DECISION

NSUARB-P-111.6
2010 NSUARB 247

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE PUBLIC UTILITIES ACT

- and -

IN THE MATTER OF A REQUEST by **NOVA SCOTIA POWER INCORPORATED** for Approval of changes to its Accounting Policy and Procedures Manual

BEFORE: Murray E. Doehler, CA, P.Eng., Member

DECISION DATE: **December 20, 2010**

DECISION: **The changes to the Accounting Policy and Procedures Manual are approved.**

I INTRODUCTION

[1] Nova Scotia Power Inc. ("NSPI" or the "Company") made an Application to the Nova Scotia Utility and Review Board ("Board" or "UARB") for approval of changes to its Accounting Policy and Procedures Manual (the "Manual")

[2] The main thrust of the changes is to make the Manual compatible with Generally Accepted Accounting Principles ("GAAP") as practiced in the United States of America ("US").

[3] NSPI, and its parent Emera Inc., are adopting US-GAAP so as to be able to present the financial results in a way that is consistent with past reporting practices. As explained in this decision, Canadian GAAP ("C-GAAP") is moving to International Financial Reporting Standards ("IFRS"), which will not allow NSPI to present its financial results in the same way as used by the Board to determine and approve rates.

II BACKGROUND

[4] On May 14, 2010, NSPI submitted amendments to the Manual, which reflect NSPI's current accounting policies and procedures, for Board approval. Updated language was incorporated to reflect changes in processes and other details since the Manual was last approved by the Board. As the Company stated in its covering letter:

> NSPI plans to use United States Generally Accepted Accounting Principles (USGAAP) for external financial reporting beginning January 1, 2011. The Company anticipates that using USGAAP <u>will provide transparency for the Board, the financial community, stakeholders, and the general public.</u>
>
> The attached version of the Manual will serve as the basis from which the Company harmonizes its policies and procedures with USGAAP. The Chart of Accounts section of the Manual has been removed as it is filed separately with the Board on an annual basis. The most recent filing of the Chart of Accounts Update was provided to the Board August 31, 2009. This included changes to the Chart of Accounts to June 30, 2009.

> NSPI has engaged KPMG to assist with the transition to the new accounting standards. The Company will draft amendments to the attached policies and request a formal review by NSPI's external auditor, Grant Thornton, before submitting these to the Board for its review and approval.
>
> [Emphasis added]

[5] On June 11, 2010, NSPI submitted a proposed change to the Manual's Accounting Policy 6960. In the submission the Company noted the upcoming change to C-GAAP:

> In February 2008, the CICA announced Canadian Generally Accepted Accounting Principles ("GAAP") for publicly accountable enterprises will be replaced by International Financial Reporting Standards ("IFRS") for fiscal years beginning on or after January 1, 2011. The Company began planning its transition to IFRS in 2008 and transition activities progressed on schedule through 2009. In Q4 2009, due primarily to the continued uncertainty around the timing and eventual adoption of a rate-regulated accounting standard under IFRS, management of Emera, NSPI's parent company, began reviewing the option of adopting US GAAP instead of IFRS. Emera's Board of Directors approved the transition to US GAAP financial reporting standards effective 2011.
>
> The adoption of US GAAP is expected to result in fewer significant changes in the Company's accounting policies than would have been experienced with the adoption of IFRS.
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> [NSPI cover letter, June 11, 2010, pp. 1-2]

[6] The Company also stated:

> By June 30, 2010, NSPI will file a proposed amendment of its accounting policy for financial instruments and hedges for the Board's review and approval in advance of the adoption of US GAAP accounting standards on January 1, 2011. This amendment will limit the volatility in fuel expense and appropriately match the recognition of the expense with the hedge settlement period.

[7] The above noted proposed amendment was filed on June 30, 2010. On July 9, 2010, NSPI filed the first of three batches of changes to the Manual so as to conform with US-GAAP. As stated in the covering letter:

> NSPI intends to make three batch filings with the Board as sections of the external auditor review are completed. Please find attached, NSPI's first filing of revisions to the Manual for harmonization with US GAAP. The updates since the Manual was filed on May 14, 2010 are highlighted for the Board's reference. Included in the 24 sections listed in Appendix A (attached) is a copy of Accounting Policy 6960 Accounting for Financial Instruments and Hedging which was filed with the Board on June 30, 2010.

[8] The second and third submissions were received on September 13 and 24, 1010. On June 3, 2010, the Board retained the services of the accounting firm BDO Canada LLP ("BDO"). BDO was requested to advise the Board on the proposed changes to the Manual as NSPI converted from C-GAAP to US-GAAP. In particular, the terms included:

- A review of whether the changes proposed to the manual are reasonable, and
- Identify any policy changes that may provide NSPI with an unfair advantage in the future.

[9] The Board had also issued, in a letter dated October 6, 2010, information requests (IRs) for both NSPI and the consultant to consider. The Board also said:

> As you are aware the Board is working with a consultant from BDO Canada on the proposed changes to the Manual to align the policies and procedures with US GAAP. The consultant has finished work on the first submission, but due to the interrelation between submissions will not be completing three individual reports to the Board, but rather a final report that encompasses all the submissions. The consultant expects to file with the Board the final report by October 22, 2010.

[10] BDO was unable to complete the review by October 22, 2010, due to extra work that was not foreseen or factored into the original deadline. This additional work arose from ongoing meetings and consultation with NSPI and the Board. As well, NSPI, in a letter dated November 25, 2010, sought an additional change to the Manual. As a consequence of the above the deadline was revised to December 10, 2010.

[11] On December 9, 2010, BDO issued its Final Report.

[12] On December 16, 2010, NSPI advised the Board they had reviewed the Final Report and were generally satisfied.

III ANALYSIS

[13] Board approval is required for any changes to NSPI's accounting standards and policies before the amendments become effective. According to the *Public Utilities Act,* Chapter 380, s. 27, the Board may prescribe the form of all books, accounts etc.

> **Form of Books and records of utility**
>
> 27 The Board may prescribe the forms of all books, accounts, papers and records required to be kept by any public utility and every public utility is required to keep and render its books, accounts, papers and records accurately and faithfully in the manner and form prescribed by the Board and to comply with all directions of the Board relating to such books, accounts, papers and records.

[14] On May 7, 2010, the Board in its Order 2010 NSUARB 97 stated:

> ...that NSPI's use of United States Generally Accepted Accounting Principles as of January 1, 2011 as the standard for reporting purposes shall be exempt from the provisions of Board Regulatory Rule 32.

[15] NSPI's registration of certain of its debt securities with the US Securities and Exchange Commission ('SEC") was accepted on July 15, 2010. As a result of this registration NSPI became "...an SEC issuer with the reporting obligations associated with being a foreign private issuer in the U.S. ...[1]". Accordingly,

> NSPI is entitled to prepare its financial statements in accordance with U.S. GAAP under applicable Canadian securities laws and under the Nova Scotia *Companies Act* (the "Companies Act") provided it is subject to reporting obligations under U.S. securities laws. The Toronto Stock Exchange accepts financial statements that comply with applicable securities laws.
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> [NSPI letter December 16, 2010, p. 2]

[16] In the Final Report, BDO found the changes to be reasonable and outlined four areas for future consideration:

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[1] NSPI letter December 16, 2010, p. 3

Based on our review of the proposed changes to the Manual, we wish to confirm that nothing has come to our attention which appears unreasonable or which provides NSPI with an unfair advantage. We have summarized below a few items for your attention going forward:

- Under some circumstances a possibility exists that under US GAAP termination costs could be recognized earlier than Canadian GAAP.
- Accounting for Employee Future Benefits under US GAAP triggers a difference with an expected increase to regulated income in 2011 and 2012. At present accounting for such costs in 2013 and beyond is expected to be consistent with Canadian GAAP.
- Management has elected to account for Investment Tax Credits (ITCs) under US GAAP are directly expensed while under Canadian GAAP these amounts were being netted against the specific asset. This could result in a difference if ITCs become material in the future.
- We recommend that the Board monitor NSPI's first US GAAP statements to identify any transitional changes which might have been processed which have not been reflected in the revised Manual.

[BDO Final Report, p 1]

[17] BDO noted two other areas that may cause future differences in reported income:

...

Income Taxes: Accounting for Income Taxes under CGAAP and US GAAP has numerous differences and this section of the policy might need to be revisited after the first year of transition. However, the likely impact on regulatory accounting should still be minimal over time given the underlying taxable status does not change as a result of changing accounting standards.

...

Internal Software Costs: Going forward any significant costs invested in software incurred beyond the development stage would be expensed under the US GAAP but these amounts would likely have been capitalized under CGAAP. Note that the preparation of the annual ACE Plan still provides the Board the ability to review and approve or deny such costs including a review of the proposed accounting treatment of the costs.

[BDO Final Report, p 2]

[18] BDO also made the following observation:

Cost Allocation Policy: We noted that the Cost Allocation Policy is comprehensive and all the expected elements appear to be addressed. In an attempt to better understand the calculations and the underlying process we did review sample elements of the process.

The following was noted:

- A minor change in management judgment and assumptions could materially impact the amounts capitalized.
- Changes in judgment or assumption and a resulting increase or decrease in costs capitalized is not necessarily more or less accurate.

IV FINDINGS

[19] The publication of IFRS is under the authority of the International Accounting Standard Board ("IASB"). Regulated entities, such as NSPI, have the ability to recognize those assets and liabilities ("regulated assets and liabilities") which have been approved by a regulator in their published financial statements. This is the present case under C-GAAP before the changeover to IFRS on January 1, 2011. Regulated assets and liabilities are, at present, and for the foreseeable future, still recognized under US-GAAP.

[20] Over the past couple of years there has been substantial debate within Canada, and at the IASB Board meetings, as to whether or not regulated assets and liabilities can be recognized under IFRS. At present, with the deferral of consideration of the matter by the IASB, IFRS, as presently drafted, does not support the recognition of regulated assets and liabilities. This issue is still being actively considered by the IASB; however, a resolution will not occur before January 1, 2011, the date when Canadian enterprises must adopt IFRS.

[21] In recognition of this lack of clarity, the Accounting Standards Board of Canada, which is the authority for C-GAAP, has ruled that rate regulated entities can defer the use of IFRS on their published financial statements for one year. In other words, Canadian rate regulated entities which wish to follow C-GAAP do not have to

use IFRS until January 1, 2012. There is some doubt as to whether the IASB will come to a conclusion on regulated assets and liabilities before this new deadline.

[22] The existence of two conflicting accounting policies for regulated assets and liabilities will cause confusion and non-comparability of the financial statements of regulated entities for the next couple of years. In a worst case scenario, a rate regulated entity could adopt IFRS as of January 1, 2011, and write-off all its regulated assets and liabilities. Thereafter, it is a possibility, that the IFRS may be amended, such that rate regulated assets and liabilities can be recognized, in which case the financial statements would revert back, giving a couple of years of confusing, non-comparable results. The non-recognition of regulatory assets and liabilities would also require regulated entities to maintain two sets of records: one for the published financial statements; and, one for the regulator to use in determining just and reasonable rates.

[23] The above was part of the rationale in support of NSPI's request to the Board to be exempt from using C-GAAP. To enable the exemption from Board Regulatory Rule 32, the Board accepts the proposed changes to the Manual as being reasonable and approves the amendments to the Manual as presented by NSPI.

[24] On an annual basis, for the next two years, the Board orders NSPI to determine and file any differences in the application of accounting principles that may be caused by: termination costs; accounting for employee future benefits; investment tax credits; income taxes; and internal software costs.

[25] The Board also orders NSPI to file comparable annual financial statements as would have been prepared under the "old" C-GAAP as compared to US-GAAP for the

first year. In this, the Board would expect the Company to only report material differences which are in excess of $100,000.

V COMPLIANCE FILING

[26] NSPI is requested to file the complete revised Manual for final review by the Board as soon as possible.

[27] An Order will issue upon receipt and approval of the compliance filing.

DATED at Halifax, Nova Scotia, this 20th day of December, 2010.

Murray E. Doehler