INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

STATUS UPDATE REPORT as at October 31 2010

TABLE OF CONTENTS

Executive Summary

Manitoba Hydro (MH) will be required to prepare financial statements in accordance with International Financial Reporting Standards (IFRS) effective for its 2012/13 fiscal year with comparative information presented for 2011/12. The 2012/13 transition year represents a one year deferral from the previous required transition year of 2011/12 and is a result of recent decisions made by the International and Canadian accounting standard setting bodies.

There are a number of differences between Canadian Generally Accepted Accounting Principles (GAAP) and IFRS that will affect the timing of when costs are recognized in MH's net income, how business transactions are recorded, and how information is presented in MH's financial statements. The transition to IFRS is expected to result in an initial increase in annual operating and administrative expense, increased volatility in net income, the recognition of additional obligations on the balance sheet, some changes to the presentation of financial statements and more extensive note disclosure. Ultimately, however, IFRS will result in improved comparability of MH's financial statements and financial performance to other energy utilities throughout the world.

MH commenced its IFRS conversion project in 2008 with the establishment of a formal project structure including a project team, steering committee and an executive sponsor. The project was divided into four phases: initial assessment & project mobilization, detailed design, solution development, and implementation. MH is managing the project internally with resources from across its business units and with assistance as necessary from external advisors. KPMG was engaged as the primary consultant on the project and to date has assisted with accounting gap analysis, identification of system and process impacts, and the interpretation of IFRS standards. MH's external auditor, Ernst & Young, has provided advice and has concurred with accounting changes that have been implemented to March 31, 2010 and has participated in discussions on various IFRS conversion issues.

In September of 2010, the International Accounting Standards Board (IASB) discontinued their project on rate-regulated accounting on the basis that this topic will require more analysis and discussion than IASB resources currently allow in consideration of other priorities. The IASB announced that it will seek future direction on this topic from their constituents in the spring of 2011. In recognition of the impact of the uncertainty around rate-regulated accounting for rate-regulated entities, in September 2010, the Canadian Accounting Standards Board (AcSB) approved an optional one year deferral on transition to IFRS for rate-regulated entities. As is the case with most other rate-regulated utilities in Canada, MH plans to adopt this deferral.

The topics in the following table have been identified as having the highest potential impact to MH:

Topic	Issue
Rate-Regulated Accounting	- IFRS does not currently recognize rate-regulated accounting - In September of 2010, the IASB discontinued their project on the accounting for Rate-regulated activities and will seek future direction on this topic from its constituents in 2011 - In September 2010, the AcSB approved an optional one year deferral for transition to IFRS for rate-regulated entities - The Canadian Electrical Association (CEA) and the "Big 4" accounting firms plan to further discuss the recognition of rate-regulated assets and liabilities under IFRS - As at March 31, 2010, MH had $296 million in net Rate-regulated assets on its balance sheet
Intangible Assets	- GAAP converged with IFRS effective for MH's 2009/10 financial statements - The impact of this change on prior years was a cumulative reduction to retained earnings of $37 million related to the write-off of ineligible research and promotional related expenditures - The annual net income impact of this change is immaterial considering the offsetting impacts of increases in operating expense and decreases in amortization
Property, Plant & Equipment (PP&E)	- The IASB has approved an exemption for rate-regulated entities to carry forward existing PP&E balances as of the transition date - IFRS is more rigorous in identifying separate components for depreciation - IFRS requires gains and losses on asset retirements to be charged to net income in the year incurred and does not allow, in the absence of an obligation, future removal costs to be included in depreciation rates - IFRS requires a liability to be recorded for "constructive asset retirement obligations" - Under IFRS, customer contributions are recognized as revenue, either immediately or over the life of the asset

Capitalization of Overhead Costs	- IFRS specifically states that administration and other general overhead costs are not eligible for capitalization - To date, MH adjustments with respect to discontinuing the capitalization of overhead costs total approximately $30 million annually
Pension Costs	- IFRS does not permit the deferral of experience gains and losses for calculating expected fund returns - First time adopters have an option to adjust unrecognized experience gains or losses to equity - Proposed Exposure Draft to recognize all actuarial gains and losses in Other Comprehensive Income
Employee Benefits	- IFRS requires the estimated obligation for the unvested portion of accumulating benefits to be recognized over the period of service - Benefits for past service must be expensed over the vesting period

IFRSs will continue to evolve both before and after the transition date. In the interim, MH will continue to review its accounting policies and design its systems and processes with sufficient flexibility to be able to capture required transactional data and meet the accounting and reporting requirements of the Corporation.

The next steps in the project will focus on advancing all topics from the solution development to the implementation phase and ensuring that key systems and processes, meet the accounting and reporting requirements for the 2011/12 comparative year and forward. This work will be performed with the assistance of MH's consultants.

1.0 Introduction

The Canadian Accounting Standards Board (AcSB) had previously declared January 1, 2011 as the date for Canadian publicly accountable enterprises to commence using International Financial Reporting Standards (IFRS) as a replacement for Canadian Generally Accepted Accounting Principles (GAAP). The Public Sector Accounting Board (PSAB) also confirmed in October of 2009 that public-sector enterprises with self-sustaining commercial-type operations such as Manitoba Hydro (MH) will be required to follow IFRS. However, as a result of the uncertainty by the IASB regarding the acceptability of rate-regulated accounting, the AcSB approved an optional one year deferral of transition for rate-regulated entities in September 2010. As such, the transition to IFRS will be reflected in MH's financial statements for the fiscal year 2012/13, along with comparative information for the 2011/12 fiscal year.

Although IFRS and GAAP are both principles-based, there are a number of differences between IFRS and GAAP that can result in differences in the timing of when costs are recognized. IFRS contains a number of accounting policy choices and it is for individual entities to determine the most appropriate accounting policies that reflect their own facts and circumstances. As an underlying principle, MH is interpreting and applying IFRS in a manner that recognizes the long term nature of its business and the need, to the extent possible, to preserve the fundamental principles of intergenerational equity amongst the present and future energy consumers of the Province. This objective underlies the preliminary accounting policy decisions discussed in this report.

The overall impacts from conversion to IFRS can be summarized in the following three categories:

a) **Transitional Adjustments**

   The transition to IFRS will likely result in adjustments to opening retained earnings as IFRS generally requires retrospective application. Such adjustments are somewhat less onerous for rate-regulated entities due to an exemption that allows rate-regulated entities to carry-forward the historical cost of its property, plant & equipment upon transition to IFRS. Therefore, MH is not expecting that the adjustment to opening retained earnings will be significant for its property, plant & equipment assets.

b) **Ongoing differences**

   There will be ongoing differences in the timing of recognition of certain transactions. In addition, IFRS may give rise to more volatility in earnings due to differences in the accounting for items such as expected returns on pension fund assets, past service employee benefits, and the recognition of gains and losses on property, plant & equipment retirements.

c) **Project Costs**

The initial conversion to IFRS will result in project costs associated with internal resources, external consulting, assurance requirements, and information systems. MH is estimating the project costs to be approximately $5.0 million.

2.0 Purpose of Report

The purpose of this report is to provide an update on MH's IFRS conversion activities along with realized and potential impacts to MH to the extent known as of the date of this report.

It is important to recognize that this document has been prepared as of October 31, 2010 and that further differences between IFRS and GAAP as applied to MH may be identified based on additional detailed analysis, future deliberations and decisions on accounting for rate-regulated activities, and future changes in IFRS standards.

3.0 Overview of IFRS Conversion Project

The following sections provide an overview of the MH IFRS conversion project structure, the project phases, and the roles of the external consultants and auditors engaged to assist MH with the adoption of IFRS.

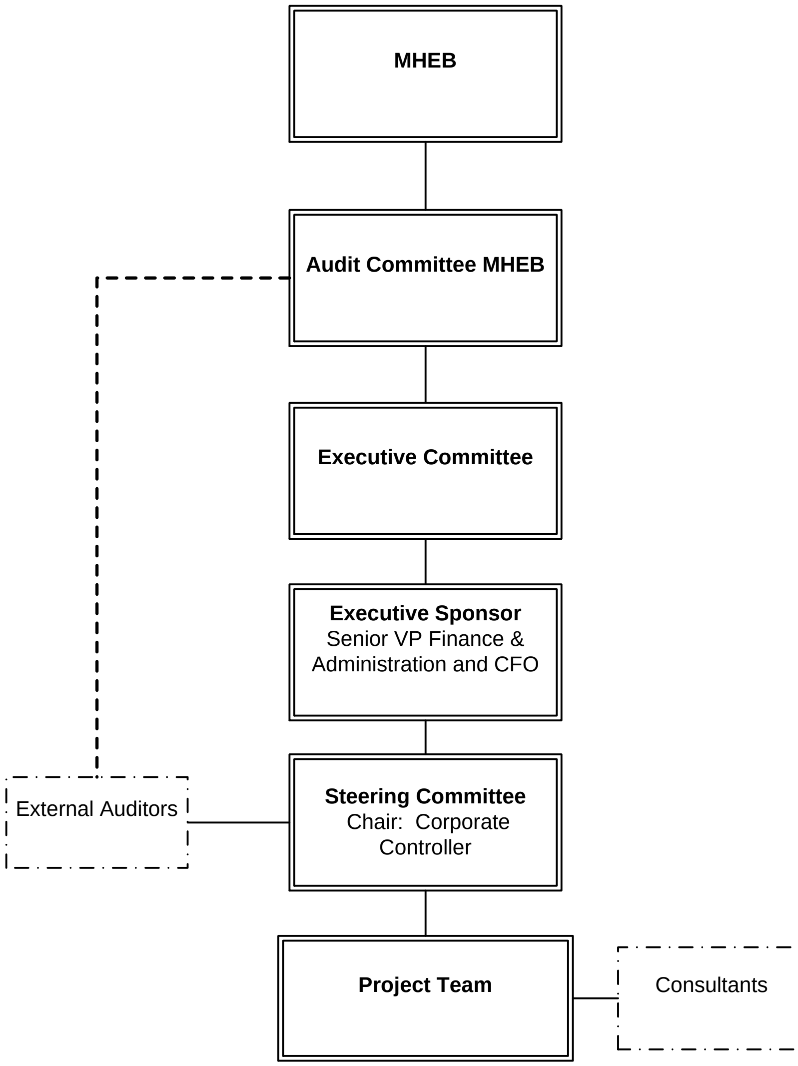
3.1 Project Structure

In 2008, MH formed a project team to manage the overall conversion to IFRS. The team consists of a dedicated Project Manager, Conversion Lead, Project Coordinator and a Project Analyst. Project team members work closely with a number of other employees throughout the Corporation to analyze the technical accounting issues and possible impacts of available options. The time commitment for these employees varies according to the complexity of the topics being considered although the overall involvement has been substantial.

In addition to the project team, a Steering Committee was established comprised of senior management representing each business unit, as well as other senior MH finance staff and a representative from MH's external auditor, Ernst & Young. The Executive Sponsor of the IFRS conversion project is the Senior Vice-President Finance & Administration and Chief Financial Officer who has responsibility for the project and the communication of project results through the Executive Committee to the Audit Committee and the Manitoba Hydro Electric Board (MHEB).

MH’s formal project structure is summarized as follows:

MANITOBA HYDRO
IFRS Corporate
Conversion Structure



3.2 Project Phases

The IFRS conversion project was divided into four phases with the following primary objectives:

1) Initial Assessment & Project Mobilization

- Establish project structure and mobilize project team;
- Develop initial project plan; and
- Identify potential gap differences between MH’s policies and IFRS.

2) Detailed Design

- Prepare detailed gap analysis between MH's policies and IFRS;
- Assessment of impact on key systems and related processes; and
- Update conversion plan.

3) Solution Development

- Develop comprehensive and detailed plans to convert systems and processes;
- Provide pro-forma financial statements and policies; and
- Develop detailed training programs.

4) Implementation

- Convert systems and processes;
- Prepare related documents and perform system testing; and
- Deliver IFRS training.

3.3 External Consultants

Through its project team and structure, MH is managing the IFRS conversion project internally with the assistance of its primary consultant KPMG. Specifically, to date, KPMG has assisted the MH project team with:

- Project plan development, establishing priorities, and monitoring progress;
- Detailed gap analysis of accounting and disclosure differences;
- Identifying accounting and system/process issues and raising awareness through educational sessions with management and staff;
- Application and interpretation of IFRS towards accounting policy and financial statement development;
- Assessment of information technology system requirements and possible solutions; and
- Detailed training and knowledge transfer.

There are also a number of technical areas involved in the IFRS project and MH has engaged Gannett Fleming Inc. and Ellement & Ellement to assist in the following areas:

Gannett Fleming Inc.:

- Application of IFRS as it applies to PP&E;
- Development of asset groupings that comply with IFRS componentization requirements;
- Development of IFRS compliant depreciation policies and practices applicable to each asset group; and
- Development of historic cost and accumulated depreciation for the new asset groups.

Ellement & Ellement:

- Actuarial services on employee benefit obligations; and
- Review and consultation on pension calculations.

3.4 External Auditors

In order to opine on MH's consolidated financial statements for the year ended March 31, 2013 under IFRS, MH’s external auditors will be required to:

- Review MH's accounting policies under IFRS standards;
- Audit MH's opening balance sheet at April 1, 2011 under IFRS, perform audit procedures on individual IFRS adjustments and the restatement of comparative periods;
- Review information system, process and internal control changes; and
- Review and comment on financial statement presentation and disclosures under IFRS.

MH's external auditor, Ernst & Young, has provided advice and has concurred with accounting changes that have been implemented to March 31, 2010. In addition, Ernst & Young, has participated in discussions on various IFRS conversion issues.

4.0 Key Areas of Impact

The main topic areas of impact to MH upon conversion to IFRS include:

1. Rate-Regulated Accounting
2. Goodwill & Intangible Assets
3. Property, Plant & Equipment
4. Capitalization of Overhead Costs
5. Pension Costs
6. Employee Benefits
7. Financial Instruments
8. Leases
9. Customer Contributions
10. IFRS 1 - Initial Adoption of IFRS

The following sections provide an overview of each of these main topic areas.

4.1 Rate-Regulated Accounting

The following sections describe rate-regulated accounting under GAAP and IFRS.

4.1.1 Rate-Regulated Accounting under GAAP

MH recognizes the impact of rate-regulation by applying various accounting policies that allow for the deferral of certain costs or credits which will be recovered or refunded in future rates. This practice is commonly referred to as rate-regulated accounting. In the absence of rate-regulated accounting, these costs or credits may otherwise have been included in the determination of net income in the year incurred.

Effective January 1, 2009, GAAP was revised to remove a temporary exemption that permitted the recognition of assets and liabilities resulting from rate regulation. In the absence of specific guidance under GAAP, rate-regulated entities in Canada are permitted to reference and apply Accounting Standards Codification 980, "Regulatory Operations" (formerly FAS 71), issued by the US Financial Accounting Standards Board (FASB), which allows for the recognition of rate-regulated assets and liabilities under the following circumstances:

a) The enterprise's rates for regulated services or products are established by or subject to approval by an independent, third-party regulator;
b) The regulated rates are designed to recover the specific enterprise's costs of providing the regulated services; and

c) It is reasonable to assume that rates set at levels that will recover the enterprise's costs can be charged to and collected from customers.

Pursuant to a practice allowed by Canadian GAAP, MH has relied on this standard to maintain its current accounting treatment for rate-regulated assets and liabilities for 2009/10 and will continue to do so until transition to IFRS.

4.1.2 IASB Exposure Draft on Rate-regulated Activities

Currently, IFRS does not include a specific standard that explicitly recognizes the economic effects of rate regulation. While IFRS does not preclude the recognition of regulatory assets and liabilities, it requires that an asset or liability must meet the existing framework for recognition. The application of the IFRS framework in other countries has not typically resulted in the recognition of regulatory assets and liabilities.

The absence of specific IFRS guidance for rate-regulated accounting has been a significant concern of the Canadian utility industry since the AcSB decision to transition to IFRS was announced. This issue was on the agenda of both the International Financial Reporting Interpretation Committee (IFRIC) and the IASB in 2008. The IASB added this project to its agenda in December 2008 because of concerns that differences of views would emerge in practice about whether it was appropriate for entities to recognize assets and liabilities arising from rate regulation and because of the ongoing requests for guidance on this issue.

The IASB issued an Exposure Draft (ED), Rate-regulated Activities*,* on July 23, 2009. The proposed standard allowed for assets and liabilities that arise from rate-regulated activities (within the scope of the ED) to be recognized under IFRS.

The responses to the ED were submitted in November 2009 and were mixed in terms of those supporting and opposing the proposed standard. MH provided commentary to the IASB on the ED and also provided input into the Canadian Electrical Association, Canadian Gas Association and Canadian Energy Pipeline Association joint response.

The IASB met to discuss the comments received and to provide direction on the Rate-regulated Activities ED on February 17, 2010. At this meeting it was tentatively confirmed that entities subject to rate regulation should be allowed an additional exemption to IFRS to carry forward existing balances of PP&E and intangibles at transition to IFRS. However, no decision as to the future direction of the ED was reached. Rather, because of the diversity in responses to the ED and the concern that diversity may arise in practice, IASB staff were directed to conduct further analysis and research and to present their findings at a future meeting.

On May 6, 2010, the IASB approved an amendment to IFRS 1 (First-time Adoption of IFRS) to allow entities with rate-regulated activities to use the carrying amount of their property, plant and equipment and intangible asset balances from their previous GAAP as deemed cost upon transition to IFRS. These balances may include amounts that would not be permitted for capitalisation under IAS 16 Property, Plant and Equipment, IAS 23 Borrowing Costs and IAS 38 Intangible Assets.

At their July 19 - 23, 2010 meetings, IASB members remained divided on whether to develop a rate-regulated activities standard. IASB staff presented four potential paths for consideration by the IASB:

- Fast track the finalization of the comprehensive project (Exposure Draft)
- Issue an Interim standard
- Issue an amendment to IFRS1
- The continuation of the research, analysis and deliberations on this issue as time and resources permit acknowledging the existing guidance and current practice that has developed in the countries that apply IFRSs

IASB members selected the fourth option.

4.1.3 Recent Developments

On July 23, 2010, the AcSB determined that entities with rate-regulated activities will require additional time to prepare themselves and the users of their financial statements for conversion to IFRSs. The AcSB thus, issued an Exposure Draft that proposed that qualifying entities with rate-regulated activities be permitted, but not required, to continue applying the Canadian GAAP standards (Part V of the CICA handbook) for an additional two years. Comments received by the AcSB supported the need for a deferral for transition for rate-regulated entities. Both MH and the CEA responded to the ACSB in support of the deferral.

On September 8, 2010, the AcSB approved a one year deferral for transition to IFRS for entities subject to rate regulation, indicating that due to the uncertainty of the timing of the resolution of this issue, they did not want to prolong the continued use of Canadian GAAP standards beyond an additional year. As is the case with most other rate-regulated utilities in Canada, MH plans to adopt this deferral.

On September 16, 2010, IASB members further reviewed the issue of rate-regulated accounting and concluded that members were clearly divided in terms of those supporting and those opposing the recognition of rate-regulated assets and liabilities. The IASB thus decided to discontinue the project on rate-regulated accounting on the basis that this topic will require more analysis and discussion than IASB resources currently allow in consideration of other priorities. The IASB will include in its public consultation in the spring of 2011 on its future agenda a request for views on what form a future project might take, if any, to address the impact of rate regulation. Potential paths forward for this topic as proposed by the IASB include:

- A disclosure only standard
- An interim standard
- A medium term project focused on the effects of rate regulation, or
- A comprehensive project on intangible assets

As a result of recent developments, the CEA and the "Big 4" accounting firms have agreed to review and assess the extent to which the actions of rate regulators result in assets and liabilities that can be recognized in accordance with existing IFRSs. The objective is to obtain resolution to this issue by early 2011.

4.1.4 Rate-Regulated Accounts

The following table summarizes MH's rate-regulated assets and liabilities as at March 31, 2010:

Table 4.1 Summary of Rate-Regulated Accounts
At March 31, 2010
(In millions of dollars)

Item	Electric	Gas	Consolidated
Power Smart Programs *	$168	$32	$200
Site Restoration Costs	35	2	37
Deferred Taxes	-	35	35
Acquisition Costs	23	-	23
Purchased Gas Variance Accounts	-	(3)	(3)
Regulatory Costs	-	4	4
	$226	$70	$296

* During the 2009/10 period, MH reclassified $168 million of electric related unamortized

Power Smart Program expenditures from deferred charges to Rate-Regulated Assets as a result of the convergence of Canadian GAAP with IFRS for intangible assets. Gas Power Smart Program expenditures were previously classified as Rate-Regulated Assets.

Should it be concluded that rate-regulated assets and liabilities cannot be recognized under IFRS, the balances in the aforementioned accounts will be adjusted to retained earnings and future expenditures will be expensed as incurred.

4.2 Goodwill & Intangible Assets

Effective for MH's 2009/10 fiscal year, GAAP was converged with IFRS for the recognition and measurement of Goodwill & Intangible Assets (GAAP section 3064). The new standard required retrospective application for the 2008/09 fiscal year.

4.2.1 Goodwill

MH acquired two major utility operations - Centra Gas in July 1999 and Winnipeg Hydro in September 2002. As a result of these acquisitions, MH has recorded Goodwill in the amount of $108 million which has remained unchanged since March 31, 2003. In accordance with GAAP, goodwill is not amortized; it is tested for impairment on an annual basis unless all of the following criteria have been met:

a) The assets and liabilities that make up the reporting unit have not changed significantly since the most recent fair value determination;
b) The most recent fair value determination resulted in an amount that exceeded the carrying amount of the reporting unit by a substantial margin; and
c) Based on an analysis of events that have occurred and circumstances that have changed since the most recent fair value determination, the likelihood that a current fair value determination would be less than the current carrying amount of the reporting unit is remote.

The goodwill accounting requirements under GAAP and IFRS are converged, however, GAAP uses a different impairment testing model from IFRS. IFRS determines an impairment loss as the excess of the carrying amount above the recoverable amount of the cash generating unit to which the goodwill is allocated, rather than the difference between carrying amount and fair value of the reporting unit's goodwill as required for GAAP.

Under IFRS, irrespective of whether there is any indication of impairment, an entity is required to test goodwill acquired in a business combination for impairment annually. The IFRS impairment testing model is applied at the cash generating unit level as compared to the GAAP model which is applied at the reporting unit level. In addition, IFRS allows for a reversal of an impairment loss for long lived assets, but it does not permit an impairment reversal for goodwill.

MH will incorporate these changes into an annual impairment test for the goodwill resulting from the acquisition of Centra Gas and Winnipeg Hydro. MH does not expect that the application of this impairment test upon transition to IFRS will result in any impairments.

Transitional Requirements (IFRS 1)

In general, the requirements are applied retrospectively when an entity adopts IFRS. This means that MH would need to consider its past acquisitions and ensure they have been accounted for in accordance with the business combination standard under IFRS, which could impact the calculation of goodwill. Under IFRS 1, a first-time adopter has the optional exemption to not retroactively restate any business combinations that occurred prior to the date of transition to IFRS. MH expects that it will take the exemption and not restate any business combinations.

4.2.2 Intangible Assets

The new Canadian standard includes criteria for an expenditure to qualify for recognition as an intangible asset and stipulates that research related expenditures are to be expensed in the period incurred. Under GAAP and IFRS, an expenditure is recognized as an intangible asset only if it meets one of the following "identifiable" criteria:

a) Is separable (i.e., is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability); or
b) Arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Examples of identifiable intangibles are franchise rights, patents, and licenses.

In addition to the “identifiable” requirement, an entity must demonstrate its ability to control and obtain the future economic benefits from the intangible asset. For internally generated intangible assets, the new section 3064 also requires the following “research” related activities to be expensed as incurred:

a) Activities aimed at obtaining new knowledge;
b) The search for, evaluation and final selection of, applications of research findings or other knowledge;
c) The search for alternatives for materials, devices, products, processes, systems or services; and
d) The formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

Activities incurred after the selection of a chosen alternative for the project are eligible for capitalization with the exception of:

- Selling, administrative and other general overhead expenditures unless this expenditure can be directly attributed to preparing the asset for use;
- Identified inefficiencies and initial operating losses incurred before the asset achieves planned performance; and
- Expenditures on training staff to operate the asset.

The following sections summarize the impact of the convergence of GAAP with IFRS for MH with respect to intangible assets.

Power Smart Programs (Demand Side Management-DSM)

MH previously recognized electric DSM program expenditures as deferred costs and natural gas DSM program expenditures as rate-regulated assets.

MH determines the feasibility of a number of electric DSM programs and only implements those which meet specific criteria for achieving cash inflows in excess of the costs of that program. MH’s electric DSM programs are a distinct and identifiable aspect of its operations that result in additional cash inflows to the company from the additional export market sales made available by the electricity conserved by domestic customers. MH assessed these programs to determine if such activities met the recognition requirements for an intangible asset under the new standard. Although these programs result in distinct and identifiable cash flows, the assessment determined that electric DSM activities do not meet the new intangible asset recognition requirements as these activities are not capable of being separated and transferred to another entity. As a result, MH reclassified unamortized electric related DSM charges to rate-regulated assets consistent with gas related DSM charges.

MH's natural gas DSM programs reduce energy costs for customers. Any decrease in natural gas volumes from DSM programs result in an overall reduction to the total commodity requirements for Manitoba customers and does not provide MH with additional cash inflows and thus, does not meet the requirements for recognition as an intangible asset.

The new standard 3064 and IFRS specifically identifies research, selling/promotion and indirect expenditures as ineligible costs for capitalization as an intangible asset. New DSM programs typically include research activities as well as promotional activities to introduce the DSM programs. To be consistent with the accounting for intangible assets, MH will expense general research and promotional activities for electric & natural gas DSM programs.

The cumulative retained earnings adjustment associated with the April 1, 2008 DSM balance for ineligible research and promotion charges was approximately $5 million for electric related DSM charges and $1 million for gas related DSM charges. Annual charges for these activities are now expensed in the period incurred.

Planning Studies

To comply with GAAP and IFRS, MH also reviewed its planning study expenditures and has separated the expenditures into two categories:

a) Next generation and transmission studies; and
b) Emerging energy studies (i.e. wind studies to identify potential sites, hybrid electric vehicles).

The studies for next generation and transmission plant meet the criteria for recognition as an asset, but because such expenditures are intended to ultimately result in the construction of a tangible plant asset, deferral as an intangible asset is not appropriate. Therefore, these expenditures will be recognized as tangible construction in progress (CWIP) assets at the point in time when there is reasonable assurance that a commitment to construction will be made. Expenditures incurred prior to this point will be expensed in the period incurred.

Planning studies for emerging energies result in the accumulation of information and /or research data that enables MH to assess the impacts of energy options on its operations. Although emerging energy studies are necessary, the information generated from such studies does not normally result in the creation of separate or identifiable intangible assets and thus, does not meet the criteria for recognition as an asset. Therefore the costs associated with emerging energy activities will be expensed in the period incurred.
The cumulative retained earnings adjustment associated with the April 1, 2008 planning studies balance for ineligible charges was approximately $25 million.

Information Technology - Application Development

MH reviewed its computer system application development process and concluded that, for the most part, expenditures of this nature met the requirements for recognition as intangible assets. However, research and planning related activities involving the need for a new system (software / hardware) or the research and feasibility analysis of alternative solutions should be expensed in the period incurred.

The cumulative retained earnings adjustment associated with the April 1, 2008 Application Development Projects balance for ineligible charges was approximately $5 million.

Presentation and Disclosure

GAAP and IFRS emphasize that intangible assets are separate and identifiable stand alone assets and as such, should be presented separately on the balance sheet rather than being classified in PP&E. Upon adoption of section 3064, MH reclassified (April 1, 2008 balances, net of accumulated amortization) $103 million of Computer Software development and $37 million of Easements from Property, Plant & Equipment to a separate category titled Goodwill and Intangible Assets.

4.2.3 Summary of Impacts

The following tables summarize the actual April 1, 2008 retained earnings adjustments with respect to the retrospective application of the new standard and the impact to net income for 2009/10 amounts:

Table 4.2.2 Summary of Transitional Adjustments to Intangible Assets - Charge to April 1, 2008 Retained Earnings
(In millions of dollars)

Item	Electric	Gas	Consolidated
Demand Side Management - Research and Promotion	$4.8	$1.2	$6.0
Planning Studies	24.6	-	24.6
IT Application Development - Research	3.8	1.0	4.8
Other	1.2	-	1.2
Decrease to Retained Earnings	**$34.4**	**$2.2**	**$36.6**

Table 4.2.3 Summary of Net Income Impacts from Intangible Assets - 2009/10
(In millions of dollars)

Item	Electric	Gas	Consolidated
Demand Side Management - Research and Promotion	($1.0)	($0.8)	($1.8)
Planning Studies	(2.0)	-	(2.0)
IT Application Development - Research	(0.6)	-	(0.6)
Other	(0.2)		(0.2)
Consolidated Amortization Offsets	**5.4**	**0.3**	**5.7**
Net Income Impact	**$1.6**	**($0.5)**	**$1.1**

The annual impacts to net income related to the changes in the standard for intangible assets reflects offsets for reductions in amortization and will vary in the future according to the degree of annual spending for these items.

4.3 Property, Plant & Equipment (PP&E)

Amounts recognized as PP&E under IFRS can differ from current GAAP both at the time of initial transition and subsequent to the transition to IFRS.

4.3.1 Transitional Requirements (IFRS 1)

In general, IFRS requires retrospective application. There are exemptions available from this general requirement under IFRS 1. Specifically, an entity may elect to measure an item of PP&E at the date of transition to IFRS at its fair value and use that fair value as its deemed cost at that date or entities with rate-regulated activities may use the carrying amount of their property, plant and equipment and intangible asset balances from their previous GAAP as deemed cost subject to an impairment test as at the date of transition. Therefore, no retroactive adjustment would be required to adjust any differences in capitalized costs.

MH supports that carrying forward historical cost is the appropriate treatment for a rate-regulated entity as existing and future rates are largely based on historical costs. MH is planning to take the exemption that a rate-regulated entity can elect to use the historical carrying value of PP&E as its deemed cost on transition.

4.3.2 Subsequent to the Transition to IFRS

Under existing GAAP, PP&E is recorded based on actual historical costs, which represents historical capitalized costs net of accumulated depreciation. Under IFRS, a company has the option of choosing either the historical cost model or the revaluation model for recording PP&E. Under the cost model, PP&E is carried at cost less accumulated depreciation. Under the revaluation model, a class of PP&E can be carried at fair value less any subsequent accumulated depreciation. Determining the appropriate method of measuring fair value may require the use of professionally qualified valuators.

MH plans to continue with the cost model as the revaluation model would continuously change the value of PP&E, increasing the volatility of depreciation expense due to changes in the fair value of the assets.

4.3.3 Componentization / Depreciation

Under GAAP, depreciation must be recognized in a rational and systematic manner over the estimated useful life of the asset. Depreciation methods and estimates of the life and useful life are reviewed on a regular basis; however, GAAP does not specify the frequency of a “regular” basis. MH currently completes a depreciation study every five years and at that time adjusts its depreciation methods and estimates as appropriate.

Under GAAP, if an item of PP&E is made up of significant separable component parts, its cost must be allocated to the parts when practicable and when estimates can be made of the lives of the separate components. MH's policy is to group assets and amortize them such that the combined cost of the assets is amortized over the estimated useful life of the group of assets.

IFRS requirements are similar to GAAP requirements. However, IFRS is more rigorous in terms of identifying separate components and addresses non-physical components of assets. To the extent assets include components with different lives that would materially impact depreciation, these components must be separately depreciated. IFRS permits the grouping of assets in determining the depreciation charge and assets can be grouped as long as they are from a homogeneous group, are individually insignificant in value, and have the same useful lives. The recognition of non-physical components means that the costs of major overhauls or inspections associated with a capital asset may need to be recognized separately and amortized over a shorter life than the life of the physical asset.

MH has reviewed its existing components and has determined that further componentization is required in particular as it pertains to generation and communication related assets.

With the assistance of its depreciation consultant, Gannett Fleming Inc., Manitoba Hydro has established new component groupings consistent with the requirements of IFRS and is in the process of quantifying opening asset balances for new and existing component groupings. Gannett Fleming Inc is currently reviewing the information required for the development of depreciation rates for new component groupings. It is expected that the depreciation study will be completed in the spring of 2011 for implementation in fiscal 2011/12 subsequent to required approvals.

4.3.4 Gains and Losses on Disposal of Assets

Canadian utilities defer gains or losses recognized on the disposal of assets either through accumulated depreciation or a deferral account. Therefore the gains or losses are not immediately recognized in the income statement. MH currently recognizes gains and loses on the retirement of plant assets in accumulated depreciation.

IFRS requires that gains and losses on disposal/retirement of assets be recognized immediately in income. MH is planning to recognize gains and losses on asset retirements to net income as they occur. The impacts on net income are not expected to be significant except when extraordinary retirements occur.

4.3.5 Negative Salvage

MH's depreciation rates currently include an amount for the costs to be incurred upon the removal of an asset. This is referred to as negative salvage value. The costs associated with the removal of an asset are charged to accumulated depreciation with no gains or losses reflected in net income.

Negative salvage is not an eligible cost of self-constructed PP&E or internally generated intangible assets under IFRS. As the IASB allows rate-regulated entities to carry over the net book value of PP&E upon transition to IFRS, any existing negative salvage amounts included in accumulated depreciation may form part of the deemed costs of assets on transition.

MH is required to eliminate the inclusion of negative salvage in depreciation rates to comply with IFRS.

4.3.6 Provisions - Asset Retirement Obligations (ARO)

The concept of provisions under IFRS encompasses a wider range of circumstances that may result in the recognition of more liabilities than GAAP. Under IFRS, the threshold for recognizing a liability or provision is whether the underlying event giving rise to the liability of provision is probable. This is lower than the "likely" threshold under GAAP and could lead to additional provisions being recognized under IFRS. In addition, under IFRS provisions must be recognized when they can be reliably estimated, and only in rare circumstances is it presumed that an estimate cannot be made.

Under GAAP, an asset retirement obligation is recorded if an entity has a legal obligation to incur an expenditure in the future associated with the retirement of an asset currently in use. IFRS requires a liability to be recorded for constructive obligations as well as for legal obligations. A constructive obligation is derived from an entity's actions by way of an established pattern of past practice, published policies or a specific current statement whereby the entity has indicated to other parties that it will accept certain responsibilities such that the other parties expect the entity to discharge its responsibilities.

Under GAAP, MH has recognized AROs for the decommissioning of two thermal generating stations and a hydraulic generating station, as well as for the removal and disposal of PCB's in HVDC converter station capacitors. MH has reviewed its circumstances and has preliminarily concluded that no new provisions exist pertaining to constructive obligations. MH will recognize such obligations when a commitment is made to decommission an asset and significant removal and/or remediation costs are expected to be incurred

4.3.7 Capitalization of Borrowing Costs

Under current GAAP, carrying costs such as interest that are directly attributable to the construction of an asset may be capitalized (Interest During Construction or IDC). IFRS requires that actual borrowing costs for a period be capitalized to an asset that takes a substantial period of time to get ready for use. A substantial period of time is not a defined term and requires judgment in its application. MH has reviewed the average time period for construction of its major capital projects and has concluded that there will not be a significant change in projects eligible for interest capitalization.

MH has also reviewed the specific items included in the calculation of the interest capitalization rate for general asset additions and has made the necessary adjustments required for compliance with IFRS. The interest capitalization rate will now consist of the weighted average debt rate for all debt outstanding for the period, including anticipated borrowings in the upcoming fiscal year. MH has implemented this change for its 2010/11 fiscal year under Canadian GAAP.

IFRS requires the segregation of specific and generally financed capital projects where possible in order to determine the borrowing costs eligible for capitalization. Therefore, where debt is designated to finance a particular capital project, MH will capitalize interest to the asset based on the interest rate from that designated debt issue.

Transitional Requirements (IFRS 1)

As the IASB allows rate-regulated entities to carry over the net book value of PP&E upon transition to IFRS, any existing capitalized interest included in PP&E may form part of the deemed costs of PP&E on transition. Therefore, no retroactive adjustment is required to adjust the differences in capitalized borrowing costs.

4.4 Capitalization of Overhead Costs

Under GAAP, MH has historically applied a full cost accounting methodology. Tangible and intangible assets are stated at cost which includes direct labour, materials, contracted services, a proportionate share of overhead costs, and interest applied at the average cost of debt. Overhead costs allocated to capital include support staff (Finance, Human Resources, Information Technology, Corporate, Legal, etc.), management time, training, depreciation, interest, and facility related charges. This approach recognizes that MH is both a capital and operating company and thus, maintains integrated resources in order to sustain all aspects of its operations.

IFRS requires that PP&E and intangible items that qualify for recognition as an asset shall be measured at cost which includes direct costs, such as materials, and all overhead costs that can be directly attributable to capital projects and intangible assets. IFRS identifies costs that are not eligible for capitalization such as the following:

a) Costs of opening a new facility;
b) Costs of introducing a new product or service (including costs of advertising and promotional activities);
c) Costs of conducting business in a new location or with a new class of customer (including costs of staff training); and
d) Administration and other general overhead costs

Based on a review of its existing cost capitalization practices, and considering industry trends to move away from full cost accounting, MH has eliminated, or is planning to eliminate, the following cost components from its capitalized overhead under GAAP (totaling $30 million annually through to the end of fiscal 2011):

Reduction to Costs Capitalized in fiscal 2008/09:

Interest and Facilities Overhead on Stores	**$5.0 million**

Reduction to Costs Capitalized in fiscal 2009/10:

Executive Costs from the Overhead Pool	$2.0 million
Property Taxes on Facilities	$2.0 million
	$4.0 million

Planned Reduction to Costs Capitalized in fiscal 2010/11:

Interest on Common Assets (Facilities & Equipment)	$12.0 million
General and Administrative Departmental Costs	$5.0 million
Interest on motor vehicles	$4.0 million
	$21.0 million

There is little specific IFRS guidance to assist with the interpretation and application of the capitalization requirements under IFRS. Manitoba Hydro is of the view that costs currently being capitalized have a strong causal relationship to capital projects or programs and it is therefore appropriate to continue to capitalize these costs. In order to demonstrate this relationship, MH is reviewing its capitalization methodology, including the cost components and activities currently being capitalized, as well as the processes in place to charge these costs to capital projects. This review will be completed in late 2010.

If a sufficient causal relationship is not found between certain costs and the related capital activities, these costs may not be eligible for capitalization under IFRS. As well, where it is found that the process used to charge costs to capital projects is not sufficiently aligned with their causal relationship to capital projects, internal charging processes may have to be modified. Any further costs that are deemed not to be eligible for capitalization under IFRS will either have to be expensed as incurred or could be deferred as a regulatory asset should the recognition of regulatory assets ultimately be allowed under IFRS.

All work necessary to allow for the accounting of capitalized costs in an IFRS compliant manner will be completed for implementation in fiscal 2011/12 to allow for comparative year reporting. Any substantial system and process changes that are deemed to be appropriate to optimize related internal accounting processes will be developed and implemented for fiscal 2012/13.

Transitional Requirements (IFRS 1)

The IASB allows rate-regulated entities to carry over the net book value of PP&E upon transition to IFRS and thus, any existing capitalized costs included in PP&E may form part of the deemed costs of PP&E on transition. Therefore, no retroactive adjustment is required to adjust the differences in capitalized overhead costs.

4.5 Pension Costs

There are a number of differences that will result from adopting IFRS for defined benefit pension plans. The components that make up the cost of defined benefit plans may be recognized on a different basis under IFRS than under existing GAAP.

4.5.1 Return on Plan Assets

The expected return on plan assets forms part of the annual pension expense. GAAP currently allows the expected return on plan assets to be estimated based on either fair value or a market-related value (moving average not exceeding a period of five years). MH uses market-related values to estimate the expected return on plan assets and to apply experience gains and losses in the corridor calculation. A market-related value approach reduces volatility of actuarial gains and losses on the expected annual return on plan assets and subsequent amortization of balances outside the corridor, therefore, reducing volatility on annual pension expense.

Under IFRS, the expected return on plan assets must be estimated using the fair value of assets at the beginning of the period. The use of fair value increases the volatility of the expected return on plan assets and will be highly dependant on the investment performance of the market during each reporting period.

4.5.2 Actuarial Gains and Losses

Under GAAP, companies have a policy choice in recording actuarial gains and losses. They can be recorded in income immediately, or amortized to income using the corridor method which accumulates gains and losses within a range (10% of the value of the fund assets or obligation, whichever is greater) and amortizes to pension expense any excess cumulative balance outside the range. Under IFRS, companies will have an additional policy choice that permits recording actuarial gains and losses immediately to Other Comprehensive Income (OCI) without any charge to net income of the period.

As of the date of this report, MH is in the process of assessing available policy options which include recording actuarial gains and losses immediately to OCI or continueing to use the corridor calculation. The assessment will also take into consideration a recent IASB Exposure Draft that requires the recording of annual actuarial gains and losses immediately to OCI; eliminating all other options for the recognition of these amounts. Should this Exposure draft be approved in 2011, MH will adopt this method of recognizing actuarial gains and losses.

4.5.3 Past Service Costs

GAAP allows past service costs associated with plan improvements/amendments to be recognized over the average remaining service life of the employee group. MH has implemented pension plan improvements that contain both vested and non-vested components and is currently amortizing these improvements over the average remaining service life of the employee group.

Under IFRS, amended benefits that are fully vested must be immediately recognized into income or amortized over the vesting period if not fully vested.

4.5.4 Transitional Requirements (IFRS 1)

The underlying principle in IFRS 1 is that a first time adopter should prepare and present financial statements as if it had always applied IFRS. Under this requirement, pension plan balances as at the transition date would be re-measured under IFRS with an adjustment to retained earnings.

Alternatively, a first time adopter of IFRS has the option to elect to recognize all cumulative actuarial gains and losses to retained earnings. As of March 31, 2010, MH’s cumulative unamortized actuarial losses amount to approximately $200 million. This transition approach would eliminate the requirement to retroactively restate pension amounts up to the transition date. As well, this approach would result in the elimination of the future amortization of these existing balances in pension expense. If this approach is adopted, the corridor method can still be applied subsequent to transition.

MH is currently assessing this transitional election with the impact of these two options depending upon the March 31, 2011 final balances of cumulative unamortized actuarial gains and losses and pending the outcome of the recent IASB Exposure Draft.

MH is also in the process of reviewing with its actuary past service costs existing in unamortized plan amendment balances to determine the value that must be charged to retained earnings upon transition to IFRS.

4.5.5 IASB Exposure Draft on Defined Benefit Plans

In April 2010, the IASB issued the "Defined Benefit Plans" Exposure Draft as part of its project to improve the accounting for employee benefits. This Exposure Draft proposes significant changes to the recognition, presentation and disclosure of defined benefit plans. The significant changes proposed by the Exposure Draft that would impact MH are as follows:

- That entities recognize remeasurements and adjustments related to changes in the value of the defined benefit obligation and in the value of the plan assets only in Other Comprehensive Income (OCI) in the period in which they occur with no subsequent recycling to net income. IAS 19 currently permits entities to recognize all gains and losses in OCI or net income when they occur, but also permits an entity to leave actuarial gains and losses unrecognized when they are within a "corridor" and to defer and amortize actuarial gains and losses outside the corridor.
- That changes in the net defined benefit liability (asset) be split into the following components:
    - Service costs to be recognized in net income as operating expense
    - Net interest income or expense to be recognized in finance expense; and
    - All remeasurements of the net defined liability (asset) to be recognized in OCI

  Currently, MH recognizes all such amounts in Operating and Administrative expense.
- That the net interest income or expense component would be determined by applying the interest rate that is used to discount the defined benefit obligation to the net defined liability (asset). Currently, the expected return on plan assets is calculated using a forecast rate of expected return appropriate for the plan asset mix of investments.
- That additional disclosure be provided for the following:
    - Breakdown of actuarial gains and losses from changes in demographic assumptions and financial assumptions

  - Breakdown of plan assets by those that have a quoted market price in an active market and those that may not
  - The present value of the defined benefit obligation excluding the effects of projected salary growth; and
  - Sensitivity analysis for each significant assumption
- That the IFRS 1 exemption allowing an entity to adjust all unamortized actuarial gains and losses to retained earnings be eliminated

The comments for this Exposure Draft were due in September 2010 and the current work plan for the IASB is to complete their analysis by June 2011. If a new standard is approved, it is likely the standard would not be applicable until fiscal periods beginning on or after January 1, 2013 with early adoption a likely option.

MH is currently in the process of evaluating its options with respect to pension accounting policies as currently available under IFRS and with consideration of the Exposure Draft as noted above.

4.6 Employee Benefits

MH offers accumulating benefits for service and currently recognizes obligations for the vested portions only under GAAP.

IFRS recognizes an obligation as an employee renders service regardless of vesting criteria. Therefore, under IFRS, actuarial obligations must be recognized for all accumulating benefit plans such as sick leave and severance. MH will be required to identify unamortized past service balances related to vested benefits that are being amortized over the average remaining service lives of the employees (e.g. Retirement Health Spending) under GAAP.

Under IFRS, experience gains and losses resulting from actuarial valuations for certain long-term employee benefits such as long-term disability must be expensed when determined. Under GAAP, these gains and losses may be amortized over the period until the next actuarial valuation (3 years for MH). Upon transition to IFRS, MH will adjust to retained earnings any unamortized gains and losses for such benefits.

MH is currently in the process of reviewing actuarially determined past service balances for unvested obligations and proposed adjustments to retained earnings with its actuary.

4.7 Financial Instruments

For the most part, GAAP is substantially harmonized with IFRS with the introduction of sections 3855 and 3865, implemented by MH in the 2007/08 fiscal year. Under the existing IFRS guidance, Financial Instruments: Recognition and Measurement, MH's financial assets such as customer loans and accounts receivable would continue to be classified as loans and receivables, initially recorded at fair value and subsequently measured at amortized cost. Long term debt and other financial liabilities would continue to be initially recorded at fair value, and subsequently measured at amortized cost using the effective interest method. Any unrealized foreign exchange gains and losses would be recorded to net income when there is no accounting hedge in place. U.S. sinking funds would continue to be classified as available-for-sale, however IFRS allows for a "natural" hedging of foreign exchange risk on foreign currency. Under IFRS, foreign exchange gains and losses related to available-for-sale monetary financial assets are recorded in net income. This means MH will continue to record foreign exchange gains/losses on its sinking fund investments in net income without the GAAP requirement to maintain a designated accounting hedge relationship between the U.S. sinking fund and the associated U.S. debt. Under both GAAP and IFRS, fair value changes related to changes in interest rates continue to be recorded in Other Comprehensive Income.

4.7.1 Hedges

As described above, GAAP requires that foreign exchange gains and losses on available for sale sinking fund assets be recorded in Other Comprehensive Income. However, designating these investments in a fair value hedge relationship has allowed MH to record offsetting foreign exchange translation gains and losses on the U.S. sinking funds (hedged item) and corresponding U.S. debt (hedging item) to net income. Under IFRS, the monthly translation of U.S. sinking fund investments would be recorded in net income as will offsetting changes in the fair value of the US debt, without the need for hedge accounting. Therefore, these fair value hedges are no longer required under IFRS.

MH's current cash flow hedges between anticipated U.S. revenues (hedged item) and U.S. debt (hedging item) are not expected to be impacted by the transition to IFRS.

4.7.2 Commodity Contracts

Under IFRS, commodity contracts that can be settled either in cash or by another financial instrument, and do not meet the "own-use" scope exception are within the scope of IAS 39 and should be accounted for as a non-financial derivative, consequently subject to fair value accounting treatment. The "own-use" exception relates to contracts for non-financial items that were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

In principle, this exemption provides MH with the ability to exclude the majority of its commodity contracts from fair value accounting treatment, as the majority of its commodity contracts are used within the normal course of its business to deliver physical energy to and from varying locations. However, there are certain instances where the "own-use" exemption may not be available under IFRS. MH will continue to review commodity contract terms to determine if the exemption is available in all circumstances.

Natural gas fixed price swaps utilized in the Primary Gas Fixed Rate Service have been identified as financial derivatives and are currently being measured at fair value on the balance sheet with changes in fair value recorded to net income. There are no accounting changes required for these contracts under IFRS.

4.7.3 IASB Exposure Draft

The IASB has a three phase project underway to replace IAS 39, Financial Instruments: Recognition and Measurement with a new standard, IFRS 9. The first phase of this project deals with classification and measurement concepts. To date, only the classification and measurement standard for financial assets has been finalized for annual periods beginning on or after January 1, 2013. Financial liabilities was excluded from the scope of this initial phase of IFRS 9 to allow further deliberation on the role of credit risk on liability re-measurement. Since then, an exposure draft was recently issued that proposes that any changes to an entity's own credit risk, should be recorded in OCI, instead of through net income, as originally proposed. Additionally, the revised exposure draft confirmed previous tentative decisions that financial liabilities should be measured at fair value through profit and loss or amortized cost if they are not held for trading. For now, financial liabilities including derivative liabilities, will remain within the scope of IAS 39. A finalized standard dealing with financial liabilities is expected by the end of this calendar year.

The second phase of the project deals with amortized cost and impairments. In this new standard, IASB has proposed to replace the existing incurred loss approach with an expected loss approach. The proposed expected loss impairment model recognizes losses over the life of the financial asset by reflecting expectations of credit losses in the effective interest rate that is used to determine interest revenues or expense. The final standard is expected to be issued in the second quarter of 2011.

The third phase focuses on hedge accounting with the exposure draft expected by the end of the 2010 and a final standard expected in 2011. The goal is to simplify the requirements for hedge designations, documentation and effectiveness testing.

4.8 Leases

In general, the principles relating to accounting for leases under section 3065 and IFRS are converged, except that:

a) IFRS uses the term “finance lease” in the same manner as Section 3065 uses “capital lease”;
b) IFRS does not subdivide finance leases into sales type leases and direct financing leases; and
c) The disclosure requirements differ.

Both standards classify leases based on whether or not substantially all the risks and rewards incidental to ownership are transferred. GAAP, however, provides more quantitative thresholds for evaluating whether a lease is a capital or operating lease. IFRS does not contain such quantitative thresholds. The interpretations provided under GAAP for determining whether an arrangement contains a lease are primarily the same under IFRS.

MH has reviewed its agreements and has not identified any additional leases that are required to be recognized upon transition to IFRS.

4.8.1 IASB Exposure Draft on Leases

In August 2010, the IASB issued an Exposure Draft on Leases. The Exposure Draft is proposed to correct for issues in existing standards which have been criticized for not meeting the needs of the users of the financial statements as they do not provide a faithful representation of leasing transactions. The IASB believes that existing standards fail to recognize rights and obligations that meet the definition of assets and liabilities within the existing IFRS framework. The significant changes proposed by the Exposure Draft that would impact MH are as follows:

- The distinction between finance and operating leases is discontinued
- The Lessee would apply a right-of-use model that would recognize an asset for its right to use an asset and a liability for its obligation to make lease payments.

MH is currently in the process of assessing the potential impacts of the proposed changes for lease accounting. The IASB is accepting comments on this issue until December 15 2010 and the current work plan is to publish a standard by the second half of 2011.

4.9 Customer Contributions

Under GAAP, non-refundable contributions in aid of construction are separately recorded on the balance sheet and amortized to income on a straight-line basis as a reduction to depreciation over the life of the related item of PP&E. Refundable contributions are recorded in Other Deferred Liabilities by MH, and are refunded to customers if the criteria for the refund have been met.

Under IFRS, customer contributions are to be recognized as revenue; either immediately or over some future period of time. The customer contribution is recognized as revenue based upon fulfillment of the performance obligations of the underlying arrangement. An entity in receipt of a capital contribution is required to assess if separately identifiable services have been provided. That is, the utility must assess if the capital contribution is solely for the purpose of connecting the customer to the utility's grid such that the utility has no obligation beyond connecting the customer or if the contribution is also linked to the ongoing supply of energy. If it can be demonstrated that the service connection represents stand-alone value to the customer then the customer contribution should be recognized as revenue immediately. If it can be demonstrated that the contribution can be linked to the ongoing supply of energy, then all revenue arising from the contribution is deferred and amortized to income as the service is provided.

MH has reviewed its customer contribution arrangements and has concluded that the service connection to the customer does not have stand-alone value as the customers are not allowed to choose their supplier in Manitoba and are not able to resell connection assets as they do not own them. The sole purpose of the connection is to provide access to an ongoing supply of energy (electricity or gas). A customer would derive no value from a connection absent the future supply of energy. As the connection does not have stand alone value for the customer, the revenue should be recognized over time as energy is provided to the customer. If the arrangement does not specify a period, the revenue shall be recognized over a period no longer than the useful lives of the connection assets.

This will result in no impact to net income. However, classification on the income statement will change as the amortization of the contribution that was previously recognized as an offset in depreciation expense will now be recognized as revenue.

Under IFRS, the method for recognizing revenue related to refundable contributions would also change. The practice under Canadian GAAP excludes 100% of the refundable capital contributions from being amortized. Under IFRS, only the amount that is expected to be refunded would be excluded from the amount that is amortized into revenue.

4.10 IFRS 1 - Initial Adoption of IFRS

IFRS 1 requires an entity to comply with all IFRSs effective at the reporting date of the entity's first annual financial statements prepared and presented in accordance with IFRS. For MH, this would include all IFRSs in effect as of March 31, 2013. New accounting policies must be retrospectively applied (unless the relevant election is available and chosen) and adjustments made at the start of comparative period. Thus, for an entity adopting IFRS for the first time on April 1, 2012, it will be necessary to prepare and present a comparative opening balance sheet under IFRS as at April 1, 2011. In the comparative opening balance sheet, an entity must:

- Recognize all assets and liabilities that IFRS require be recognized;
- Derecognize from assets and liabilities those items for which IFRS do not permit recognition;
- Reclassify items when, in accordance with the GAAP previously followed by the entity, they would have been presented differently from how they would be in accordance with IFRS
- Apply IFRS in remeasuring all recognized assets and liabilities

The underlying principle in IFRS 1 is that a first time adopter should prepare and present financial statements as if it had always applied IFRS, i.e., retrospective adjustment of accounts; however, there are certain exemptions and/or elections to this general principle which would allow prospective application. IFRS 1 prohibits retrospective application in certain areas. Exemptions are and will continue to be included in amendments to IFRS 1.

There are IFRS 1 elections for areas including financial assets and liabilities, hedge accounting, business combinations, insurance contracts, value of PP&E, leases, employee benefits, financial instruments, decommissioning liabilities, and borrowing costs. Where applicable, MH has addressed the transitional elections it is reviewing in the various sub-sections of this report.

5.0 Financial Reporting & Disclosure

There are a number of differences in the disclosure requirements of GAAP compared to IFRS. Set out below is a summary of the major differences that are likely to arise on an on-going basis.

5.1 On-Going Disclosures - Primary Statements

Under IFRS, there will be a number of changes to the primary financial statements which include the income statement, balance sheet, and cash-flow statement. The following section outlines these changes.

Statement of Income

Under IFRS, the presentation of the income statement will be similar to GAAP. However, MH will be required to present its expenses based on their nature or by function. In addition, disclosure will be required of all employee benefit expenses and finance costs.

Statement of Financial Position (Balance Sheet)

MH does not expect that there will be any substantive changes to the current presentation of the statement of financial position, although balances currently disclosed as “other assets” and “other liabilities” will need to be classified according to their type.

Statement of Cash-Flow

Under IFRS, MH will have the choice of presenting its cash-flow on a direct or indirect basis. Currently MH discloses on a direct basis. In addition, MH will have the choice of presenting cash-flows from interest received as either operating or investing activities and cash-flows from interest paid as either operating or financing activities.

Incremental disclosures include:

- Separate disclosure of disposal proceeds and capital contributions received;
- Disclosure of total amount of interest paid (whether expensed or capitalized); and
- Reconciliation of cash-flows from operating activities to net income.

Other

In addition, MH will be required to present a separate statement of changes in equity. This will incorporate information currently presented in the statement of retained earnings and the statement of Accumulated Other Comprehensive Income.

5.2 On-Going Disclosures - Notes to the Financial Statements

Under IFRS, there will be a number of changes to the notes to the financial statements which are outlined below.

Property, Plant and Equipment

The main incremental disclosure will be the requirement to present a detailed continuity schedule for each class of PP&E. In addition, given that MH will elect to deem its net book value on transition as its opening cost under IFRS, this will require that accumulated depreciation be set to zero.

Pension Assets and Liabilities

IFRS requires that the amount recognized as a defined benefit liability should be the net total of the defined benefit obligation, unrecognized actuarial gains/losses, unrecognized past service costs, and the fair value of plan assets.

IFRS also requires disclosure of the amounts for the current and previous four periods of: the present value of the defined benefit obligation; the fair value of plan assets, any surplus or deficit in the plan; and experience adjustments on plan liabilities and plan assets. A first time adopter can elect to only disclose 2 years of information and it is likely that MH will elect to do this.

MH will also be required to disclose its best estimate of future contributions expected to be paid to the plan.

Provisions and Asset Retirement Obligations

IFRS requires disclosure of detailed continuity schedules for each class of provisions.

Other

IFRS requires disclosure of related party information, including details of the entity's parent and controlling party.

IFRS also requires uniform accounting policies to be applied to all entities in a consolidated group and requires greater disclosure of judgments and estimates in the financial statements.

5.3 Initial adoption of IFRS (IFRS 1)

The first accounts that are prepared under IFRS are required to include a number of extensive reconciliations and narratives showing the effects of the transition from GAAP to IFRS. This information must include details of key changes in accounting policies, IFRS 1 elections made and measurement differences from GAAP.

MH is in the process of reviewing changes in financial statement presentation, required disclosures and related system and process changes for transition to IFRS.

6.0 Key Systems & Processes

As identified early in this project, the conversion to IFRS will have impacts on systems and related business processes. MH established an information technology (IT) team to identify and address these impacts. As part of this work, MH reviewed the capability of its SAP system to produce the required financial information for the 2011/12 fiscal period and forward. Through this review, MH concluded that, with modifications, the existing SAP system is capable of meeting the financial reporting requirements under IFRS. MH is also reviewing financial systems that interface with SAP to ensure they will also be capable of meeting the financial reporting requirements.

The key areas of IFRS that will impact systems and process are:

6.1 Componentization of Property Plant & Equipment

This change will require that capital project forecasts and expenditures be further delineated into constituent components. Fixed Asset ledgers and depreciation calculation processes will also have to change to comply with the more stringent requirements of IFRS. Although the SAP system is capable of providing the framework necessary to facilitate these changes, there will be a large element of change management and training to ensure that new requirements are properly understood and adhered to.

6.2 Calculation of IFRS compliant depreciation

Under GAAP, depreciation expense calculations incorporate factors relating to the service life of assets and cost of removals using a mass property approach based upon historical plant values. IFRS depreciation compliance requires that the Net Book Value (NBV) at transition be used as the basis for depreciation calculations and requires a transfer of asset retirement costs as well as the NBV of the retired asset to the income statement. The SAP asset management system is capable of providing the framework necessary for this work; however there will be a significant effort to transfer existing assets and ongoing projects into their new components at the transition date. New routines will be developed to ensure that asset retirements are identified and processed correctly.

6.3 Changes to Cost Allocations

Under IFRS, administration and other general overhead costs can no longer be capitalized. Work is underway to ensure that the costing systems and processes capture and allocate costs to capital projects in a manner that is IFRS compliant. This will require changes to activity rates, changes to overhead rates and changes to internal cost allocation routines. It may also require changes to time carding instructions and processes to ensure that costs charged are properly linked to the capital projects to which they pertain. The basic cost allocation framework developed in SAP is capable of meeting these requirements. However, there will be significant reworking of allocation processes and a significant change management and training requirement at the cost centre level.

Subsystems must also be assessed to ensure that the correct IFRS compliant information is being provided into the system and processed correctly. Reporting outputs may change and steps must be taken to ensure that they are understood correctly by the users of such information.

All work necessary to allow for the accounting of capitalized costs in an IFRS compliant manner will be completed for implementation in fiscal 2011/12 to allow for comparative year reporting. Any substantial system and process changes that are deemed to be appropriate to optimize related internal accounting processes will be developed and implemented in fiscal 2012/13.

7.0 Future IFRS Changes

MH is required to prepare its first set of IFRS financial statements in accordance with the standards that are in effect as at the end of the first year of adoption of IFRS (ie; March 31, 2013). MH chooses its accounting policies based on these standards and then applies them from the beginning of the comparative period, i.e. from April 1, 2011. MH's preliminary accounting policy choices as set out in this report, should not therefore, be considered final and may continue to evolve as the IFRS standards themselves change both before and after the transition date.

The IASB has a very active agenda and a number of projects may impact MH significantly. The effective date of any IFRS amendments and new standards is usually 6-18 months after their publication date. However, the IASB considers all relevant facts including whether to allow early adoption. It is important to note that many IFRS requirements will not change between now and fiscal 2012/13. However, there are significant changes to IFRS expected to be published by 2011 which may be available to be early adopted by MH and therefore may be applied by MH as it transitions to IFRS.

Set out below is a summary of the active projects that are relevant to MH:

Table 7.1 Relevant IASB Active Projects

Topic	Issues	Timing
Financial Instruments	The IASB has a three-part project to replace IAS 39, *Financial Instruments: Recognition and Measurement* with a new standard, IFRS 9. The three main parts of the project are: a) Classification and measurement; b) Amortized cost and impairment (loan loss provisions); and c) Hedge accounting. An additional part was added to the project to address the offsetting of assets and liabilities.	To date only the phase to address the classification and measurement of financial assets has been completed and the new standard was issued in Nov 2009. Proposals to address amortized cost and impairment were issued in Nov 2009. Proposals for the other parts of the project are expected in Q4 2010. The final standard is expected to be issued in Q2 2011. IFRS 9 has an effective date of Jan 1, 2013. However, the IASB indicated that it will consider delaying the effective date if delays on the impairment phase of the project make it necessary.
Fair Value Measurement Guidance	Potential guidance on definition and measurement of "fair value".	Proposals re fair value measurement were issued in May 2009. Expect final standard in Q1 2011.
Liabilities	Change in recognition criteria for all liabilities. "Stand ready obligations" must be recognized. Measurement based on expected present value. New rules for measuring obligations re services (e.g. decommissioning liabilities).	Initial proposals were issued in 2005. Limited scope amendments reissued in Dec 2009. Based on comments received, the IASB decided to continue deliberations and reconsider certain aspects of the project. The IASB tentatively agreed that once decisions have been reached, the revised standard will be re-exposed in its entirety for further comment. Expect the final standard post June 2011.
Post Employee Benefits	Fundamentally revisit accounting for employee benefits.	Proposals were issued in April 2010. Expect final standard in Q1 2011.
Emission Trading Schemes	Develop comprehensive guidance on accounting for emission trading schemes.	Expect proposals post June 2011.
Financial Statement Presentation	Fundamental reconsideration of the presentation of the contents of primary financial statements.	Expect proposals for the other primary statements in Q1 2011 and the final standard post June 2011.
Leases	Reconsideration of accounting for leases. Move to eliminate operating and finance lease classifications. All lessees to recognize a "right of use" asset and an obligation to pay.	Proposals were issued in Aug 2010. Expect final standard in Q2 2011.
Revenue Recognition	Develop a single comprehensive set of principles for revenue recognition.	Proposals were issued in June 2010. Expect final standard in Q2 2011.

8.0 Next Steps

The next steps in the project will focus on advancing all topics through phase 3 to phase 4 and ensuring that key systems and processes meet the accounting and reporting requirements for the 2011/12 comparative year and forward. This work will be performed with the assistance of MH's consultants.

8.1 Advancing Topics to Phase 4

Most topics are at the solution development stage where conclusions are being formulated for final review and approval. MH is advancing the componentization of PP&E assets and the establishment of IFRS compliant depreciation rates and plans to be in a position to implement this aspect of the project in the fall of 2011. MH is also advancing the review of its overhead capitalization policies and processes and plans the initial implementation of required changes in the spring of 2011. Any substantial system and process changes that are deemed to be appropriate to optimize related internal accounting processes pertaining to overhead capitalization policies will be developed and implemented for fiscal 2012/13. Solutions are being developed for a number of other topics with planned implementation in the 2011/12 comparative year. Lastly, detailed discussions with MH's external auditor Ernst & Young, will occur over the next year to obtain confirmation that MH has interpreted and applied IFRS consistent with their interpretation.

8.2 Changes to Key Systems and Processes:

For each accounting topic analyzed by MH, key systems and related processes and interfaces were identified. As outlined in section 6.0 of this document, the key system changes identified in the project pertain to impacts created by the additional componentization of PP&E assets and changes to overhead capitalization policies. The focus over the next year will be to implement planned changes, ensure all interfacing systems and processes are modified accordingly, document new systems and processes where required and train all users of the various systems and processes.

8.3 Training Programs

Throughout the project, MH has incorporated training into the various phases. Where possible, those most impacted by IFRS related changes have been involved in the development of solutions and identification of issues and related systems and processes. The next phase of the training process is to work with those groups to formalize detailed training programs so as to embed IFRS into the "business as usual" practices of MH. It is expected that this form of training will focus on the accounting policies that are changing, the reason for the change, and the impact on the systems and processes, as well as additional training for staff that are the most impacted on a day to day basis.