Rate Impact of adopting US GAAP

1. Based on Gazifère's analysis of US GAAP, the only impacts to rates identified as a result of adopting USGAAP are related to Pensions & Other post-employment benefits (OPEB).
2. Gazifère is requesting the Régie's approval to recover OPEB expense and pension expense on an accrual basis calculated in accordance with USGAAP rather than on the cash basis commencing January 1, 2013 in a manner appropriate for a rate regulated entity and incorporating the impacts as a Z factor to the incentive regulation (IR) formula (see GI-17, document 2.4).
3. Gazifère is also requesting the Régie to incorporate the estimated net rate decrease of $531,800 (see Appendix 1, GI-16, document 2.2.1), resulting from the change in accounting for Pensions & OPEB to an accrual basis as prescribed by USGAAP in the Z factor to the IR formula (see GI-17, document 2.4).

OPEB

4. The most significant post-employment benefits provided to employees are pension related benefits. In addition, employees are often entitled to non-pension related benefits. These are commonly referred to as OPEB. Unlike pensions, they are not typically pre-funded by employers. Gazifère does not set aside any funds for the future payouts but rather it is on a pay-as-you-go basis.
5. Under the current incentive regulation term ("IR"), Gazifère would recover OPEB expense based on amounts paid in providing the OPEB benefits as this is what affects earnings (i.e., cash basis of expense). In Gazifère's IR mechanism, OPEB cash basis expense of $32,600 is included in the base

year amount of the formula.

6. For Gazifère's employees, OPEB expenses include items such as supplemental health plans, dental plans, health spending accounts, and life insurance coverage for qualifying retirees.
7. These benefit plans are considered part of the employee's compensation package. Gazifère must provide these benefits to an employee in future periods relating to service provided by the employee in the current period.
8. OPEB payouts for current employees do not occur until the future when the employees are retired. Therefore many assumptions must be used to calculate the OPEB liability and expense. This involves actuarial analysis of future costs utilizing management's assumptions, which are discounted to present value. Gazifère utilizes the services of Mercer (Canada) Limited ("Mercer") for the estimate of the future OPEB liability and expense. Some of these assumptions utilized include discount rates, mortality rates, and estimated medical and drug costs.

Accounting for OPEB

9. Historically, the accounting for OPEB was straight forward for regulatory and financial reporting. The cash contributions, equal to benefit payments for retired employees, that Gazifère was required to contribute to meet its OPEB liabilities was the amount that was expensed on the income statement.
10. For fiscal periods beginning on or after January 1, 2000, Canadian companies were required to adopt accrual accounting for OPEB for external reporting purposes pursuant to Section 3461 of the Canadian Institute of Chartered Accountants ("CICA") Handbook – *Employee Future Benefits*. However, Gazifère and other rate regulated utilities in Canada were permitted to record OPEB on a cash basis with no recognition of the OPEB liability. Accordingly, there was no difference in the methodology for

calculating OPEB expense between financial reporting and regulatory purposes.[1]

11. Transitional Obligations occur on the adoption of the accrual method of accounting for OPEB. The Transitional Obligation represents the cumulative difference between accounting treatments up to the implementation date of the accrual method (i.e., October 1, 2000). This Transitional Obligation was to be amortized over 15 years (ending in 2015 if CGAAP would have continued) for accrual accounting for OPEB, representing the expected remaining average service life of employees at that time. There was no impact to Gazifère from a financial reporting perspective as it was permitted to continue utilizing cash accounting for OPEB. The Transitional Obligation had an unamortized amount of $111,000 as at December 31, 2011.
12. Effective January 1, 2009, the CICA removed the rate regulated entity exemption noted in paragraph 9 above and Gazifère and other utilities began to record as a regulatory asset, the cumulative difference in OPEB costs calculated under the accrual method and OPEB costs for regulatory purposes. The offsetting regulatory asset is not a Régie approved account but rather recognition of the difference between the existing regulatory approved method and amounts that are required costs which are reasonably recoverable regardless of differences in regulatory versus accounting recognition.
13. The impact of the removal of this exemption for rate regulated entities in Canada was that Gazifère had to record on the income statement an OPEB expense on an accrual basis which was then offset by the impact of recording a regulatory asset. On a net basis however, the net impact of these entries was that the OPEB expense reflected in the income statement

[1] It should be noted that OPEB expense for regulatory purposes would be based on expected OPEB costs whereas the OPEB expense on the financial statements would be based on actual cash payments.

equaled what would be recorded using the cash basis for financial reporting, consistent with the regulatory methodology. The balance sheet reflected the recognition of the OPEB liability along with the offsetting regulatory asset. The OPEB liability balance at December 31, 2010 and 2011 were approximately $768,000 and $854,000 respectively.

OPEB Accounting: Current Accounting (CGAAP) vs. USGAAP

Income Statement

14. OPEB expense calculated in accordance with CGAAP on an accrual basis commenced in 2009, although the impact of the offsetting regulatory asset resulted in an OPEB expense equal to the cash basis. Accrual expense under CGAAP for OPEB plans is typically made up of the following elements:
    a) Current service cost
    b) Interest cost
    c) Transitional obligation amortization
    d) Actuarial (loss)/gains amortization
15. Similar to CGAAP, USGAAP does not permit the cash basis to be used as a basis of accounting for OPEB. However, while an offsetting regulatory asset can be set up in CGAAP, in USGAAP there are only limited circumstances in which an offsetting OPEB regulatory asset can be recorded pursuant to ASC 980-715-25, the main criteria being Regulator's approval for deferral and future collection. Therefore, the regulatory asset recognized under CGAAP will be written-off to Retained Earnings upon adoption of US GAAP and Gazifère is requesting to recover that amount through its Z factor.
16. Accrual expense is required for USGAAP pursuant to ASC 715-60-35-7. The accrual expense under USGAAP is calculated in a manner that is very similar to CGAAP, with two exceptions. First, there is no concept of Transitional Obligation relating specifically to CGAAP conversion under

USGAAP so there is no related amortization amount included in USGAAP expense. The remaining unamortized portion will be written off to Retained Earnings upon adoption of USGAAP and Gazifère is requesting to recover that amount through its Z factor. Second, unamortized gains and losses are not directly charged to earnings but rather to Other Comprehensive Income ("OCI"). Unamortized gains and losses are charged to OCI and amortized into earnings over the expected average remaining service life of employees.

17. USGAAP expense for OPEB plans will typically consist of the following elements:

a) Current service cost

b) Interest cost

c) Actuarial (loss)/gains amortization

18. The calculation of accrual expense is similar in both USGAAP and CGAAP. Under CGAAP, accrual expense included the amortization of the Transitional Obligation, which has been written off for USGAAP purposes. Historically, the annual amortization has been approximately $27,000 and would be fully written off by 2015 if CGAAP had continued to exist.

<u>Balance Sheet</u>

19. As noted in paragraph 12 above, Gazifère's balance sheet has reflected an OPEB liability and an offsetting regulatory asset since the beginning of 2009. Previous to that, the amounts were only disclosed in notes to the financial statement. The OPEB liability recorded on the balance sheet is comprised of the sum of the following elements:

a) Opening OPEB Accrued Benefit Obligation

b) Current Service Cost - accounts for present value of the benefits accrued by current employees during the current year

c) Interest Cost - accounts for the cost of increase in present value of existing OPEB liability due to passage of time

d) Actuarial loss (gain) - accounts for the change in the OPEB liability as a result of changes in actuarial assumptions (i.e. discount rates, mortality rates, etc.) and plan experience

e) Benefits paid – cash amounts paid out by Gazifère

f) Unamortized Transitional Obligation – see paragraph 10

g)Unamortized net actuarial loss/(gain) – difference between actual experience and assumptions not yet recognized in the balance sheet liability

20. Gazifère's OPEB liability was approximately $854,000 as of December 31, 2011 for CGAAP purposes.

21. For USGAAP purposes, a regulatory asset cannot be recorded as noted previously without future recoverability substantiation and the existing asset will be written-off to Retained Earnings upon adoption of USGAAP. The OPEB liability recorded represents the funded status of the plan (i.e., OPEB Accrued Benefit Obligation)[2]. There are no plan assets to take into account. Gazifère's estimated OPEB liability was approximately $1,622,000 as of December 31, 2011 for USGAAP purposes (see GI-16, document 2.5, page 4), the difference between this amount and the $854,000 recognized under CGAAP relates to the exclusion of the unamortized Transitional Obligation and unamortized net actuarial gain. Based on Mercer's estimates, Gazifère's OPEB liability at Dec. 31, 2012 is expected to be approximately $1,729,000 (see GI-16, document 2.5, page 4).

22. For USGAAP purposes, the OPEB liability will include all elements as per CGAAP with two exceptions.

[2] ASC 715-60-25, *Defined Benefit Plans, Other Post-Retirement – Recognition*

a) Unamortized Transitional Obligation - this amount will be written off to Retained Earnings upon conversion to USGAAP.

b) Unamortized net actuarial loss/(gain) – this amount is now part of Accumulated Other Comprehensive Income (“AOCI”).

Accrual Basis of Accounting for OPEB

23. As noted, Gazifère proposes to adopt the accrual method of accounting for OPEB costs for regulatory purposes effective January 1, 2013.

24. There are several benefits of adopting the accrual method for OPEB accounting, including:

   i) OPEB regulatory accounting would then be in accordance with the accounting principles utilized for financial reporting purposes (i.e. USGAAP), and there would be reduced complexity for users of Gazifère’s financial statements. This would eliminate the need for OPEB related regulatory adjustments.

   ii) Harmonization with other utilities’ method of accounting for OPEB in Quebec, including Gaz Metro. This would assist in benchmarking against other utilities.

   iii) From an equity perspective, it makes more sense for the OPEB expense to be attributed to the periods in which the employees are providing services rather than burdening the full cost to future customers. According to the CICA handbook, “*The objective of accounting for the cost of Employee Future Benefits is to recognize a liability and a cost in the reporting period in which an employee has provided the service that gives rise to the benefits*”[3]

   iv) Harmonization with the concept of matching costs to the period in which they are earned rather than when they are paid.

[3] *CICA Handbook Section 3461, paragraph .002*

Forecasted accrual vs. cash OPEB expense (2013 – 2017)

25. Gazifère has considered the impact to the ratepayer over the next five years if it were to switch from cash basis of OPEB expense to the accrual basis of OPEB expense.

26. The baseline scenario results as prepared by Mercer for the next 5 years are as follows (in $ thousands) (see exhibits GI-16, document 2.5, page 5 and GI-16, document 2.6, page 3):

	Accrual basis	**Cash basis**
2013	$143	$43
2014	$139	$45
2015	$135	$52
2016	$131	$58
2017	$129	$60
Total	**$677**	**$258**

27. It is Gazifère's belief that future annual increases in the cash basis as a result of increased costs of OPEB will exceed the annual increases as calculated under the accrual method.

28. As highlighted in #4 above, OPEB is on a pay-as-you-go basis and therefore the projected cash funding costs shown in #26 are not sensitive to changes in the yield curve.

29. Mercer has also provided a sensitivity analysis on the impact to Gazifère under the accrual method if there is a +/- 1% change to the yield curve relative to current market assumptions. The impact to USGAAP accrual expense is as follows (in $ thousands) (see exhibit GI-16, document 2.5, page 8):

	+ 1%	**- 1%**
2013	($16)	$21
2014	($15)	$18
2015	($13)	$16
2016	($11)	$14
2017	($11)	$12

30. Based on the benefits of utilizing the accrual method as listed above, adjusting to the accrual method from the current cash method impacts the timing of when amounts are collected from ratepayers and not what is collected over the life of the OPEB plan. In fact, the accrual method ensures that the expense is attributed to the periods in which the employees are providing services rather than burdening the full cost to future customers. Gazifère is therefore proposing to recover OPEB on an accrual basis for rate making purposes.

<u>Rate impact of adopting accrual method for OPEB</u>

31. Gazifère estimates that the net impact of adopting the accrual method of accounting for OPEB is an increase in revenue requirement of $1,037,000, which represents the historical difference between the accrual basis and the amounts Gazifère has previously collected in rates determined on the cash basis (Appendix 1, GI-16, document 2.2.1). This impact, combined with the impact from adopting accrual method of accounting for Pensions results in a net decrease in revenue requirement of $531,800 (Appendix 1, GI-16, document 2.2.1).

Pensions

32. Under the current IR, Gazifère would recover pension expense based on amounts paid/contributions made to the pension plans as this is what affects earnings (i.e., cash basis of expense). Until 2012, Gazifère has not had to make such contributions and as such has not had to recover any amounts for rate-making purposes. The base amount to the IR formula does not include any pension expense.
33. Gazifère is proposing to switch from the cash basis of pension expense to the accrual basis of pension expense and as such would like to recover pension expense for rate-making purposes on the accrual basis.

Benefits of accrual pension expense

34. Accounting bodies have generally tried to match expenses to the proper time period in which the costs are incurred and revenues that are generated from those expenses. In the case of pension expense, the expense should be recognized in the period in which employees render services to qualify for employee future benefits. Current treatment of recovering pension expense on a cash basis does not factor in the period in which employee services were rendered, but rather the cash outlay in a year from employer contributions that has accumulated from years of employee services rendered. Further current treatment of recovering pension expense on a cash basis is unfair to current ratepayers as they bear the burden of an accumulation of years of employee services rather than current year of employee services.
35. Ultimately at the time the pension plan is wound up, pension expense under the cash basis and accrual basis would be the same. However the pattern in which these expenses are incurred differ under both scenarios as the cash

basis expense only arises when Gazifère is required to make contributions to the plan as stipulated by legislative requirements set by the Financial Services Commission of Ontario (since Gazifère's pension plan is part of the Enbridge Gas plan, administered in Ontario) and calculated in accordance with actuarial standards/rules. Accrual basis of expense on the other hand arises annually as employee services are rendered. Therefore the accrual basis of expense is fair to ratepayers and also provides for less volatility in rates.

36. Gazifère has considered the impact to the ratepayer over the next five years if it were to switch from cash basis of pension expense to the accrual basis of pension expense.

37. The baseline scenario results as prepared by Gazifère's actuary, Mercer, for the next 5 years are as follows (see exhibits GI-16, document 2.3, page 6 and GI-16, document 2.4, page 8) :

	Accrual basis	**Cash basis**
2013	$989,088	$812,720
2014	$853,100	$761,470
2015	$760,631	$721,196
2016	$678,155	$690,191
2017	$604,308	$667,033
Total	**$3,885,282**	**$3,652,610**

38. Although the accrual basis expense over the next 5 years is slightly higher than the cash basis expense, it is Gazifère's position that the accrual basis expense is more stable in the long run as it is less succeptible to shock from changes in assumptions. Mercer estimated the magnitude of impact on the total pension expense over the next 5 years under each basis as follows (in $

millions) (see exhibits GI-16, document 2.3, page 9 and exhibits GI-16, document 2.4, page 11) :

	Accrual basis	**Cash basis**
+ 20% equity return	$1.2	$1.5
- 20% equity return	$1.3	$1.0
+ 1% shift in yield curve	$0.8	$2.3
- 1% shift in yield curve	$0.6	$1.5

The Mercer estimates show that in general accrual basis expense is not as sensitive to shocks in pension plan assets and obligation as cash basis expense. This coupled with the benefits of accrual expense highlighted in #34 & #35 above support Gazifère's request to switch from the current cash basis to accrual basis of pension expense for rate-making purposes.

Accounting for Pensions

39. Gazifère's historical accounting for Pensions was similar to OPEB, with a consistent basis between financial reporting and regulatory purposes. Cash contributions equal to the net funding required per the actuarial valuation was the amount that was expensed on the income statement.

40. Upon adoption of CICA section 3461, Gazifère continued to record Pension on a cash basis with no recognition of the funded status on the balance sheet. There was no difference in the methodology for calculating pension expense between financial reporting and regulatory purposes.

41. A Transitional Asset occured on the adoption of the accrual method of accounting for pensions. This Transitional Asset represents the cumulative difference between accounting treatments up to the implementation date of the accrual method (i.e., October 1, 2000). This Transitional Asset was to be

amortized over 15 years (ending in 2015 if CGAAP would have continued) for accrual accounting for pension, representing the expected remaining average service life of employees at that time. There was no impact to Gazifère from a financial reporting perspective as it was permitted to continue utilizing cash accounting for Pension. The Transitional Asset had an unamortized amount of $399,400 as at December 31, 2011.

42. Subsequent to CICA's removal in 2009 of the rate regulated entity exemption Gazifère and other utilities began to record as a regulatory liability, the cumulative difference in Pension costs calculated under the accrual method and Pension costs for regulatory purposes. This offsetting regulatory liability is not a Régie approved account but rather recognition of the difference between the existing regulatory approved method and amounts that are required costs.

43. Gazifère had to record on the income statement a Pension expense on an accrual basis which was then offset by the impact of recording a regulatory liability. On a net basis however, the net impact of these entries was that the pension expense reflected in the income statement equaled what would be recorded using the cash basis for financial reporting, consistent with the regulatory methodology. The balance sheet reflected the recognition of the pension asset along with the offsetting regulatory liability. The pension asset balance at December 31, 2010 and 2011 were approximately $3,036,000 and $2,132,000 respectively.

Pension Accounting: Current Accounting (CGAAP) vs. USGAAP

Income Statement

44. Pension expense calculated in accordance with CGAAP on an accrual basis commenced in 2009, although the impact of the offsetting regulatory liability resulted in a pension expense equal to the cash basis.

45. Accrual expense is required for USGAAP. The accrual expense under USGAAP is calculated in a manner that is very similar to CGAAP, with two exceptions. First, there is no concept of Transitional Asset relating specifically to CGAAP conversion under USGAAP so there is no related amortization amount included in USGAAP expense. The remaining unamortized portion for the Transitional Asset will be written off to Retained Earnings upon adoption of USGAAP and Gazifère is requesting to recover that amount through its Z factor. Second, unamortized gains and losses are not directly charged to earnings but rather to OCI. Unamortized gains and losses are charged to OCI and amortized into earnings over the expected average remaining service life of employees.
46. The calculation of accrual expense is similar in both USGAAP and CGAAP. Under CGAAP, accrual expense included the amortization of the Transitional Asset, which has been written off for USGAAP purposes. Historically, the annual amortization has been approximately $234,159 and would be fully written off by 2015 if CGAAP had continued to exist.

<u>Balance Sheet</u>

47. Gazifère's balance sheet has reflected a Pension asset and an offsetting regulatory liability since the beginning of 2009. The net pension asset is recognized to reflect the positive funded status of the pension plan, indicating that the actuarial value of pension assets exceeds the pension liability. Previous to that, the amounts were only disclosed in notes to the financial statement.
48. Gazifère's Pension funded status (asset) was approximately $2,132,000 as of December 31, 2011 for CGAAP purposes.
49. With the recognition of pension expense on the accrual basis as proposed by Gazifère, the regulatory pension liability that was first recognized in 2009, will

need to be removed because going forward there would no longer be any difference between the regulatory and financial reporting pension expense as both would be on an accrual basis as proposed. Therefore, the regulatory liability recognized under CGAAP would be written-off to retained earnings upon adoption of USGAAP.

50. Similar to OPEBs, the unamortized loss/(gain) relating to Pensions is recognized in OCI and amortized to earnings through the accrual expense over the estimated average remaining service life of employees. Gazifère's estimated pension liability at Dec. 31, 2011 is $2,969,000 for USGAAP purposes, the difference between this amount and the $2,132,000 reported under CGAAP relates to removal of Transitional Asset and unrealized actuarial loss. Based on Mercer's estimates, Gazifère's pension liability is expected to be approximately $2,916,000 at Dec. 31, 2012.

Rate impact of adopting accrual method for pensions

51. Gazifère estimates that the net impact of adopting the accrual method of accounting for pensions is a decrease in revenue requirement of $1,568,800, which represents the historical difference between the accrual basis and the amounts Gazifère has previously collected in rates determined on the cash basis (Appendix 1, GI-16, document 2.2.1). This impact, combined with the impact from adopting accrual method of accounting for OPEB results in a net decrease in revenue requirement of $531,800 (Appendix 1, GI-16, document 2.2.1).