MANITOBA HYDRO
2015/16 & 2016/17 GENERAL RATE APPLICATION

APPENDIX 5.7
ACCOUNTING POLICY & ESTIMATE CHANGES

1.0 ACCOUNTING POLICY & ESTIMATE CHANGES

In Order 43/13, the PUB accepted the accounting policy changes that have been made by Manitoba Hydro to 2013/14 for the purposes of rate setting but indicated that until an IFRS Status Update Report is filed at the next GRA, no further changes should be made for rate-setting purposes.

> *"The Board understands that Manitoba Hydro has been making changes to its accounting policies since 2007/08 to be more consistent with other electric utilities as well as to be consistent with International Financial Reporting Standards. The Board in past orders had expressed concern with the level of capitalization and Manitoba Hydro has begun to address these concerns. In the Board's view, Manitoba Hydro's proposed accounting changes are appropriate for the test years. The Board will direct Manitoba Hydro to file an International Financial Reporting Standards status update at the next General Rate Application. Until such time, the Board expects Manitoba Hydro not to make any further accounting changes for rate-setting purposes."* (Order 43/13, pages 14-15)

> *"The Board accepts the depreciation rates applied April 1, 2011, which rates reflect the changes in service lives and the true-up of the accumulated depreciation surplus for the two test years. The Board also accepts Manitoba Hydro's position that net salvage should be removed from depreciation rates when International Financial Reporting Standards are implemented rather than during the test years."*(Order 43/13, page 18)

There are a number of prospective accounting changes that Manitoba Hydro is making for financial reporting purposes in 2014/15 and 2015/16. The most significant of these include the implementation of a comprehensive depreciation study in 2014/15 and further changes to the level of capitalized overhead and deprecation methodologies as part of the implementation of IFRS in 2015/16. These changes are discussed in the following sections.

2.0 DEPRECIATION STUDY 2014/15

Manitoba Hydro recently completed a new depreciation study in October 2014, which developed new Canadian GAAP (CGAAP) and IFRS compliant depreciation rates. In 2014/15, the Corporation will be implementing new CGAAP depreciation rates that reflect the extension of services lives of certain asset groups, which reduces annual depreciation expense. As outlined in Appendix 5.7 this change in accounting estimate of the asset service lives results in a reduction in depreciation expense of $25 million in 2014/15, $29 million in 2015/16, and $30 million in 2016/17.

3.0 IFRS IMPLEMENTATION 2015/16

Manitoba Hydro will be transitioning to IFRS effective April 1, 2015 for its 2015/16 fiscal year with comparative information presented for 2014/15. In addition, Manitoba Hydro will early adopt interim standard IFRS 14 Regulatory Deferral Accounts upon transition. This interim standard allows Manitoba Hydro to continue to recognize regulated assets and liabilities. This standard will provide temporary guidance until the IASB completes its comprehensive project on Rate-regulated accounting, which is expected to take several years to complete. MH14 assumes that regulatory deferral accounts will continue to be recognized throughout the 20 year forecast period. Please see Appendix 5.4 for the IFRS Status Update Report.

Generally speaking, the transition to IFRS will result in timing differences between when expenditures are recognized into income between Canadian Generally Accepted Accounting Principles (CGAAP) and IFRS. Manitoba Hydro recognizes that the different financial reporting requirements under IFRS will both increase and decrease annual net income. As such, Manitoba Hydro has considered the range of potential impacts and where possible, has selected accounting policies aimed at minimizing the overall impact to financial results and revenue requirements.

The primary impacts of IFRS accounting policy changes that are included in MH14 are as follows:

- Administrative and other general overhead costs are not eligible for capitalization under IFRS and must be expensed as incurred (please see Appendix 5.5 for more information);
- IFRS is more rigorous in terms of the componentization of assets and the recognition of gains and losses on the disposal/retirement of assets and does not allow the inclusion of asset retirement costs in depreciation rates (please see Appendix 5.7 for more information and the results of the 2014 electric depreciation study); and,
- Unamortized experience gains and losses on pension balances will be reclassified to accumulated other comprehensive income (AOCI) upon transition to IFRS.

3.0 TOTAL IMPACT OF ACCOUNTING POLICY AND ESTIMATE CHANGES

As summarized in the table below, the overall impacts of the accounting policy and estimate changes that are forecast to be made in 2014/15 and 2015/16 offset each other and result in an overall reduction in Manitoba Hydro's future revenue requirements. The significance of the net changes are minimal in the 2015 to 2017 period, and as such are not driving the need for the proposed rate increases.

Figure 5.6.1: Accounting Policy & Estimate Changes

Accounting Policy & Estimate Changes Electric operations (in millions of $s)										
	2015	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
OM&A Expense Changes		51	56	57	58	58	59	60	61	62
Depreciation Expense Changes	(25)	(53)	(57)	(60)	(76)	(86)	(96)	(101)	(103)	(105)
Other		(3)	(3)	(4)	(3)	(3)	(4)	(4)	(3)	(4)
Total Increase (Decrease) in Revenue Requirement	(25)	(4)	(4)	(7)	(22)	(31)	(41)	(45)	(46)	(48)

Given the offsetting nature of the various IFRS accounting changes and the depreciation estimate change as noted in the figure above, as well as the adoption of the interim standard IFRS 14 Regulatory Deferral Accounts, the use of IFRS financial reporting policies for rate-setting purposes is appropriate as there is no negative impact to ratepayers.

The following schedules provide additional detail with respect to the accounting policy and estimate changes in MH14.

SCHEDULE A - ACCOUNTING POLICY & ESTIMATE CHANGES - IFF14

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Ref
Electric only (in millions of $'s)											
OM&A											
Administrative Overhead		55	55	56	56	57	57	58	59	60	**1**
Meter Compliance, Exchange and Sampling		(1)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	**2**
Pension		0	3	3	3	3	3	3	4	4	**3**
Employee Benefits		(2)	(0)	(1)	(1)	(0)	(0)	(0)	(0)	(0)	**4**
Subtotal OM&A Changes		**51**	**56**	**57**	**58**	**58**	**59**	**60**	**61**	**62**	
DEPRECIATION EXPENSE											
Average Service Life Changes (2014 Depreciation Study)	(25)	(29)	(30)	(30)	(34)	(38)	(43)	(41)	(43)	(42)	**5**
Administrative Overhead		(0)	(2)	(4)	(6)	(7)	(9)	(11)	(13)	(14)	**1**
Meter Compliance, Exchange and Sampling		0	0	0	0	0	0	1	1	1	**2**
Removal of Net Salvage		(60)	(63)	(67)	(86)	(96)	(107)	(117)	(117)	(119)	**6**
Change to IFRS Compliant Depreciation		36	38	41	49	55	63	67	68	69	**7**
Subtotal Depreciation Changes	**(25)**	**(53)**	**(57)**	**(60)**	**(76)**	**(86)**	**(96)**	**(101)**	**(103)**	**(105)**	
FINANCE EXPENSE											
Total Finance Expense Accounting Changes		(0)	(0)	(1)	(1)	(1)	(2)	(2)	(2)	(3)	**8**
CAPITAL TAX EXPENSE											
Total Capital Tax Expense Accounting Changes		(3)	(3)	(3)	(2)	(2)	(2)	(2)	(1)	(1)	**8**
Total Increase (Decrease) in Revenue Requirement	**(25)**	**(4)**	**(4)**	**(7)**	**(22)**	**(31)**	**(41)**	**(45)**	**(46)**	**(48)**	

SCHEDULE B - ACCOUNTING POLICY & ESTIMATE CHANGES - IMPACT TO RETAINED EARNINGS & ACCUMULATED OTHER COMPREHENSIVE INCOME- IFF14

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	**Total**
Electric only (in millions of $'s)											
IMPACT TO RETAINED EARNINGS											
Annual change to OM&A	-	(51)	(56)	(57)	(58)	(58)	(59)	(60)	(61)	(62)	(521)
Annual change to Depreciation & Amortization	25	53	57	60	76	86	96	101	103	105	763
Annual change to Finance & Capital Tax Changes	-	3	3	3	3	3	4	4	4	5	(16)
Write Offs to:											
Administrative Overhead		(54)									(54)
Provision for Asset Removal		57									57
Change to Equal Life Group Depreciation		(33)									(33)
Pension & Employee Benefits		(24)									(24)
Total (Decrease) Increase to Retained Earnings	**25**	**(50)**	**4**	**7**	**22**	**31**	**41**	**45**	**46**	**48**	**171**
IMPACT TO AOCI											
IFRS Changes											
Pension Adjustment to AOCI		(445)	-	-	-	-	-	-	-	-	(445)
Pension Adjustment for discount rate changes		-	-	61	40	40	-	-	-	-	141
Total Annual Impact to AOCI	**-**	**(445)**	**-**	**61**	**40**	**40**	**-**	**-**	**-**	**-**	**(304)**

Reference	Description	Accounting Handbook Reference
1	The reduction in administrative and general overhead capitalized reflects adjustments to comply with IFRS upon transition. IFRS does not permit the capitalization of general administrative and overhead costs. The adjustments result in the following: • an annual increase in operating and administrative expense; • reductions in plant asset values for amounts no longer capitalized; and • reductions in depreciation expense as a result of reduced asset values.	**IFRS - IAS 16 Property, plant & equipment:** .19 Examples of costs that are not costs of an item of property, plant and equipment are:,… (d) administration and other general overhead costs.
2	IFRS requires uniform accounting policies to be applied to all entities in a consolidated group. Manitoba Hydro will be harmonizing its accounting policy with respect to costs associated with its Meter Sampling, Exchange and Testing program.	**IFRS 10 Consolidated Financial Statements** 19 A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances. <u>Uniform accounting policies</u>: B87 If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies.
3	Overall, changes to the accounting for pension and benefits results in an increase in pension and benefit costs upon transition to IFRS. The primary pension accounting changes include: • upon transition, unamortized pension gains and losses will be adjusted to accumulated other comprehensive income; • the elimination of "corridor" determined amortization for unrealized pension experience gains and losses as IFRS requires annual gains and losses to be recognized in Other Comprehensive Income; and • the use of the pension discount rate for recording expected returns on plan assets as opposed to the expected market interest rate of return as per CGAAP.	**IFRS – IAS 19 Employee Benefits:** .120 An entity shall recognize the components of defined benefit cost, except to the extent that another IFRS requires or permits their inclusion in the cost of an asset, as follows: (a) service cost in profit or loss;…, (c) re-measurements of the net defined benefit liability (asset) in other comprehensive income. .125 Interest income on plan assets is a component of the return on plan assets, and is determined by multiplying the fair value of the plan assets by the discount rate specified in paragraph 83, both as determined at the start of the annual reporting period, taking account of any changes in the plan assets held during the period as a result of contributions and benefit payments. .103 An entity shall recognize past service cost as an expense at the earlier of

		the following dates: (a) when the plan amendment or curtailment occurs; and (b) when the entity recognizes related restructuring costs or termination benefits (see paragraph 165).
Reference	**Description**	**Accounting Handbook Reference**
4	**Employee benefits:** The primary employee benefit related changes include: • upon transition, unamortized past service adjustments will be adjusted to retained earnings; and • future annual benefits expense will be higher for the recognition of benefits attributed to unvested employees for benefits such as sick leave and severance. Such unvested benefits were not recognized under CGAAP, but are required to be recognized under IFRS.	**Employee Benefits:** .15 Accumulating paid absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. ,..., An obligation arises as employees render service that increases their entitlement to future paid absences. The obligation exists, and is recognized, even if the paid absences are non-vesting, although the possibility that employees may leave before they use an accumulated non-vesting entitlement affects the measurement of that obligation.
5	The net result of the 2014 depreciation study and the average service life approach is an overall reduction in annual depreciation expense for MH due to changes in the service lives for certain asset groups. This change is required to be implemented under Canadian GAAP.	**CGAAP – 3061 Property, plant & equipment:** .28 Amortization should be recognized in a rational and systematic manner appropriate to the nature of an item of property, plant and equipment with a limited life and its use by the enterprise. .33 The amortization method and estimates of the life and useful life of an item of property, plant and equipment should be reviewed on a regular basis. [DEC. 1990 *****]
6	Upon adoption of IFRS, MH will be removing the impact of net salvage from depreciation rates.	-The Inclusion of net salvage in depreciation rates is a regulatory practice applied under CGAAP by Canadian utilities. Manitoba Hydro will be removing negative salvage from depreciation rates in order to manage the other accounting changes and minimize overall impacts to revenue requirement.
7	In order to satisfy the componentization requirements of IFRS, MH will be moving from the Average Service Life method of depreciation to the Equal Life Group method upon its adoption of IFRS.	**IFRS - IAS 16 Property, plant & equipment:** The key IFRS references supporting the move to the ELG method are: .43 Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

		.68 The gain or loss arising from the de-recognition of an item of property, plant and equipment shall be included in profit or loss when the item is de-recognized. Gains shall not be classified as revenue.
8	The changes to finance expense and capital and other taxes reflect the cumulative impacts of changes 1 – 7 as identified in this chart.	**Please see descriptions as provided in 1- 7.**

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SCHEDULE C - ACCOUNTING POLICY & ESTIMATE CHANGES - IMPACT ON IFF14

ELECTRIC OPERATIONS (MH14)
PROJECTED OPERATING STATEMENT
IMPACT OF ACCOUNTING POLICY & ESTIMATE CHANGES
(In Millions of Dollars)

For the year ended March 31	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
REVENUES										
General Consumers										
at approved rates	1 437	1 454	1 460	1 483	1 490	1 501	1 506	1 513	1 525	1 538
additional*	-	57	118	183	250	321	394	471	554	641
BPIII Reserve Account	(30)	(32)	(34)	(36)	(11)	-	-	-	-	-
Extraprovincial	409	434	450	457	479	514	817	943	959	987
Other	15	14	14	14	15	15	15	15	16	16
	1 831	1 928	2 008	2 101	2 222	2 351	2 732	2 944	3 054	3 182
EXPENSES										
Operating and Administrative	486	491	496	500	513	527	542	547	558	569
Accounting Changes:	-	51	56	57	58	58	59	60	61	62
Finance Expense	495	510	548	582	753	888	1 196	1 327	1 336	1 352
Accounting Changes:	-	(0)	(0)	(1)	(1)	(1)	(2)	(2)	(2)	(3)
Depreciation and Amortization	430	454	480	505	597	610	708	768	840	857
Accounting Changes:	(25)	(53)	(57)	(60)	(76)	(86)	(96)	(101)	(103)	(105)
Water Rentals and Assessments	124	123	112	112	112	114	124	127	132	132
Fuel and Power Purchased	134	130	191	202	207	205	234	263	257	267
Capital and Other Taxes	99	110	123	137	146	146	146	152	152	162
Accounting Changes:	-	(3)	(3)	(3)	(2)	(2)	(2)	(2)	(1)	(1)
Corporate Allocation	9	8	8	8	8	8	8	8	8	8
Other Expenses	2	2	2	2	2	3	3	3	3	3
	1 754	1 824	1 956	2 044	2 317	2 471	2 920	3 150	3 239	3 304
Non-controlling Interest	(25)	(12)	(8)	(7)	(5)	(4)	(10)	(0)	1	3
Net Income	102	115	59	64	(90)	(116)	(178)	(206)	(187)	(124)
* Additional General Consumers Revenue										
Percent Increase	0.00%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%
Cumulative Percent Increase	0.00%	3.95%	8.06%	12.32%	16.76%	21.37%	26.17%	31.15%	36.33%	41.72%

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