**Diane Roy**
Director, Regulatory Affairs - Gas
**FortisBC Energy Inc.**

16705 Fraser Highway
Surrey, B.C. V4N 0E8
Tel: (604) 576-7349
Cell: (604) 908-2790
Fax: (604) 576-7074
Email: diane.roy@fortisbc.com
www.fortisbc.com

Regulatory Affairs Correspondence
Email: gas.regulatory.affairs@fortisbc.com

April 7, 2011

British Columbia Public Interest Advocacy Centre
Suite 209 – 1090 West Pender Street
Vancouver, BC
V6E 2N7

Attention: Mr. James L. Quail, Executive Director

Dear Mr. Quail:

**Re: The FortisBC Utilities**
**Application to Adopt US Generally Accepted Accounting Principles ("US GAAP") effective January 1, 2012**

**Response to the British Columbia Public Interest Advocacy Centre on behalf of the British Columbia Old Age Pensioners Organization *et al* ("BCOAPO") Information Request ("IR") No. 1**

---

On February 9, 2011, the Fortis BC Utilities (comprised of FortisBC Inc. and the FortisBC Energy Utilities [including FortisBC Energy Inc., FortisBC Energy (Vancouver Island) Inc. and FortisBC Energy (Whistler) Inc.[1]]), filed the Application as referenced above.

In accordance with Commission Order No. G-25-11 setting out the Regulatory Timetable for the review of the Application, the Fortis BC Utilities respectfully submit the attached response to BCOAPO IR No. 1.

If you have any questions or require further information related to this Application, please do not hesitate to contact Roger Dall'Antonia at (604) 443-6570 or by email to roger.dall'antonia@fortisbc.com.

Yours very truly,

**on behalf of the FORTIS BC UTILITIES**

***Original signed:***

Diane Roy

Attachment

cc (e-mail only): Erica Hamilton, Commission Secretary
Registered Parties

---

[1] Formerly Terasen Gas Inc., Terasen Gas (Vancouver Island) Inc. and Terasen Gas (Whistler) Inc. respectively

**1.0 Reference: Exhibit B-1, page 3 and page 9, Section 5**

**Cost Recovery**

1.1 Please explain why, should recovery of one-time conversion costs from customers be approved, a <u>rate base</u> deferral account is the appropriate type of account for booking these costs.

**<u>Response:</u>**

The Companies believe that the one-time conversion costs are prudent and should be recoverable. A deferral account is the most appropriate mechanism for recovery of non-capital costs that are one-time in nature. The following paragraphs discuss why FortisBC Inc. and the FortisBC Energy Companies respectively believe the creation of a <u>rate base</u> deferral account is the appropriate method of recovery.

In the case of the FortisBC Inc. (the electric company), the current PBR regime, as approved by Commission Order G-58-06, allows for z-factor treatment of "extraordinary costs outside of the "steady state" operations as determined by the formula described for Base O&M expenses". In the case where these extraordinary items were unforeseen and not included in the Companies' Revenue Requirements, the costs are to be captured in a rate base deferral account pending disposition.

In the case of the FortisBC Energy Companies, either rate base deferral accounts or non-rate base deferral accounts attracting AFUDC have historically been approved, and the recommendation for one treatment over the other has primarily been one of timing, or as a means to stream cost recovery to a particular customer or group of customers separate from all other customers. In the case of a timing issue, if the Companies are able to forecast balances for deferral accounts and include them in revenue requirements, then that is the preferred treatment. In situations where the rates for a particular year have already been set and costs need to be recorded in a deferral account, that deferral account will be non-rate base attracting AFUDC until such time as rates are re-set under the next revenue requirement, and the account is rolled into rate base. Consistent with the Uniform System of Accounts, items that are recoverable from customers but not included in rate base (such as Work in Progress or non-rate base deferral accounts) are afforded AFUDC treatment so that the utility is afforded the opportunity to earn a fair return on costs prudently incurred to provide service to customers.

**2.0 Reference: Exhibit B-1, page 4**

2.1 Did the FortisBC Utilities (FBU) consider using a <u>modified</u> IFRS approach for regulatory purposes? That is, IFRS allowing for the recognition of regulatory assets and liabilities? If not, please explain; if so, please explain why such an alternative was rejected.

**<u>Response:</u>**

For external financial reporting purposes, the Companies have chosen to report under US GAAP. US GAAP for regulatory purposes therefore provides efficiency (cost avoidance), transparency and comparability.

The use of a modified IFRS approach for regulatory purposes does not achieve the same benefits. Aside from regulatory deferral accounts, there are other differences between IFRS and US GAAP that would require an ongoing reconciliation of modified IFRS (used for regulatory reporting) to US GAAP (used for financial reporting).

One example is that the calculation of pension expense under US GAAP and IFRS will be different, requiring the creation of additional regulatory deferral accounts for reconciliation purposes.

Another example is capitalized overheads. Under IFRS, a lower percentage of capitalized overheads would be allowed to be included in plant balances than what would be allowed under US GAAP (which allows the percentage approved by the regulator to be included in plant). Although the difference could be recorded in a regulatory deferral account (for regulatory purposes only), this treatment would unnecessarily complicate the reconciliation process into the foreseeable future and the differences will compound over time.

These differences can arise because IFRS with deferral accounts would require that ALL differences between IFRS and regulatory treatment be captured in deferral accounts. Contrast this to US GAAP, where the accounting treatment allowed by the regulator is also allowed under US GAAP, with the result that differences can be held in plant or other accounts, as well as deferral accounts.

This rework and reconciliation would require additional resources and result in costs which can be partly mitigated by reporting publicly and for regulatory purposes on the same financial basis. By using US GAAP for regulatory purposes, the Commission, Intervenors and other stakeholders will more easily be able to compare future regulatory information to historic regulatory information, thus increasing comparability.

Please also see responses to BCUC IR 1.7.1.3 and 1.7.1.4.

**3.0 Reference: Exhibit B-1, page 6, Section 3.1,**

**Transparency under US GAAP**

3.1 With respect to the listing of "an existing investment grade, non-convertible debt instrument on the New York Stock Exchange," please provide details regarding (i) the debt instruments that Terasen Gas Inc. and FortisBC Inc. expect to list, including term, interest rate, and any other salient characteristics, (ii) the fees and any other incremental costs such as legal, financial, and administrative costs plus any other external costs incurred by the listing requirements, and (iii) potential impacts under plausible adverse scenarios that may fall to FBU, its parent and ratepayers as a result of this listing.

**<u>Response:</u>**

(i)

| | **FortisBC Energy Inc. (formerly known as Terasen Gas Inc.)** | **FortisBC Inc.** |
|---|---|---|
| Description of Debt. | Unsecured Series 22 Medium Term Notes | 6.10% Medium Term Note Debentures, Series 1 |
| a) Principal amount initially issued and currently outstanding. | $250,000,000.00 | $105,000,000.00 |
| b) Maturity date. | 02-Oct-37 | 02-Jun-39 |
| c) Interest rate, or if the interest rate varies (e.g., "floating rate" securities) the basis for the interest variation. | 6.0% per annum | 6.10% per annum, payable semi-annually in arrears |
| d) Seniority of the debt securities relative to other debt securities of the issuer. | Senior unsecured | Senior unsecured |

(ii) As a result of also listing debt instruments on the NYSE, rate payers are expected to be impacted by the Fortis BC Utilities incurring approximately $0.4M of one-time conversion costs relating specifically to the review and registration with the SEC and listing debt on the NYSE. The FortisBC Utilities are proposing that these one-time conversion costs, along with other US GAAP adoption costs, be accumulated in deferral accounts with disposition in future rates. These costs are included under the US GAAP column in the table at the bottom of page 9, Section 5 Cost Recovery in the Application.

(iii) While there is every expectation that the Fortis BC Utilities will be successful with listing their debt instruments on the NYSE, there is always the risk of an adverse scenario. Failure to list could result in a certain amount of stranded costs, depending how far along in the process, that are included in the US GAAP one-time conversion costs. In order to avoid such an adverse scenario, the FortisBC Utilities have engaged external accounting and securities legal counsel who have significant experience in the listing process, including communication with the SEC and NYSE.

**4.0 Reference: Exhibit B-1, page 6, Section 3.2.1.1**

**Accounting for income taxes and uncertain income tax positions**

4.1 With respect to the US GAAP treatment of accounting for income taxes and uncertain tax positions, please explain whether the adoption of US GAAP will have any impact on the income taxes reported for regulatory purposes or on the actual recovery of income taxes from ratepayers.

**<u>Response:</u>**

To date in our review of US GAAP, we have not identified any material impacts on income taxes reported for regulatory purposes from uncertain tax positions. Since income taxes for regulatory purposes is calculated using the taxes payable method, at enacted Canadian income tax and Canadian CCA rates, it is unlikely that US GAAP differences in the measurement or disclosure of income tax expense for accounting purposes would affect income taxes recovered from rate payers. Any differences would be of a timing nature only and could be addressed through the use of deferral accounts.

**5.0 Reference: Exhibit B-1, page 7, Section 3.2.2,**

**IFRS versus Current Regulatory Treatment**

5.1 Of the six bulleted IFRS-related changes adopted by the Terasen Utilities (now known as the FortisBC Utilities), are any of them required under US GAAP? If so, please identify.

**Response:**

While the FortisBC Energy Utilities (formerly the Terasen Utilities) are currently assessing the differences between CDN GAAP (and IFRS) and US GAAP, it is our belief that none of these adjustments would have been required under US GAAP but that they are permitted under US GAAP. As for the last bullet, given that the FBU have not adopted IFRS in 2011, the pension expense has been calculated under CDN GAAP, but since the 2011 approved pension expense was calculated under IFRS, the differences between the CDN GAAP calculation and the IFRS expense have been captured in the pension variance deferral account for future recovery from customers.

**6.0 Reference: Exhibit B-1, page 8, Section 4,**

**Debt Covenants**

Preamble: *"Due to CDN GAAP adopting all IFRS standards, regulatory assets and liabilities would be included as revenues and expenses when calculating both debt covenants and issuance tests under CDN GAAP."* (Emphasis added.)

6.1 Would it be more correct to state that in February 2008, the AcSB announced a changeover from Canadian GAAP to IFRS for the interim and annual financial statements for publicly accountable, profit-oriented enterprises?

**Response:**

Yes, except that the changeover would be applicable to publicly accountable enterprises, not just profit-oriented enterprises. The wider definition will capture more enterprises than just profit-oriented enterprises. The CICA handbook has adopted IFRS standards via two omnibus exposure drafts in 2009.

The AcSB determines the contents of the CICA Handbook, which have been updated to include different sets of accounting standards depending on the type of entity preparing financial statements. IFRS, as issued by the International Accounting Standards Board and IFRS Interpretations Committee, has been incorporated into Part I of the CICA Handbook. CDN GAAP, as has been used historically, will cease to exist once an entity adopts one of the following sets of accounting standards which are considered CDN GAAP prospectively:

Part I – International Financial Reporting Standards (applies to publicly accountable enterprises).
Part II – Accounting Standards for Private Enterprises (applies to profit-oriented entities that are not publicly accountable enterprises).
Part III – Accounting Standards for Not-for-Profit Organizations
Part IV – Accounting Standards for Pension Plans

6.2 Will Canadian GAAP cease to exist or rather cease to be supported by the AcSB, going forward?

**Response:**

In 2009, the Accounting Standards Board ("AcSB") introduced the first of two omnibus exposure drafts which essentially replaced existing CDN GAAP for publicly accountable entities starting on January 1, 2011 (a one year deferral option was granted for rate regulated enterprises). So CDN GAAP still does exist, but, depending on the type of entity, there are different sections of CDN GAAP to follow. While the AcSB determines the contents of the CICA Handbook, which have been updated to include different sets of accounting standards depending on the type of entity, the content of Part I is set by the IASB. IFRS, as issued by the International Accounting Standards Board and IFRS Interpretations Committee, has been incorporated into Part I of the CICA Handbook.

CDN GAAP, as has been used historically, (i.e., Part V of the CICA Handbook) will cease to exist once an entity adopts one of the following sets of accounting standards which are considered CDN GAAP prospectively:

Part I – International Financial Reporting Standards (applies to publicly accountable enterprises).
Part II – Accounting Standards for Private Enterprises (applies to profit-oriented entities that are not publicly accountable enterprises).
Part III – Accounting Standards for Not-for-Profit Organizations
Part IV – Accounting Standards for Pension Plans

6.3 Would a modified IFRS approach as described above allayed any concerns regarding debt covenants? If not, please explain.

**Response:**

No, a modified IFRS approach would not allay debt covenant concerns. As required under the various debt agreements, the Fortis BC Utilities' debt covenants are determined based on external financial statements which are audited and reviewed by external auditors. External financial reporting options for the Fortis BC Utilities only include IFRS, which does not permit accounting for rate regulated activities, and US GAAP, which will permit the continued recognition of rate regulated activities similar to how CDN GAAP has historically been applied.

**7.0 Reference: Exhibit B-1, pages 9-10, Section 5.1,**

**Estimated Costs for adopting US GAAP**

7.1 Please provide an explanation why continued ongoing compliance with US GAAP is expected to cost more than continued ongoing compliance with Canadian GAAP. We are seeking a non-confidential, high-level explanation similar to the one provided for the one-time conversion costs of adopting US GAAP.

**Response:**

The primary reason for an increase in ongoing compliance under US GAAP compared to CDN GAAP is the result of fees related to ongoing SOX 404 internal control attestation. These are the estimated ongoing costs only required under US GAAP for an external independent audit firm to provide an opinion on internal controls over financial reporting, of which there are no comparable costs under CDN GAAP.

Beginning in 2012, there are no longer any costs associated with ongoing compliance with CDN GAAP. The only options are to adopt US GAAP or IFRS in 2012, both of which are expected to have a higher ongoing cost of compliance as compared to current CDN GAAP.