with current regulatory practice to
23 capitalize AFUDC on assets that take a substantial period of time to place into
24 use and additional deferrals in this area may not be required. However that
25 determination will likely not be finalized until 2010 at which time a final IFRS
26 standard on Rate-regulated Activities will have been issued and interpreted. Any
27 unanticipated adjustments will be captured in a non-rate base IFRS transitional
28 deferral account in 2010 and the proposed recommendations for recognition and
29 settlement will be proposed in the 2011 Revenue Requirements.

1 **iv. Capitalization of Depreciation on Assets Used in Construction**

2 IAS 16, *Property, Plant & Equipment*, allows the depreciation of certain assets
3 used in the construction of other assets to be capitalized when the future
4 economic benefits embodied in an asset are absorbed in producing other assets.
5 The Company has identified certain vehicles, tools, and other assets that may be
6 used in constructing other assets. The decrease to depreciation expense as a
7 result of capitalizing depreciation of certain assets is estimated to be
8 approximately \$3.7 million in 2010, although that determination will likely not be
9 finalized until 2010. Therefore the Company is requesting approval for a non-
10 rate base deferral for the decrease to depreciation for 2010, with a recommended
11 settlement of the deferred amount to be proposed in the 2011 Revenue
12 Requirements.

13 **v. Capitalization of the Current Service Cost Component of Pensions and**
14 **Employee Future Benefits**

15 The capitalization of these costs will likely not result in any IFRS differences for
16 FortisBC since the Company already includes an appropriate amount of pension
17 and employee future benefit costs in labour loading rates.

18 **vi. Cessation of Capitalization When Plant Put Into Service**

19 FortisBC does not expect any capitalization differences to result between current
20 practice and the requirements of IFRS between when projects become available
21 for use and put into plant in service.

22 **vii. Property, Plant and Equipment - Gains and Losses on Disposal of Assets**

23 Since it is not explicitly addressed in IFRS there is still uncertainty around
24 whether gains and losses incurred on the disposal of assets will be permitted to
25 follow current regulatory practice of being charged to accumulated depreciation
26 instead of being immediately taken into income which is required under IAS 16,
27 *Property, Plant and Equipment*. It is estimated that losses incurred on disposal
28 of assets during 2010 will be approximately \$2.0 million. As a result, FortisBC is
29 requesting approval to record gains and losses recognized on disposition or
30 retirement of PP&E in 2010 in a non-rate base deferral account, with a

1 recommendation for settlement to be proposed in the 2011 Revenue
2 Requirements.

3 **viii. Customer Contributions Amortization Rate and Timing**

4 FortisBC's current treatment of customer contributions (Contributions in Aid of
5 Construction or "CIAC") is to recognize as a credit to PP&E, with amortization of
6 the contributions calculated on these deferred balances at the start of the year
7 and recognized as a reduction in depreciation expense over the life of the related
8 assets. International Financial Reporting Interpretations Committee ("IFRIC") 18,
9 *Transfers of Assets from Customers*, which was released in January 2009,
10 requires the following treatment of CIACs which differs from current regulatory
11 practice:

- 12 • Deferred customer contributions should be recognized as a liability,
13 rather than a credit to PP&E, and amortized to revenue, rather than as
14 a reduction to depreciation, over the life of the related assets;
- 15 • Amortization of the deferred customer contributions is required at the
16 rate of the related assets, and in the case of FortisBC this would be the
17 depreciation rate associated with distribution assets. If depreciation
18 rates change for IFRS purposes, there could be a rate change from the
19 3 percent currently used to amortize CIACs; and
- 20 • Additions to CIACs throughout the year need to be amortized as
21 incurred rather than on the deferred balance at the start of the year.

22 As a result of the differences identified above, FortisBC is requesting a non-rate
23 base deferred liability in the estimated amount of approximately \$0.5 million in
24 2010, with a recommendation for settlement to be proposed in the 2011 Revenue
25 Requirements.

1 **ix. Constructive and Asset Retirement Obligations (“ARO”)**

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

13 In the case of interim component replacements made over the course of the
14 network's useful life, the cost of removing and decommissioning these
15 components does not represent a provision to be recognized in accordance with
16 IAS 37. For 2010 external financial statement purposes under IFRS, the
17 Company is proposing to continue its current depreciation methodology, which
18 considers the cost of interim component replacements.

19 At this time FortisBC has not forecast any new legal and constructive obligations
20 to be recorded as a result of scope, recognition or measurement criteria defined
21 under IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

22 Therefore, there is not expected to be a significant impact on the Company's
23 transition to IFRS in 2010. That determination will not be finalized until 2010
24 when all related IFRS has been issued and interpreted. FortisBC is requesting
25 approval for any unanticipated adjustments to be captured in a non-rate base
26 IFRS transitional deferral account in 2010 and the proposed recommendations
27 for recognition and settlement to be addressed in the 2011 Revenue
28 Requirements.

1 **x. Depreciation Changes for Property, Plant & Equipment**

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

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

13 Depreciation expense in the 2010 Revenue Requirements is based on the rates
14 agreed upon in the 2006 NSA. FortisBC has engaged an external consultant to
15 conduct an updated depreciation study of its plant assets for IFRS purposes,
16 which is scheduled to be complete by the end of 2009. The new depreciation
17 rates are expected to increase depreciation for IFRS purposes in 2010, but will
18 not be included in the 2010 Revenue Requirements for the determination of
19 depreciation.

20 The depreciation changes as a result of new components, rates and timing are
21 estimated to increase depreciation expense by as much as approximately \$7.5
22 million in 2010 for IFRS purposes. Therefore the Company is requesting
23 approval of a non-rate base deferral in 2010 for the increase to depreciation in
24 2010 with a recommended settlement of the deferred amount to be proposed in
25 the 2011 Revenue Requirements.

1 **Depreciation of Major Inspections**

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

11 The increase to depreciation expense as a result of the separate depreciation of
12 major inspections is estimated at approximately \$0.2 million in 2010. The
13 Company therefore requests the recognition of a non-rate base deferral account
14 for the increase to depreciation for 2010 with recommended settlement of the
15 deferred amount to be proposed in the 2011 Revenue Requirements.

16 **xi. Deferred Income Taxes**

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

19 *“The Commission has found that the public interest will best be*
20 *served with a change to “flow-through” accounting for income tax*
21 *purposes for the Applicant. The change is to occur effective August*
22 *1, 1984. The balance of deferred income taxes on the books of the*
23 *Applicant as at July 31, 1984 will remain and be included in the*
24 *capital structure as zero cost capital.”*

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

1 purposes, other than for the regulatory assets and deferred charges recorded net
2 of their income tax impacts.

3 As explained in Section A, "Changes to GAAP", effective January 1, 2009,
4 FortisBC is required to record a deferred income tax liability with a corresponding
5 offset to regulatory assets for amounts expected to be included in approved rates
6 charged to customers in the future. Prior to the change in GAAP, the Company
7 had not recognized future income taxes for its rate-regulated operations as it was
8 expected that when these amounts become payable, they would be recovered
9 through future rates. Under IFRS, the measurement concept of the future
10 income tax liability is not expected to differ materially under IAS 12, *Income*
11 *Taxes*.

12 The future income tax liability arises primarily due to the differences between the
13 depreciation rates approved by the Commission for rate setting purposes
14 compared with the rates of depreciation used for the Company's tax calculation
15 purposes. As a result of FortisBC's current capital expenditure plan, the future
16 income tax liability will continue to increase due to these tax timing differences.
17 The effect of the increasing future income tax liability is evident in the 2010
18 Revenue Requirements where the effective tax rate is approximately 10 percent
19 compared with the statutory rate of 28.5 percent. The lower effective tax rate is
20 expected to continue and provide a benefit to customers over the foreseeable
21 future. The deferred income tax balance would eventually be paid to Canada
22 Revenue Agency in future periods when the Company's timing differences
23 reverse. This raises the issue of inter-generational inequity where eventually
24 future customers would pay a higher effective tax rate compared to the statutory
25 tax rate at that time.

26 The Company is not requesting recovery or inclusion of deferred income taxes in
27 rates in the 2010 Revenue Requirements. As a result, for purposes of 2010
28 Revenue Requirements, FortisBC is requesting inclusion of a non-rate base
29 regulatory asset in the amount of \$92.0 million. This non-rate base regulatory
30 asset will offset the otherwise recognized expense resulting from the future

1 income tax liability arising on the Company's regulated operations. The nature of
2 this account is consistent with what was included in Appendix 2 of the 2009
3 Revenue Requirements.

4 **xii. Pension and Employee Future Benefit Costs - Cumulative Unamortized**
5 **Actuarial Gains and Losses Upon Transition**

6 The transition to IFRS requires entities to recalculate historical amounts following
7 guidance in IAS 19, *Employee Benefits* or they may elect to recognize all
8 cumulative actuarial gains and losses as part of the pension and other post-
9 retirement benefits asset or liability, with an offsetting entry to retained earnings.
10 Based on discussions with the Company's actuary, retrospectively recalculating
11 the amounts that would have been recognized under IFRS is impracticable.
12 Therefore FortisBC is requesting approval for a non-rate base deferral account to
13 recognize all cumulative actuarial gains and losses on transition for 2010, with a
14 recommended settlement to be proposed in the 2011 Revenue Requirements.

15 **xiii. Pension and Employee Future Benefit Costs - Actuarial Gains and Losses**

16 Under IAS 19, *Employee Benefits*, an entity may elect to use a 'corridor'
17 approach that leaves some actuarial gains and losses unrecognized. This
18 method is generally consistent with GAAP and FortisBC will likely be electing to
19 use this 'corridor' approach to minimize actuarial gains and losses. Should there
20 be any further developments to IAS 19 during 2010, FortisBC will address the
21 impacts in the 2011 Revenue Requirements.

22 **xiv. Pension and Employee Future Benefit Costs - Past Service Costs**

23 FortisBC proposes to recognize past service costs in accordance with IFRS,
24 which will generally result in immediate recognition since past service costs
25 would already have vested. The Company's unamortized past service costs will
26 require immediate recognition on January 1, 2010. Therefore FortisBC is
27 requesting inclusion of the unamortized past service costs in the proposed non-
28 rate base deferral account for employee future benefits on transition in 2010, as
29 per item (XIII), with recommended settlement to be proposed in the 2011
30 Revenue Requirements.

xv. 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.

xvi. 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 (December 31). In the determination of pension and other post retirement benefits for 2010 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 and show the comparative 2010 pension and other post retirement benefits based on a December 31 measurement date. The three month "stub period" from October 1, 2009 to December 31, 2009 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, 2010. Therefore the Company is requesting inclusion of the pension expense for the three months from October 1, 2009 to December 31, 2009, in the proposed non-rate base deferral account for employee future benefits on transition in 2010, as per item (XIII), with recommended settlement to be proposed in the 2011 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 2010. This request is similar to the approval requested in Appendix 2 on page 11 of the 2008 Annual Review and granted in the 2009 Revenue Requirements Negotiated Settlement Agreement. Based on existing BCUC regulatory orders that provide guidance on

1 recognition and settlement, FortisBC has recorded certain items to be recovered from
2 customers in future rates in FortisBC's external financial statements. The continued
3 acceptance of these non-rate base deferral items in 2010 and the approval that the
4 deferrals are based on timing differences and will be collected in future customer rates
5 may provide further support for the items to be recognized as regulatory assets in 2010
6 under both GAAP and IFRS.

7 **xvii. Brilliant Terminal Station Capital Lease**

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

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

17 A timing difference exists between the recovery of the capital cost of the BTS, the
18 cost of financing the BTS Obligation and the related operating costs, and the
19 BTS lease payments made on a cash basis (as an operating lease). Therefore
20 the Company is requesting regulatory approval to continue to recognize the
21 timing differences related to the BTS lease in a non-rate base deferral account
22 for 2010.

23 **xviii. Other Post-Retirement Benefits**

24 In prior years, the Company has not collected in customer rates the full accrual
25 cost of other post-retirement benefits which differs from the GAAP and IFRS
26 requirements to record at full accrual costs. The regulatory other post-retirement
27 benefits non-rate base deferral represents the deferred portion of the expense
28 relating to other post-retirement benefits that is expected to be recovered from
29 customers in future rates as per BCUC Order No. G-52-05, Appendix A:

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

11 Therefore FortisBC is requesting regulatory approval to continue to recognize a
12 non-rate base deferral for the other post-retirement timing differences in 2010.

13 **xix. Trail Office Building Lease**

14 Under a sale-leaseback agreement, on September 29, 1993 the Company began
15 leasing its Trail, BC office building for a term of 30 years. The Company is
16 accounting for the lease as an operating lease. The terms of the agreement
17 require increasing stepped lease payments during the lease term. As per BCUC
18 Order G-41-93, the Company recovers the Trail office lease payments from
19 customers and records the lease costs on a cash basis. Under GAAP and IFRS,
20 the lease payments are to be levelized. The difference is recorded as a
21 regulatory asset, which represents the deferred portion of the lease payments
22 that is expected to be recovered from customers in future rates as the stepped
23 lease payments increase. Therefore the Company is requesting regulatory
24 approval to continue to recognize a non-rate base deferral for lease timing
25 differences in 2010.



International Financial Reporting Standards (IFRS):

A Summary of Anticipated Impacts of Transition to IFRS on Rate Regulated Utilities in British Columbia

10 June 2009

1	TABLE OF CONTENTS	
2	1.0	Introduction 4
3	1.1	Background 4
4	1.2	Purpose 5
5	1.3	Limitations..... 6
6	2.0	Regulatory Assets and Liabilities (Deferral Accounts) (updated 30 April 2009) 9
7	2.1	Canadian GAAP 9
8	2.2	International Financial Reporting Standards 10
9	3.0	Property, Plant and Equipment - Valuation (updated 30 April 2009) 13
10	3.1	Initial Adoption of IFRS..... 13
11	3.2	After Transition to IFRS 14
12	3.2.1	Canadian GAAP 14
13	3.2.2	International Financial Reporting Standards 14
14	4.0	Property, Plant and Equipment - Capitalization (updated 30 April 2009) 16
15	4.1	Capitalization of Overhead Costs..... 16
16	4.1.1	Canadian GAAP 16
17	4.1.2	International Financial Reporting Standards 16
18	4.2	Capitalization of Borrowing Costs..... 16
19	4.2.1	Canadian GAAP 16
20	4.2.2	International Financial Reporting Standards 17
21	4.3	Other Capitalization Differences..... 17
22	5.0	Property, Plant and Equipment - Other Items (updated 30 April 2009)..... 18
23	5.1	Gains and Losses on Disposal of Assets 18
24	5.1.1	Canadian GAAP 18
25	5.1.2	International Financial Reporting Standards 18
26	5.2	Customer Contributions..... 19
27	5.2.1	Canadian GAAP 19
28	5.2.2	International Financial Reporting Standards 19
29	5.3	Asset Retirement Obligations 19
30	5.3.1	Canadian GAAP 19
31	5.3.2	International Financial Reporting Standards 19
32	6.0	Provisions, Legal and Constructive Obligations (updated 30 April 2009)..... 21
33	6.1	Legal and Constructive Obligations..... 21
34	6.1.1	Canadian GAAP 21
35	6.1.2	International Financial Reporting Standards 21
36	6.2	Criteria for Recognizing a Provision 22

1	6.2.1	Canadian GAAP	22
2	6.2.2	International Financial Reporting Standards	22
3	6.3	Measurement of a Provision.....	22
4	6.3.1	Canadian GAAP	22
5	6.3.2	International Financial Reporting Standards	23
6	7.0	Depreciation (updated 30 April 2009).....	24
7	7.1	Canadian GAAP	24
8	7.2	International Financial Reporting Standards	24
9	8.0	Income Taxes (updated 30 April 2009).....	27
10	8.1	Canadian GAAP	27
11	8.2	International Financial Reporting Standards	27
12	9.0	Pension and Employee Future Benefit Costs (updated 30 April 2009).....	29
13	9.1	Initial Adoption of IFRS.....	29
14	9.2	Actuarial Gains and Losses.....	30
15	9.2.1	Canadian GAAP	30
16	9.2.2	International Financial Reporting Standards	30
17	9.3	Past Service Costs.....	31
18	9.3.1	Canadian GAAP	31
19	9.3.2	International Financial Reporting Standards	31
20	9.4	Return on Plan Assets	31
21	9.4.1	Canadian GAAP	31
22	9.4.2	International Financial Reporting Standards	32
23	9.5	Measurement Date	32
24	9.5.1	Canadian GAAP	32
25	9.5.2	International Financial Reporting Standards	32
26	9.6	Summary of Pensions and Employee Future Benefits.....	33
27	10.0	Conclusion	34

28
29

LIST OF TABLES

30	Table 1. Summary of Standards and Interpretations Expected to Change in the Next Two	
31	Years	7
32	Table 2. Project Milestones.....	10
33	Table 3. On Transition PP&E: Alternatives and Implications.....	14
34	Table 4. PP&E Valuation: Alternatives and Implications	15
35	Table 5. On Transition Pension and Employee Future Benefit Costs: Alternatives and	
36	Implications	29
37	Table 6. Actual Gains or Losses: Alternatives and Implications.....	31

1

2

LIST OF APPENDICES

3 Appendix A: The CICA's Guide to IFRS in Canada

1 **1.0 Introduction**

2 **1.1 Background**

3 The financial records of publicly accountable utilities in British Columbia that are
4 regulated by the British Columbia Utilities Commission (Commission) are maintained
5 in accordance with Generally Accepted Accounting Principles (GAAP) and are audited
6 by independent public accounting firms. As GAAP moves from Canadian standards to
7 IFRS, those utilities will adapt their financial records to meet the requirements of the
8 new standards. There are a number of differences between IFRS and current
9 Canadian GAAP which could have material impacts on the accounting values
10 reported in those financial records. In addition, since IFRS, like Canadian GAAP, is
11 principles-based, how specific utilities interpret and implement the standards may
12 differ.

13 These impacts can be summarized under three categories. With the exception of the
14 third category, the changes from Canadian GAAP to IFRS do not affect total costs to
15 be recovered from ratepayers, but the standards do change the timing of when those
16 costs might be recovered in rates.

17 (a) Transitional adjustments

18 For financial statement purposes, the transition to IFRS will result in
19 adjustments to a utility's opening retained earnings. The impact of those
20 adjustments on future rates needs to be determined.

21 (b) Ongoing differences

22 Ongoing differences in the timing of recognition of certain transactions under
23 IFRS will result. This could give rise to short-term volatility in rates and/or
24 earnings, depending on the use of deferral accounts.

1 (c) Additional costs

2 Costs will arise in connection with the conversion itself and may include
3 additional internal resources, external consulting and IT systems costs. In
4 addition, ongoing compliance costs may increase due to additional
5 reconciliation and assurance requirements, including external audit fees due to
6 assurance over new disclosure and the duplicate audit opinion required for
7 2010 (includes Canadian GAAP opinion in 2010 and IFRS opinion for current and
8 comparative 2010 year for 2011).

9 IFRS adoption will be required for publicly accountable utilities for the first fiscal
10 period beginning on or after January 1, 2011, with comparative amounts for the prior
11 year restated to be compliant with IFRS. As a result, utilities will only be able to
12 provide regulatory schedules prepared under IFRS for this comparative year and
13 going forward. The availability of the 2010 comparative IFRS financial statements will
14 vary among utilities. At a minimum, the 2010 comparatives will be available in 2011
15 as required. There will also be transitional adjustments to meet the requirements of
16 IFRS 1 First Time Adoption of IFRS. The timing of when utilities may seek to recover
17 these differences may vary depending on the timing of their own revenue
18 requirements applications and the materiality of each item to each utility.

19 **1.2 Purpose**

20 The purpose of this report is to provide a summary of those differences between
21 Canadian GAAP and IFRS that have been identified by the Utilities IFRS Working
22 Group (described below) as having the most significant impact on regulatory
23 accounting and rate making. This summary could then be referred to by the utilities
24 in their various filings and related discussions on IFRS accounting impacts.

25 The Utilities IFRS Working Group was created as a venue for discussion of IFRS issues,
26 evaluation of alternatives, and how those alternatives could be implemented in the
27 financial systems, accounting practices, and regulatory practices of the member

1 utilities. The utilities involved in the Group are BC Hydro, BC Transmission
2 Corporation, FortisBC, Terasen Gas, and Pacific Northern Gas.

3 **1.3 Limitations**

4 This report should only be used for the purpose set out above, and is intended for
5 use as information by the accounting, financial and regulatory personnel of the
6 utilities in the Utilities IFRS Working Group, Commission staff, and intervenors or
7 other interested parties. It should be noted that the individual utilities in the Utilities
8 IFRS Working Group may not adopt all interpretations in this document.

9 The following matters have been specifically excluded from the report:

- 10 (a) Recommendations by the Utilities IFRS Working Group on which IFRS
11 alternative is preferred;
- 12 (b) Discussion of how these IFRS changes may be implemented in revenue
13 requirements applications and other filings;
- 14 (c) A comprehensive discussion of all IFRS changes, many of which may have an
15 impact on some utilities. See Appendix A for an extract from the website of the
16 Canadian Institute of Chartered Accountants, which compares IFRS to Canadian
17 GAAP and includes a listing of the individual standards and interpretations.

18 As with all accounting standards, IFRS will continue to evolve over time, whereas this
19 document has been prepared as of the date specified on the cover title page and
20 each section will be updated as required. For pending changes to standards and
21 major projects, the International Accounting Standards Board (IASB) has prepared a
22 work plan outlining its estimate of document publication dates. See the table below
23 for a summary of those standards and interpretations expected to change in the next
24 two years.

1
2

Table 1. Summary of Standards and Interpretations Expected to Change in the Next Two Years

	Changes Likely To Be Available Before the End of 2009	Changes Likely To Be Available In 2010 - 2011
1	Group Cash-settled Share-based Payment Transactions (Q2 2009)	Financial Instruments (2010)
2	Joint Ventures (Q3 2009)	Fair Value Measurement Guidance (2010)
3	First-time Adoption of IFRS (Q3 2009)	Income Taxes (2010)
4	Related Party Disclosures (Q3 2009)	Rate-regulated Activities (2010)
5	Discontinued Operations (Q4 2009)	Earnings per Share (2010)
6	Consolidation (Q4 2009)	Management Commentary (2010)
7	Emissions Trading Schemes (Q4 2009)	Derecognition of Financial Assets (2010)
8	Liabilities (Q4 2009)	Financial Statement Presentation (2011)
9	Financial Instruments - Characteristics of Equity (Q4 2009)	Insurance Contracts (2010)
10		Leases (2011)
11		Post-employment Benefits (2011)
12		Revenue Recognition (2011)

3

4

This document will be updated periodically to reflect the issuance of new standards or interpretations, but cannot be assumed to reflect current IFRS at any point in time.

5

6

The following sections summarize the IFRS impacts that are relevant to those items that are generally included in the rate-setting methodology. Some utilities earn a return based on capital structure, while others earn a return on rate base. Depending on the rate-setting methodology of the individual utility, the application of accounting standards under either Canadian GAAP or IFRS could have different impacts.

7

8

9

10

11

12

Throughout this document references are made to applicable Canadian GAAP and IFRS sections. Canadian GAAP and IFRS references should be read as the section followed by the paragraph number. For example, "CICA 3061.16" should be read as section 3061, paragraph 16, of the CICA Handbook. It should be noted that the IFRS references include "IFRS", "IAS" and "IFRIC" sections. These three should be read in

13

14

15

16

1 a similar format as Canadian GAAP with the standard or interpretation number
2 followed by the paragraph number. For example, “IAS 23.8” should be read as
3 standard number 23, paragraph 8, of the International Accounting Standards.

4 International Accounting Standards (IAS) were issued by the predecessor body of the
5 IASB, the International Accounting Standards Committee (IASC) prior to 2002. Since
6 that time, the IASB has issued IFRSs, although both have the same authority.

7 Interpretations issued by the International Financial Reporting Interpretation
8 Committee (IFRIC) are essentially additional guidance or interpretations provided on
9 newly identified financial reporting issues not specifically addressed in IASB
10 Standards. IFRICs are analogous to interpretations issued by the Emerging Issues
11 Committee (EIC) under Canadian GAAP.

1 **2.0 Regulatory Assets and Liabilities (Deferral Accounts) (updated 30 April 2009)**

2 The use of deferral accounts is a recognized component of rate making, allowing
3 costs and revenues to be matched and streamed to ratepayers over the period to
4 which they relate, to allow for reduced exposure to volatility in rates, and to
5 neutralize or dampen the impacts of forecast error on items that the utility has little
6 or no control over.

7 **2.1 Canadian GAAP**

8 *Based on standards issued as of: April 30, 2009*

9
10 Effective January 1, 2009, Canadian GAAP was revised to remove a temporary
11 exemption from applying Canadian GAAP to the recognition of assets and liabilities
12 resulting from rate regulation (CICA 1100.32B). In the absence of guidance available
13 under Canadian GAAP, rate regulated utilities in Canada are permitted to apply US
14 Statement of Financial Accounting Standards No. 71 *Accounting for the Effects of*
15 *Certain Types of Regulation*, which allows the recognition of rate regulated assets
16 and liabilities under the following circumstances.

- 17 (a) The enterprise's rates for regulated services or products provided to its
18 customers are established by or are subject to approval by an independent,
19 third-party regulator or by its own governing board empowered by statute or
20 contract to establish rates that bind customers;
- 21 (b) The regulated rates are designed to recover the specific enterprise's costs of
22 providing the regulated services or products;
- 23 (c) In view of the demand for the regulated services or products and the level of
24 competition, direct and indirect, it is reasonable to assume that rates set at
25 levels that will recover the enterprise's costs can be charged to and collected
26 from customers. This criterion requires consideration of anticipated changes in

1 levels of demand or competition during the recovery period for any capitalized
2 costs.

3 **2.2 International Financial Reporting Standards**

4 *Exposure Draft expected: July 2009*

5 *Rate-regulated Activities final standard expected: During 2010*

6
7 Currently, IFRS do not explicitly recognize the economic effect of rate regulation
8 through the existence of deferral and variance accounts, unlike US standards.
9 Instead, individual accounts should be assessed under the International Accounting
10 Standards Board's Conceptual Framework to determine if they meet the definition of
11 an asset or a liability.

12 However, in July 2009, the International Accounting Standards Board (IASB) is
13 expected to issue an Exposure Draft on Rate-regulated Operations, which if issued as
14 a standard would allow recognition of these deferral and variance accounts under
15 certain circumstances. There are a number of steps for the Exposure Draft to go
16 through before it becomes a Standard, as illustrated in the following table. The
17 publication of the final standard is not expected until June 2010, and until that time
18 any of the recommendations included in preliminary discussions or drafts will be
19 subject to change.

20 **Table 2. Project Milestones**

	Date	Project Milestone
1	April 2009	Major decisions finalised
2	May 2009	Pre-ballot draft provided to Board members
3	June 2009	Board meeting to discuss remaining technical issues and any other sweep issues
4	July 2009	Publication of Exposure Draft with 120-day comment period
5	November 2009	Comment Letter due date
6	January 2010	Begin re-deliberation of Comment Letter analysis
7	June 2010	Publication of final standard
8	January 2011	Effective date

1

2 The Exposure Draft would be confined to those rate-regulated entities that meet the
3 following criteria:

4 (a) Where an authorized body is empowered to establish rates that bind
5 customers;

6 (b) Where the rate regulation takes the form of cost-of-service regulation.

7 Further, for a cost to be included in the determination of rates, it must be
8 “allowable”. Allowable costs are usually defined as actual or estimated costs for
9 which revenue is intended to provide recovery. Allowable costs include interest costs
10 and a reasonable return on shareholders’ investments (Allowance for Funds Used
11 During Construction).

12 At the Board meeting in April, the Board discussed recognition and measurement,
13 presentation and disclosure and additional scope issues of this project. The following
14 is an extract of the meeting summary from the IASB website.

15 “Recognition and measurement

16 The Board tentatively decided that assets and liabilities recognized as a result
17 of rate regulation should be excluded from the scope of IAS 38 Intangible
18 Assets and IAS 37 Provisions, Contingent Liabilities and Contingent Assets
19 respectively. Once the entity has determined that its activities are in the
20 scope of the project, the effects of rate regulation should be recognized,
21 therefore there is no requirement for specific recognition criteria.

22 The Board decided tentatively that a probability-weighted average of possible
23 future cash flows should be used to measure assets and liabilities recognized
24 as a result of rate regulation both on initial recognition and at each
25 subsequent reporting date.

1 Presentation and disclosure

2 The Board decided tentatively that regulatory assets and liabilities should not
3 be offset in the statement of financial position. Additionally, when an entity
4 presents a classified statement of financial position, it should distinguish
5 between current and non-current assets and liabilities recognized as a result
6 of rate regulation.

7 Additional scope considerations

8 The Board agreed tentatively with the staff recommendation that the
9 standard should include guidance on the application of the scope criteria.”

1 **3.0 Property, Plant and Equipment - Valuation (updated 30 April 2009)**

2 Amounts recognized as Property, Plant and Equipment (PP&E) under IFRS can differ
3 from current Canadian GAAP both at the time of initial adoption and after transition
4 to IFRS.

5 **3.1 Initial Adoption of IFRS**

6 *Based on standards issued as of: April 30, 2009*
7 *Exposure Draft Additional Exemptions for First-time Adopters issued: September 2008*
8 *IFRS 1 final amendments expected: Q3 2009*

9
10 First time adoption of IFRS generally requires that a company restate its results as if
11 IFRS accounting policies have always been applied (IFRS 1.10, IFRS 1.11). For most
12 utilities that have been providing service to customers for many years, it would be an
13 extremely costly and time-consuming, if not impossible, task to restate as many as
14 fifty or sixty years of transactions to be compliant with IFRS. For this reason, there
15 are exemptions to this requirement under IFRS 1, specifically for items of PP&E:

16 (a) On transition to IFRS, a utility may elect to measure PP&E at its fair value and
17 use that as its deemed cost (IFRS 1.30, IFRS 1 D5).

18 (b) A proposed exemption, that a rate regulated utility may use historical carrying
19 value of property, plant and equipment as its deemed cost on transition, if it is
20 **impracticable** to determine the fair value or to restate historical costs for IFRS.
21 This exemption may be extended to apply to those intangible assets that had
22 been classified as PP&E prior to adoption of the IFRS-compliant Handbook
23 Section 3064. (Exposure Draft issued September 2008 Additional Exemptions
24 for First-time Adopters)

1

Table 3. On Transition PP&E: Alternatives and Implications

	Alternative	Implications for Utilities
1	Historical Cost	No conversion activities necessary
2		Availability dependent on meeting the requirements of the final IFRS 1 exemption which is not yet approved
3	Retrospective Restatement	Significant time and effort required to identify and segregate the non-compliant historical costs
4		Transition differences to be addressed
5	Fair Value	Significant time and effort required to determine fair value
6		Transition difference to be addressed

2

3 Although most utilities would elect to use historical carrying value as deemed cost on
 4 transition if possible, the current wording of the proposed exemption is problematic.
 5 Comments have been provided back to the standard setters on two issues. One is to
 6 seek clarification of the word “impracticable” and the other is to determine if the
 7 proposed exemption would extend to items that were previously recognized as PP&E
 8 under Canadian GAAP but have since been classified as Intangible Assets (items such
 9 as computer software, rights of way).

10 On transition utilities will be required to perform an impairment test and record any
 11 impairment losses that may exist at that date.

12 **3.2 After Transition to IFRS**

13 **3.2.1 Canadian GAAP**

14 *Based on standards issued as of: April 30, 2009*

15

16 Under Canadian GAAP, PP&E is recorded based on actual historical costs (CICA
 17 3061.16), which at any point in time represents many years of capitalized costs and
 18 applied depreciation policies.

19 **3.2.2 International Financial Reporting Standards**

20 *Based on standards issued as of: April 30, 2009*

1
2 Under IFRS, a company has the option of choosing either the cost model or the
3 revaluation model for valuation of property, plant and equipment (IAS 16.29). Under
4 the cost model, PP&E is carried at cost less accumulated depreciation and
5 accumulated impairment losses. Under the revaluation model, where the fair value
6 of PP&E can be measured reliably, that item can be carried at fair value less any
7 subsequent accumulated depreciation. The appropriate method of measuring fair
8 value may require the use of professionally qualified valuers.

9 **Table 4. PP&E Valuation: Alternatives and Implications**

	Alternative	Implications for Utilities
1	Cost model	Status quo
2	Fair value model	Effort to maintain and update fair value records
3		Difficulties in determining fair value
4		Increased volatility in rate base and reported earnings
5		Possible multiple sets of books

10

1 **4.0 Property, Plant and Equipment - Capitalization (updated 30 April 2009)**

2 **4.1 Capitalization of Overhead Costs**

3 **4.1.1 Canadian GAAP**

4 *Based on standards issued as of: April 30, 2009*

5

6 Currently, utilities report PP&E based on cost plus an element of general and
7 administrative expenses (CICA 3061.20), some of which is applied to PP&E through an
8 overhead capitalization rate, and some of which is directly charged to capital through
9 internal accounting processes.

10 **4.1.2 International Financial Reporting Standards**

11 *Based on standards issued as of: April 30, 2009*

12

13 In the future, IFRS requires that additions to PP&E continue to be recorded at cost,
14 but has further defined cost to include only items that are **directly attributable** to the
15 asset (IAS 16.16b). Therefore, costs related to administration and general overhead
16 would be excluded (IAS 16.19d).

17 Utilities will be required to evaluate all costs that are currently capitalized to
18 determine if they meet the definition of “directly attributable”.

19 **4.2 Capitalization of Borrowing Costs**

20 **4.2.1 Canadian GAAP**

21 *Based on standards issued as of: April 30, 2009*

22

23 Under current GAAP, carrying costs, such as interest, that are directly attributable to
24 the construction of an asset may be capitalized (Interest During Construction or IDC)
25 (CICA 3061.23). Utilities are alternatively allowed to capitalize an allowance for funds
26 used during construction (AFUDC) (CICA 3061.23).

1 **4.2.2 International Financial Reporting Standards**

2 *Based on standards issued as of: April 30, 2009*

3
4 Under IFRS, borrowing costs that are incurred in relation to an asset that takes a
5 substantial period of time to get ready for use, are **required** to be capitalized
6 (substantial period of time being a subjective definition and will likely vary across
7 utilities) (IAS 23.8). AFUDC is not allowed to be capitalized, since it contains an equity
8 component (IAS 23.6). However, it appears that AFUDC may be allowed to be
9 recognized under the proposed Exposure Draft on Rate-regulated Operations.

10 **4.3 Other Capitalization Differences**

11 Canadian GAAP allows judgment and policy choices in the capitalization of certain
12 costs. In contrast, IFRS is more explicit and specifically requires the capitalization of a
13 number of other items, which include:

- 14 (a) Capitalization of depreciation on assets used in construction (IAS 16.49);
- 15 (b) Capitalization of the current service cost component of pensions and
16 employee future benefits (IAS 16.17a);
- 17 (c) The point where capitalization stops, being when an asset is available for use
18 rather than put into use (IAS 16.55). See section 7.2(a) for further details on
19 commencement of depreciation, definition of available for use, and additions to
20 plant.

1

2 **5.0 Property, Plant and Equipment - Other Items (updated 30 April 2009)**

3 There are a number of aspects of PP&E that are afforded different treatment under
4 IFRS than under Canadian GAAP. These primary differences are:

5 (a) Gains and losses on disposal of assets;

6 (b) Customer contributions;

7 (c) Asset retirement obligations.

8 **5.1 Gains and Losses on Disposal of Assets**

9 **5.1.1 Canadian GAAP**

10 *Based on standards issued as of: April 30, 2009*

11

12 Under Canadian GAAP, rate-regulated utilities are allowed to defer any gain or loss
13 arising on disposal of assets if it is to be considered in the determination of future
14 rates charged to customers. The gain or loss is deferred, either through accumulated
15 depreciation or a deferral account, and not immediately recognized in the income
16 statement (CICA 3475.26).

17 **5.1.2 International Financial Reporting Standards**

18 *Based on standards issued as of: April 30, 2009*

19

20 IFRS requires that gains and losses on disposal of assets be recognized immediately in
21 income, and cannot be charged or credited to accumulated depreciation for recovery
22 in future depreciation rates (IAS 16.68).

1 **5.2 Customer Contributions**

2 **5.2.1 Canadian GAAP**

3 Utilities in British Columbia show contributions in aid of construction as contra assets
4 (a credit to PP&E) or as a deferred credit, and amortize them as a reduction of
5 depreciation over the life of the related item of PP&E.

6 **5.2.2 International Financial Reporting Standards**

7 *Based on standards issued as of: April 30, 2009*

8
9 Under IFRS, the customer contribution received is recognized as revenue in
10 accordance with the obligation to the customer that underlies that transaction (IFRIC
11 18.13). The contribution is recognized as revenue either immediately or over a period
12 of time such as a contract period or the life of the underlying asset (IFRIC 18.18 –
13 IFRIC 18.20). Contributions not yet recognized as revenue are shown as liabilities (IAS
14 18.13).

15 **5.3 Asset Retirement Obligations**

16 **5.3.1 Canadian GAAP**

17 *Based on standards issued as of: April 30, 2009*

18
19 Under Canadian GAAP, an asset retirement obligation is recorded if a utility has a
20 legal obligation to incur an expenditure in the future associated with the retirement
21 of an asset currently in use (CICA 3110.03a).

22 **5.3.2 International Financial Reporting Standards**

23 *Based on standards issued as of: April 30, 2009*

24 *Exposure Draft Liabilities issued: June 2005*

25 *Liabilities final amendments expected: Q4 2009*

26
27 Under IFRS, asset retirement obligations (decommissioning and restoration
28 obligations) are recognized for both legal and constructive obligations at the best
29 estimate to settle the present obligation (IAS 37.25). Further information on the

- 1 recognition and measurement of these obligations is contained in Section 6,
- 2 Provisions, Legal and Constructive Obligations.

1 **6.0 Provisions, Legal and Constructive Obligations (updated 30 April 2009)**

2 **6.1 Legal and Constructive Obligations**

3 **6.1.1 Canadian GAAP**

4 *Based on standards issued as of: April 30, 2009*

5
6 Under Canadian GAAP, liabilities arise from predominantly legal or constructive
7 obligations. These may relate to contractual arrangements, those derived from legal
8 or statutory requirements, or inferred from the facts in a particular situation (CICA
9 1000.34).

10 **6.1.2 International Financial Reporting Standards**

11 *Based on standards issued as of: April 30, 2009*

12 *Exposure Draft Liabilities issued: June 2005*

13 *Liabilities final amendments expected: Q4 2009*

14
15 Under IFRS, liabilities can also arise from legal and also constructive obligations (IAS
16 37.14a). Constructive obligations arise where through an established pattern of past
17 practice, policy, or specific statement, an entity has indicated to other parties that it
18 will accept certain responsibilities (IAS 37.10). If a valid expectation is created
19 whereby other parties expect the entity to discharge these responsibilities, then a
20 liability will need to be recognized. IFRS also distinguishes a provision from other
21 liabilities such as trade payables and accruals. The difference is related to the
22 existence of uncertainty about the timing or amount of the future expenditure
23 required to settlement of a provision (IAS 37.11). The concept of provisions under
24 IFRS encompasses a wider range of circumstances that require recognition of
25 liabilities than Canadian GAAP.

26 IFRS also discusses the concept of an onerous contract. These are arrangements
27 where the unavoidable costs of meeting an obligation under the contract exceed the
28 economic benefits to be received under it (IAS 37.10). For example, a Company is
29 leasing an office building and decides to relocate to a new building. The lease on the

1 old office building continues for the next four years and it cannot be cancelled and
2 the Company cannot sublet it to another user. In this case a provision is recognized
3 for the best estimate of the unavoidable lease payments.

4 These concepts of provisions and onerous contracts may potentially result in
5 additional liabilities being recognized under IFRS.

6 **6.2 Criteria for Recognizing a Provision**

7 **6.2.1 Canadian GAAP**

8 *Based on standards issued as of: April 30, 2009*

9
10 Under Canadian GAAP, the probability threshold for recognizing a liability is whether
11 the underlying event giving rise to the liability is likely to occur (CICA 3290.09)
12 (commonly interpreted as 70% or greater).

13 **6.2.2 International Financial Reporting Standards**

14 *Based on standards issued as of: April 30, 2009*

15 *Exposure Draft Liabilities issued: June 2005*

16 *Liabilities final amendments expected: Q4 2009*

17
18 Under IFRS, the probability threshold for recognizing a liability or provision is
19 whether the underlying event giving rise to the liability or provision is probable (IAS
20 37.14b) (commonly interpreted as greater than 50%) (IAS 37.23).

21 This is noticeably lower than the “likely” threshold under Canadian GAAP and could
22 lead to additional provisions being recognized under IFRS.

23 **6.3 Measurement of a Provision**

24 **6.3.1 Canadian GAAP**

25 *Based on standards issued as of: April 30, 2009*

26
27 Under Canadian GAAP, liabilities are to be measured at management’s best estimate
28 to settle. For contingent liabilities, a reasonable estimate is based on the most likely

1 outcome of the ultimate loss. If no estimate is more likely than any other, then the
2 low end of the range is used for estimating the potential loss (CICA 3290.13).

3 **6.3.2 International Financial Reporting Standards**

4 *Based on standards issued as of: April 30, 2009*
5 *Exposure Draft Liabilities issued: June 2005*
6 *Liabilities final amendments expected: Q4 2009*

7
8 Under IFRS, liabilities and provisions are also measured at management's best
9 estimate to settle (IAS 37.36). Estimates subject to a range of possibilities are derived
10 on an expected value basis. If no estimate is more likely than any other, then the
11 mid-point of the range is used for estimating the potential loss (IAS 37.40). Under
12 IFRS, the presumption that an estimate cannot be made is expected in only
13 extremely rare circumstances (IAS 37.26).

14 As indicated in the timetable in Section 1.3, the IFRS standard on Liabilities is
15 expected to be revised in the next two years.

1 **7.0 Depreciation (updated 30 April 2009)**

2 **7.1 Canadian GAAP**

3 *Based on standards issued as of: April 30, 2009*

4

5 Depreciation under Canadian GAAP follows these guidelines:

6 (a) Depreciation must be recognized in a rational and systematic manner over the
7 estimated useful life of the asset (CICA 3061.28);

8 (b) Depreciation is allocated to the periods of service of an asset (CICA 3061.29).
9 Canadian GAAP does not provide guidance on when the “period of service”
10 begins to commence depreciation, however, a common policy choice is to
11 commence depreciation on an asset when it is placed into service or is in use;

12 (c) The depreciation methods and estimates of the life and useful life are reviewed
13 on a regular basis (CICA 3061.33), however, Canadian GAAP does not specify
14 the frequency of a “regular basis”;

15 (d) If an item of PP&E is made up of significant separable component parts, its cost
16 must be allocated to the parts when practicable and when estimates can be
17 made of the lives of the separate components (CICA 3061.30);

18 (e) Common practice to group assets and amortize them such that the combined
19 cost of the assets is amortized over their estimated useful life (group
20 depreciation method) (CICA 3061.31).

21 **7.2 International Financial Reporting Standards**

22 *Based on standards issued as of: April 30, 2009*

23

24 IFRS requirements are largely the same as Canadian GAAP requirements, with the
25 following exceptions:

- 1 (a) IFRS specifically requires that depreciation of assets, including spare parts,
2 commences when the asset is available for use rather than put in use,
3 *“Depreciation of an asset begins when it is available for use, ie when it is in the*
4 *location and condition necessary for it to be capable of operating in the manner*
5 *intended by management.”* (IAS 16.55). Once an asset is determined to be
6 available for use, capitalization of costs ceases (see also 4.3(c) above), the asset
7 is added to plant, and depreciation commences;
- 8 (b) Reviews of depreciation methods and estimates are to be conducted at each
9 financial year end, at a minimum (IAS 16.61);
- 10 (c) IFRS does indicate that where a significant part of an item of property, plant
11 and equipment may have a useful life and a depreciation method that are the
12 same as the useful life and the depreciation method of another significant part
13 of that same item, such parts may be grouped in determining the depreciation
14 charge (IAS 16.45). However, common group accounting practices employed by
15 utilities will need to be reviewed to determine if they comply with IFRS.
- 16 The major differences in IFRS are that accounting for components is more vigorously
17 followed than under Canadian GAAP, and that non-physical components of assets are
18 also recognized.
- 19 (a) To the extent asset classes include components with different lives that would
20 materially impact depreciation, these components must be separately
21 depreciated (IAS 16.43). This requirement will require utilities to analyze each
22 asset class and determine if further componentization is required, and may lead
23 to additional asset classes that do not currently exist;
- 24 (b) The recognition of both physical and non-physical components means that
25 costs of major overhauls (IAS 16.13) or inspections (IAS 16.14) embodied in a
26 capital asset may need to be split out and depreciated over a shorter period of

- 1 life than the actual physical asset. Under Canadian GAAP, these costs would
- 2 have been expensed as incurred.

1 **8.0 Income Taxes (updated 30 April 2009)**

2 **8.1 Canadian GAAP**

3 *Based on standards issued as of: April 30, 2009*

4
5 Currently, utilities in British Columbia that are taxable use the taxes payable (flow-
6 through) method to calculate income tax for regulatory purposes, under which
7 income tax expense is recognized only for taxes that are currently payable to Federal
8 and Provincial governments. In addition, many utilities treat their deferral accounts
9 in their regulatory records on a net-of-tax basis, to allow for differences in the timing
10 of income taxes payable or receivable in rate-setting.

11 Although the taxes payable method is used for regulatory purposes, Canadian GAAP
12 requires taxes to be recorded using the liability method, which includes the
13 recognition of future income tax expense (CICA 3465.102). To reconcile the
14 differences between the liability method and the taxes payable method, there is a
15 second step permitted under Canadian GAAP. This second step requires the utility to
16 assess whether future income taxes may be expected to be recovered from future
17 customers, and where this is true, to recognize an asset for that expected future
18 revenue (CICA 3465.103).

19 **8.2 International Financial Reporting Standards**

20 *Based on standards issued as of: April 30, 2009*

21 *Exposure Draft on Income Taxes issued: March 2009*

22 *Income Taxes final amendments expected: During 2010*

23

24 Although IFRS is largely consistent with Canadian GAAP, the second step of recording
25 a regulated future income tax asset or liability is not permitted in the IFRS section on
26 income taxes (IAS 12.15). However, depending on the outcome of the proposed
27 Exposure Draft on Rate-regulated Operations, to the extent this resulting asset or
28 liability meets the recognition criteria under the new standard, the current treatment
29 may continue.

- 1 As indicated in the table in Section 1.3, the IFRS standard on Income Taxes is
- 2 expected to be revised in the next two years.

1 **9.0 Pension and Employee Future Benefit Costs (updated 30 April 2009)**

2 There are a number of differences that will result from adopting IFRS for defined
3 benefit plans. A number of components that make up the cost of defined benefit
4 plans, described under Sections 9.2 to 9.4 below, may be recognized on a different
5 basis than under Canadian GAAP. As indicated in Table 1 in Section 1.3, the standard
6 on Pension and Employee Future Benefit Costs is expected to be revised in the next
7 two years.

8 **9.1 Initial Adoption of IFRS**

9 *Based on standards issued as of: April 30, 2009*

10

11 On transition, utilities may choose to recalculate historical amounts following
12 International Financial Reporting Standards, or they may make a one-time choice to
13 recognize all cumulative actuarial gains and losses not previously recognized in the
14 financial statements as part of the pension asset or liability, with an offsetting entry
15 to retained earnings (IFRS 1 D10).

16

**Table 5. On Transition Pension and Employee Future Benefit Costs:
Alternatives and Implications**

17

	Alternative	Implications for Utilities
1	Restatement of historical amounts under IFRS	Significant time and effort required to identify and segregate the non-compliant historical costs
2		Information may not be available for accurate restatement
3		Transition differences to be addressed
4	Recognize cumulative gains and losses as a one-time entry	Transitional retained earnings difference to be addressed

18

1 **9.2 Actuarial Gains and Losses**

2 **9.2.1 Canadian GAAP**

3 *Based on standards issued as of: April 30, 2009*

4

5 Currently, utilities have a choice in recording actuarial gains and losses. They can be
6 recorded in income immediately (CICA 3461.087), or amortized to income using the
7 corridor method whereby gains and losses are recorded in income on a systematic
8 basis with a minimum amount being amortized in any one year (CICA 3461.088).

9 **9.2.2 International Financial Reporting Standards**

10 *Based on standards issued as of: April 30, 2009*

11 *Exposure Draft Post-employment Benefits expected: Q3 2009*

12 *Post-employment Benefits final amendments expected: During 2011*

13

14 Under IFRS, utilities will have an additional choice in recording actuarial gains and
15 losses. They may be recorded:

16 (a) In income immediately (IAS 19.95) or on an accelerated basis (IAS 19.93);

17 (b) Amortized to income using the corridor method (IAS 19.92);

18 (c) In equity immediately (additional choice under IFRS) (IAS 19.93A).

19 A proposed change to the pension and future benefit cost standard may eliminate
20 the option of using the corridor method. Transitional impacts resulting in increased
21 volatility in income or equity will need to be addressed. See transition rules in
22 section 9.1.

1 **Table 6. Actual Gains or Losses: Alternatives and Implications**

	Alternative	Implications for Utilities
1	Income (immediate or accelerated)	Increased volatility in income
2	Corridor Method	Impacts of gains and losses are smoothed into income
3		May not be available in future
4	Equity	Increased volatility in equity

2

3 **9.3 Past Service Costs**

4 **9.3.1 Canadian GAAP**

5 *Based on standards issued as of: April 30, 2009*

6

7 Canadian GAAP allows past service costs to be recognized over the remaining service
8 life of the employee group (CICA 3461.079).

9 **9.3.2 International Financial Reporting Standards**

10 *Based on standards issued as of: April 30, 2009*

11 *Exposure Draft Post-employment Benefits expected: Q3 2009*

12 *Post-employment Benefits final amendments expected: During 2011*

13

14 Under IFRS, past service costs must be amortized over the vesting period (when the
15 employee's right to receive the benefit is not conditional on continued employment)
16 (IAS 19.96). In the majority of cases, past service costs would be already vested and
17 would therefore be recognized immediately in income.

18 **9.4 Return on Plan Assets**

19 **9.4.1 Canadian GAAP**

20 *Based on standards issued as of: April 30, 2009*

21

22 Canadian GAAP allows the return on plan assets to be estimated at either fair value
23 or a market-related value (value over a period not exceeding five years) (CICA

1 3461.067). A market-related value dampens the impact of the volatility of actuarial
2 gains and losses on the return on plan assets.

3 **9.4.2 International Financial Reporting Standards**

4 *Based on standards issued as of: April 30, 2009*
5 *Exposure Draft Post-employment Benefits expected: Q3 2009*
6 *Post-employment Benefits final amendments expected: During 2011*

7
8 Under IFRS, the expected return on plan assets must be estimated using the fair
9 value of assets at the beginning of the period to record investment income which
10 forms part of the pension and employee future benefit expense (IAS 19.106). The use
11 of fair value increases the volatility of actuarial gains and losses on the return on plan
12 assets.

13 **9.5 Measurement Date**

14 **9.5.1 Canadian GAAP**

15 *Based on standards issued as of: April 30, 2009*

16
17 For a defined benefit plan, plan assets and the accrued benefit obligation should be
18 measured as of the balance sheet date, except that they may be measured as of a
19 date not more than three months prior to that date provided the entity adopts this
20 practice consistently from year to year (CICA 3461.044).

21 **9.5.2 International Financial Reporting Standards**

22 *Based on standards issued as of: April 30, 2009*
23 *Exposure Draft Post-employment Benefits expected: Q3 2009*
24 *Post-employment Benefits final amendments expected: During 2011*

25
26 Under IFRS, entities should measure the present value of defined benefit obligations,
27 and the fair value of any plan assets, at the balance sheet date. For entities not
28 measuring defined benefit plans at the balance sheet date, the measurement date
29 would need to be changed which could result in an increase in pension expense or “a
30 charge to equity” in the year of the change (IAS 19.56 & 57 and IAS 19.BC15).

1 **9.6 Summary of Pensions and Employee Future Benefits**

2 These changes to the recognition of pensions and employee future benefits may
3 result in the pension and employee future benefit expenses being more volatile
4 depending on the alternatives chosen for the recognition of actuarial gains and
5 losses.

6

1 **10.0 Conclusion**

2 This document has summarized those differences between Canadian GAAP and IFRS
3 that have been identified by the Utilities IFRS Working Group as having the most
4 significant impacts on regulatory accounting and rate making. Although this summary
5 may be referred to by the utilities in their various filings and related discussions on
6 IFRS accounting impacts, how the changes will be implemented in the utilities'
7 financial records and rate filings will be discussed in their individual applications to
8 the Commission.