INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

STATUS UPDATE REPORT as at April 30, 2012

Manitoba Hydro

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Executive Summary

Manitoba Hydro (MH) will be required to prepare financial statements in accordance with International Financial Reporting Standards (IFRS) effective for its 2013/14 fiscal year with comparative information presented for 2012/13. The 2013/14 transition year represents an additional one year deferral to MH's previous deferred transition date of 2012/13 and is the result of a recent decision by the Accounting Standards Board of Canada (AcSB) to extend the option for rate-regulated entities to defer their transition date to IFRS to 2013.

Overall, the transition to IFRS will not have significant impacts on the annual net income of MH. Increases to operating and administrative expenses due to reduced capitalization and elimination of deferrals will be substantially offset by corresponding reductions in depreciation and amortization. The net impact of the transition to IFRS for 2013/14 is expected to be a decrease to net income of approximately $13 million. The most significant impact of the transition to IFRS is that retrospective application for changes in accounting resulting from differences from existing GAAP is required. For MH, the transition to IFRS will result in an initial adjustment to retained earnings of approximately $361 million. The following table identifies the consolidated transitional adjustments and projected 2013/14 net income impact of MH's transition to IFRS:

IFRS IMPACTS INCREASE / (DECREASE) (In millions of dollars)		
	Retained Earnings April 1, 2013	**Net Income 2013/14**
Power Smart Programs	(236)	(7)
Site Remediation	(38)	2
Deferred Taxes (Centra)	(29)	2
Acquisition Costs (Centra & Winnipeg Hydro)	(20)	1
Regulatory Costs	(3)	-
Administrative Overhead	(38)	(38)
Employee Benefits	(22)	2
Removal of Asset Retirement Costs from Depreciation	58	60
Change to Equal Life Group Method of Depreciation	(33)	(35)
Total	**(361)**	**(13)**

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

Topic	Issue
Rate-Regulated Accounting	- IFRS does not currently recognize rate-regulated accounting, but recent discussions between the AcSB and the IASB indicate that the IASB may consider adding a project that addresses the impacts of rate regulation to its future agenda - The optional transitional deferral for rate-regulated entities was extended an additional one year to 2013 in March 2012 by the AcSB - In the absence of a standard that permits rate-regulated accounting, MH will charge approximately $326 million in rate regulated accounts and other items to retained earnings upon transition to IFRS and future expenditures on these items will be expensed as incurred - This change is expected to result in an increase to 2013/14 operating and administrative expense of approximately $48 million which is mainly offset by a decrease in annual amortization, finance expense, and taxes of approximately $46 million for a net income impact of $2 million.
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
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 - MH has established new components as part of their review for compliance with IFRS and has completed a depreciation study based on these new components - MH will change from the Average Service Life procedure to the Equal Life Group method for calculating depreciation rates so as to ensure that each asset within a pool is fully depreciated upon its retirement - MH will remove the provision for asset removal costs (negative salvage) from depreciation rates as this is not an IFRS eligible cost for self-constructed assets - The impacts to 2013/14 net income from the change to the Equal Life Group method and the removal of the provision for asset removal costs will result in an annual decrease in depreciation of $25 million

Topic	Issue
Capitalization of Overhead Costs	- IFRS specifically states that administration and other general overhead costs are not eligible for capitalization - To 2012/13, MH adjustments with respect to discontinuing the capitalization of overhead costs total approximately $58 million annually - MH will discontinue the capitalization of an additional $38 million of general overhead costs annually upon transition to IFRS - The $38 million is comprised primarily of expenditures for training, services and administration, and managerial related charges
Pension Costs	- IFRS does not permit the deferral of experience gains and losses for calculating expected fund returns and does not permit the use of expected asset returns in determining the discount rate used to measure the pension obligation - IFRS IAS 19 has been amended (effective January 1, 2013) such that all actuarial gains and losses are to be recognized in Other Comprehensive Income - MH expects to reclassify unrecognized actuarial experience losses to Accumulated Other Comprehensive Income upon adoption of IFRS
Employee Benefits	- IFRS requires the estimated obligation for the unvested portion of accumulating benefits to be recognized over the period of service - IFRS also requires past service benefit charges to be expensed as incurred - Upon transition, MH expects to recognize approximately $10 million of additional obligations with corresponding adjustments to retained earnings for unvested sick leave and severance benefits. - In addition, MH expects to charge approximately $12 million to retained earnings for unamortized past service balances for Retirement Health Spending Plan amendments

1.0 Introduction

The 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) standards requires that public-sector enterprises with self-sustaining commercial-type operations (government business enterprises) such as Manitoba Hydro (MH) 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 was to be reflected in MH's financial statements for the fiscal year 2012/13.

In March 2012, following discussions between the AcSB and the IASB, the AcSB approved an additional optional one-year deferral of transition to IFRS for rate regulated entities. These discussions suggested that the IASB may add a project that will address the impacts of rate-regulated accounting to its future agenda. The AcSB extended the transition date to IFRS for rate-regulated entities so as to allow time for the AcSB to consider its next steps should the IASB add such a project to its agenda. MH will adopt the additional one-year deferral and thus, the transition to IFRS wil be reflected in MH's financial statements for the fiscal year 2013/14 along with comparative information for the 2012/13 fiscal year.

Although IFRS and GAAP are both principles-based, there are a number of differences between IFRS and GAAP that will result in differences in the timing of when costs are recognized by MH. MH has completed its assessment of the major differences and has identified adjustments to retained earnings and ongoing differences in the timing of the recognition of certain transactions. The impacts of the transition to IFRS affect primarily the accounting for rate-regulated accounts, property, plant and equipment (PP&E), general and administrative overhead capitalized, and pension and benefits.

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

a) **Transitional Adjustments**

MH's transition to IFRS will result in adjustments to opening Retained Earnings and Accumulated Other Comprehensive Income (AOCI) as IFRS generally requires retrospective application. Such adjustments are somewhat less onerous due to an exemption that allows rate-regulated entities to carry-forward the historical cost of its PP&E upon transition to IFRS.

b) Ongoing differences

MH has identified ongoing differences in the timing of recognition of certain transactions under IFRS. In summary, increases in the amounts reported as annual operating and administrative expense resulting from annual expenditures that no longer qualify for capitalization or deferral is substantially offset by reductions in annual depreciation and amortization charges.

The following table identifies the consolidated transitional adjustments and projected 2013/14 net income impact of the transition to IFRS and the related accounting changes:

IFRS IMPACTS INCREASE / (DECREASE) (In millions of dollars)		
	Retained Earnings April 1, 2013	**Net Income 2013/14**
Power Smart Programs	(236)	(7)
Site Remediation	(38)	2
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Total	**(361)**	**(13)**

c) Project Costs

The initial conversion to IFRS will result in project costs associated with internal resources, external consulting, assurance requirements, and information systems. To date, MH has incurred and expensed project costs of approximately $4.5 million and is estimating the total project costs at completion to be approximately $6 million.

2.0 Overview of IFRS Conversion Project

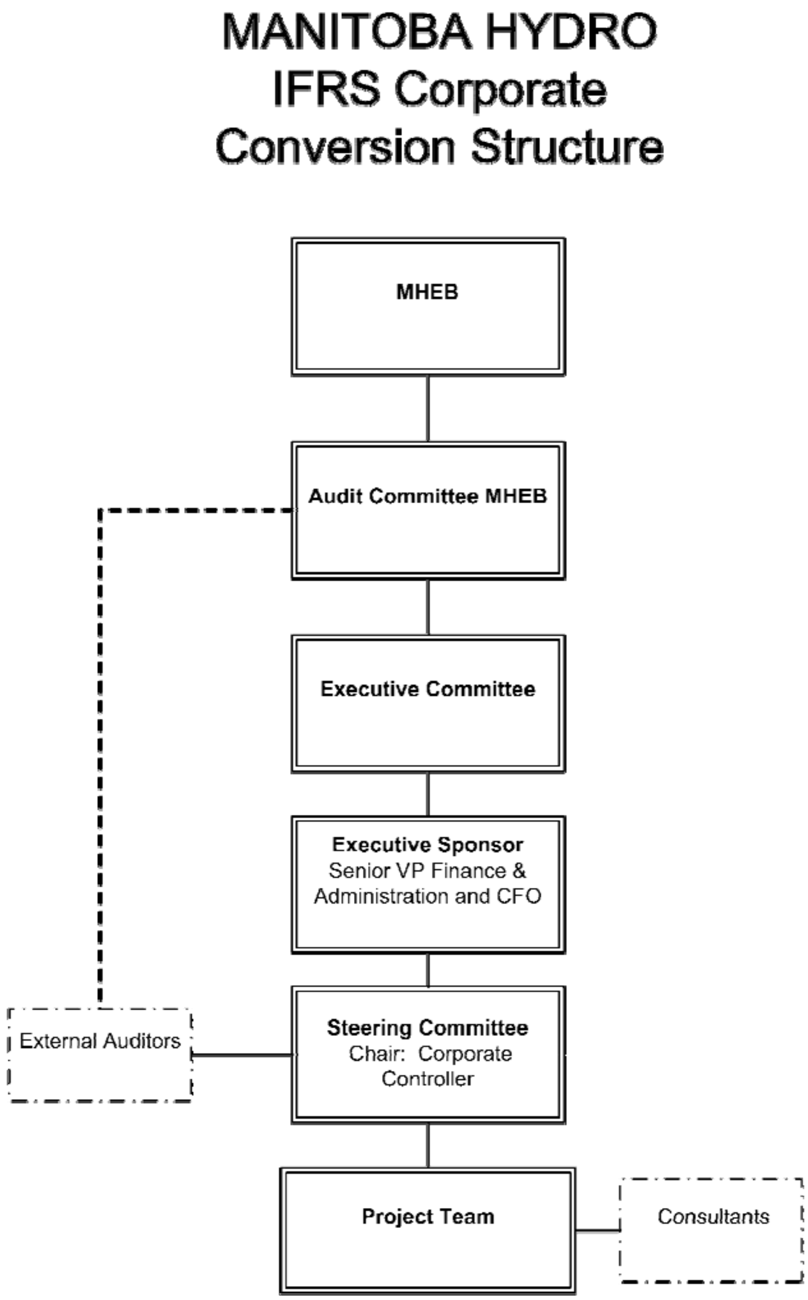
The following sections provide an overview of the MH IFRS conversion project structure, the project phases, and the roles of the external consultants and auditors engaged to assist MH with the adoption of IFRS.

2.1 Project Structure

In 2008, MH formed a project team to manage the overall conversion to IFRS. 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:



2.2 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 the 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.

2.3 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 rates and related 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.

2.4 External Auditors

In order to opine on MH's consolidated financial statements for the year ended March 31, 2014 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, 2012 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 current external auditor, Ernst & Young, has provided advice and has concurred with accounting changes that have been implemented to March 31, 2012. In addition, Ernst & Young has participated in discussions on various IFRS conversion issues particularly with respect to overhead costs eligible for capitalization and pension and benefits.

3.0 Key Areas of Impact

The following topic areas were analyzed as to their impact to MH upon conversion to IFRS:

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

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

3.1 Rate-Regulated Accounting

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

3.1.1 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 through to 2012/13.

3.1.2 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 (CEA), 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 PP&E 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 capitalization under IAS 16 Property, Plant and Equipment, IAS 23 Borrowing Costs and IAS 38 Intangible Assets.

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. On September 8, 2010, the AcSB approved an optional 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 adopted this deferral.

On September 16, 2010, the IASB 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. Potential paths forward for this topic as proposed by the IASB included:

- 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

In December 2010, the CEA met with the major international audit and accounting firms to discuss the potential for recognition of rate-regulated accounts under the existing IFRS framework. The firms did not support the CEA arguments on the premise that the ability to realize the future benefit from the asset was dependent on the provision of future services and for this reason, regulatory assets do not satisfy the criteria for recognition as an asset under IFRS. The firms also noted that rate regulated assets and liabilities are virtually non-existent under IFRS in all other countries. Only in limited circumstances, a financial asset may be created as a result of unconditional contractual rights to receive monies without the requirement to provide future service.

3.1.3 IASB Agenda Consultation:

In July 2011, the IASB issued an Agenda Consultation document that requested feedback from its constituents as to future strategic priorities and those areas of financial reporting that should be given the highest priority for improvement. The document lists the deferred projects of the IASB (including the rate-regulated accounting project) and requests suggestions for selecting new projects or removing projects to free up resources for other priorities. Comments on the IASB agenda consultation were due November 30, 2011. In the CEA's response to the consultation they indicated the need for the future agenda to address the impacts of rate regulation so as to reduce the extent of divergence in financial reporting emerging in the Canadian utility industry.

3.1.4 Recent Developments

In March 2012, members the IASB met with the AcSB, the Big 4 accounting firms and industry representatives (including members from the CEA) to discuss the Canadian feedback from the IASB 2012 agenda consultation. One of the main issues discussed was the divergence in practice (IFRS, US GAAP and modified IFRS) emerging in the financial reporting of Canadian utilities due to a perceived lack of clarity regarding the accounting for rate-regulated activities under IFRS. Participants at the meeting agreed that it would be preferred to address the rate-regulated accounting issue by way of a project on intangible assets as compared to a project to develop a stand alone standard for rate-regulated accounting. A project on intangible assets may also address the accounting for other utility related issues such as emissions trading. This option was well received by the IASB members attending the meeting, but as the IASB members pointed out, such a project on intangible assets would take several years to complete and would not solve the immediate financial reporting needs of the industry. In response, It was further suggested that an interim standard permitting the continued use of rate-regulated accounting in conjunction with the transition to IFRS be issued so as to reduce divergence in practice while a project on intangible assets was underway.

IASB representatives at the meeting acknowledged that this issue should be a priority and were amenable to an interim solution, but time and resources would prevent them from issuing an interim standard prior to 2015. IASB representatives noted, however, that its constraints did not preclude the AcSB from issuing some form of temporary relief pending the outcome of the IASB decisions on its future agenda. The IASB is expected to publish a feedback summary to their agenda consultation in the second quarter of 2012 and publish its agenda setting strategies thereafter.

Based on these discussions, on March 30, 2012, the AcSB announced its intention to extend the optional deferral of the mandatory changeover date to IFRS for entities with qualifying rate regulated activities by an additional one-year to January 1, 2013. The AcSB is expected to revise the CICA handbook to allow for the additional deferral in May of 2012. The deferral period will allow the AcSB time to consider its actions should the IASB add a project that will address the impacts of rate regulation to its agenda. MH is adopting the additional one year deferral and thus changing its transition date to IFRS from April 1, 2012 to April 1, 2013. As such, the transition to IFRS will be reflected in MH's financial statements for the fiscal year 2013/14, along with comparative information for the 2012/13 fiscal year.

3.1.5 Rate Regulated Accounts – Summary Impacts

MH's rate-regulated assets consist of the following:

- **Power Smart Programs:** represent expenditures for the costs of the Corporation's energy conservation programs for both the electric and gas operations.
- **Site Restoration Costs:** represent expenditures on restoring MH electric (including diesel sites) and gas sites.
- **Deferred Taxes:** represent the unamortized balance of taxes paid upon the acquisition of Centra Gas by MH. Upon Centra's acquisition, Centra became a nontaxable entity which triggered this charge to MH.
- **Acquisition costs**: represent the internal and external costs associated with the acquisitions of Centra Gas and Winnipeg Hydro.
- **Regulatory costs**: represent past MH internal and external costs associated with electric and gas regulatory hearings.

MH's regulatory assets do not meet the recognition criteria for intangible or financial assets under the current IFRS standards. Unless the IASB issues a standard that allows for the recognition of rate-regulated accounting prior to MH's transition to IFRS, these accounts will be adjusted to retained earnings and future charges will be expensed as incurred.

The following table summarizes the projected consolidated adjustments to retained earnings for rate-regulated assets upon the transition to IFRS (assuming current IFRS standards):

Table 3.1.1 Summary of Rate-Regulated Assets adjusted to Retained Earnings
(In millions of dollars)

Item	Electric		Gas		Consolidated
	March 31 2012	Fiscal 2012-13*	March 31 2012	Fiscal 2012-13*	
Power Smart Programs	178	5	46	7	236
Site Remediation Costs	35	1	2	-	38
Deferred Taxes	-	-	31	(2)	29
Acquisition Costs	21	(1)	-	-	20
Regulatory Costs	2	-	1	-	3
Reduction to Retained Earnings					**326**
Non-Rate Regulated Adjustments:					
Administrative Overhead					38
Removal of Asset Retirement Costs from Depreciation					(58)
Change in Equal Life Group Depreciation					33
Employee Benefits					22
Total Reduction to Retained Earnings					**361**

* 2012-13 projected expenditures net of amortization

The following table identifies the consolidated projected 2013/14 net income impact of the transition to IFRS for rate regulated accounts (assuming current IFRS standards):

Table 3.1.2 Summary of Rate-Regulated Accounts impact on 2013/14 Net Income (In millions of dollars)

CONSOLIDATED OPERATIONS IMPACTS – RATE REGULATED ACCOUNTS EXPENSE INCREASE / (DECREASE) FISCAL 2013-14 (In millions of Dollars)			
ACCOUNT	**ELECTRIC**	**GAS**	**CONSOLIDATED**
OPERATING & ADMINISTRATIVE			
Power Smart Programs	32	12	44
Site Remediation	2		2
Regulatory Costs	1	1	2
Total Operating & Administration	**35**	**13**	**48**
AMORTIZATION			
Power Smart Programs	(31)	(8)	(39)
Site Remediation	(4)	-	(4)
Regulatory Costs	(1)	(1)	(2)
Acquisition Costs	(1)	-	(1)
Total Amortization	**(37)**	**(9)**	**(46)**
FINANCE EXPENSE			
Power Smart Programs	2	-	2
Deferred Taxes	-	2	2
Total Finance Expense	**2**	**2**	**4**
CAPITAL & OTHER TAXES			
Deferred Taxes	-	(4)	(4)
Total Capital & Other Taxes	**-**	**(4)**	**(4)**
Net Income Decrease (Increase)	**-**	**2**	**2**

If the IASB issues a standard that allows rate-regulated accounting prior to MH's transition to IFRS, the retained earnings and net income impacts in tables 3.1.1 and 3.1.2 may be reduced or eliminated.

In addition to regulatory assets, Centra Gas also maintains a Purchased Gas Variance Account (PGVA) which represents the deferral of timing differences in the cost of gas from the actual amounts paid by MH and the amounts permitted to be recovered from the customers. This account may, at any time, be in an asset or liability position. MH is currently reviewing the appropriate treatment for the PGVA upon transition to IFRS.

3.2 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.

3.2.1 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 generally 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 and GAAP, 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)

IFRS 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, however, 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 will take the exemption and not restate any past business combinations.

3.2.2 Intangible Assets

The new Canadian standard (section 3064) 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. Upon the issuance of section 3064, an assessment determined that electric DSM activities did not meet the new intangible asset recognition criteria 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.

The new standard 3064 and IFRS specifically identify 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. Thus, upon adoption of section 3064, MH retrospectively adjusted unamortized DSM related balances for ineligible research and promotional related balances. The cumulative retained earnings adjustment associated with the April 1, 2008 DSM balance was approximately $5 million for electric related DSM charges and $1 million for gas related DSM charges.

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.

3.2.3 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.

3.2.4 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 3.2.1 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	5	1	6
Planning Studies	25	-	25
IT Application Development - Research	4	1	5
Other	1	-	1
Decrease to Retained Earnings	**35**	**2**	**37**

Table 3.2.2 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)	(1)	(2)
Planning Studies	(2)	-	(2)
IT Application Development - Research	(1)	-	(1)
Other	-	-	-
Consolidated Amortization Offsets	**5**	**-**	**5**
Net Income Impact	**1**	**(1)**	**0**

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.

3.3 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.

3.3.1 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 will 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.

3.3.2 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 its net book value – i.e. historical 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 will 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.

3.3.3 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 average 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. 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 similar useful lives. To the extent assets include components with different lives that would materially impact depreciation, these components must be separately depreciated. 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 primarily for generation and distribution assets.

With the assistance of its depreciation consultant, Gannett Fleming Inc., MH has established new component groupings consistent with the requirements of IFRS and has completed a depreciation study based upon these new component groupings. Normally, a depreciation study process is routine and involves updating the retirement experience of existing asset classes and reviewing operational factors to assess what new considerations are warranted. However, because of the new component groupings required under IFRS, an extensive effort involving accounting and operational personnel was required to research historical records and to assess operational factors of all new, existing and modified component groupings in order to establish account balances and to estimate service lives.

MH has implemented the new service lives that resulted from the depreciation study during its 2011/12 fiscal year. The impact of this change in estimate is to decrease depreciation expense by $36 million in 2011/12.

3.3.4 Change to Equal Life Group Method

A further IFRS related enhancement to depreciation calculations was that of moving from the Average Service Life (ASL) procedure to the Equal Life Group (ELG) procedure.

The ASL procedure, which has been used by MH in the past, calculates depreciation expense based upon the average life of all assets within each class. Under this method, those assets that have a shorter life than average will not be fully depreciated when retired from service. Conversely, other assets in this class that have a longer life than average will be over-depreciated when they are retired from service. Although broadly accepted for utility accounting under current GAAP, this method is viewed as deficient from an IFRS perspective because, except for those assets which have a life exactly equal to the average service life of that group, assets are being depreciated over a longer or shorter timeframe than their expected service life.

The ELG procedure addresses these deficiencies by developing depreciation rates with specific consideration of the expected retirement pattern for each asset type within each class. Every asset in the class is depreciated over its own expected service life and therefore is expected to be fully depreciated (not over or under depreciated) when it is removed from service. The resulting depreciation expense calculations are in compliance with IFRS.

Because the ELG procedure ensures that assets with a shorter service life than average are fully depreciated at their expected retirement date, there is an earlier recognition of depreciation expense (i.e. an increase to expense) than would be the case under the ASL procedure.

3.3.5 Gains and Losses on Disposal of Assets

Under existing GAAP, Canadian utilities are generally allowed to defer gains or losses that occur 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 losses on the retirement of plant assets in accumulated depreciation.

IFRS requires that any gains and losses on disposal/retirement of assets be recognized immediately in income. As indicated in the previous section, the application of the ASL depreciation methodology results in there being over or under depreciated assets when they are removed from service. To the extent that assets are over or under depreciated when they are removed from service, a gain or loss occurs. A further advantage of the ELG depreciation methodology is that depreciation expense is calculated such that these gains or losses are minimized or eliminated thereby minimizing any related charges against income.

3.3.6 Elimination of Asset Removal Costs from Depreciation Rates

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. This "precollection" of asset removal costs is maintained in accumulated depreciation reserves, and when assets are ultimately removed from service, the costs associated with the removal of an asset are charged against that reserve. Under this methodology, there are no direct charges against income for asset removal costs.

Negative salvage is not an eligible cost of self-constructed PP&E 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. To the extent that it is necessary to remove existing assets in order to replace them, the costs of removal of replaced assets will be capitalized as a cost component of the replacement asset. All other asset removal costs will be charged against income as incurred.

3.3.7 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 or provision is probable or "more likely than not". 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 a thermal generating station and a hydraulic generating station spillway, as well as for the removal and disposal of PCB's in HVDC converter station capacitors. MH has reviewed its circumstances and has concluded that no new provisions exist pertaining to constructive obligations relating to ARO's. 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.

3.3.8 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 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 April 1, 2012 retroactive adjustment is required to adjust for differences in capitalized borrowing costs. In addition, there are no April 1, 2012 retroactive adjustments that are required for componentization, the change to ELG, and the removal of negative salvage from depreciation rates.

3.3.9 Summary Impacts

The following Table summarizes the adjustments to retained earnings upon transition to IFRS for items pertaining to PP&E:

Table 3.3.1 Summary of Transitional Adjustments
(In millions of dollars)

Item	**Electric Fiscal 2012/13**	**Gas Fiscal 2012/13**	**Consolidated**
Change to ELG	(31)	(2)	(33)
Removal of the pre-collection of Retirement Costs	53	5	58
Increase to Retained Earnings	**22**	**3**	**25**

The following Table summarizes the net income impact in 2013/14 for items pertaining to PP&E:

Table 3.3.2 Summary of Net Income Impacts
(In millions of dollars)

Item	**Electric**	**Gas**	**Consolidated**
Change to ELG methodology	(33)	(2)	(35)
Removal of Net Salvage	55	5	60
Net Income Increase (Decrease)	**22**	**3**	**25**

3.4 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 construction 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 the following cost components from its capitalized overhead under GAAP (totaling $30 million annually through to the end of 2011/12):

Table 3.4.1 Costs no Longer Capitalized

Reduction to Costs Capitalized in fiscal 2008/09 (In millions of dollars)**:**

Interest and Facilities Overhead on Stores	**5**

Reduction to Costs Capitalized in fiscal 2009/10 (In millions of dollars)**:**

Executive Costs	2
Property Taxes on Facilities	2
	4

Reduction to Costs Capitalized in fiscal 2010/11(In millions of dollars)**:**

Interest on Common Assets (Facilities & Equipment)	12
General and Administrative Departmental Costs	5
Interest on motor vehicles	4
	21

MH will further eliminate $28 million of cost components from its capitalized overhead under GAAP in fiscal 2012/13. The $28 million is comprised of the following:

Reduction to Costs Capitalized in fiscal 2012/13 (In millions of dollars)**:**

IT Infrastructure and Related Support	18
Building Depreciation and Operating Costs	10
	28

MH has completed its review of its capitalization methodology, including the cost components and activities currently being capitalized to assess costs eligible for capitalization under IFRS. This review considered all guidance available in the accounting standards, interpretations from the major international accounting firms (including Ernst & Young), as well as information from the CEA and other Canadian utilities.

The review concluded that an additional $38 million (Electric - $36 M, Gas $2 M) of annual charges do not meet the IFRS criteria for capitalization. A summary of these ineligible charges is as follows:

Table 3.4.2 Additional Costs Ineligible for Capitalization upon Transition to IFRS (In millions of dollars)**:**

Technical and Soft Skills Training	11
Service Areas (Management accounting, Treasury, HR, Safety, etc)	9
Administrative & Clerical Support Staff	9
Division and Department Manager	7
Fleet & Stores Administration	2
	38

The $38 million of ineligible charges consists of expenditures where a direct link to a specific capital asset cannot be made due to the nature of the expenditure or expenditures for items such as training which is explicitly disallowed for capitalization by IFRS unless incurred in respect of specific staff to commission a specific asset.

Work to allow for the accounting of capitalized costs in an IFRS compliant manner will be completed for implementation in fiscal 2012/13 to allow for comparative year reporting.

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 to April 1, 2012. However, $38 million of expenditures capitalized under GAAP for the fiscal 2012/13 fiscal year will have to be adjusted to retained earnings upon transition to IFRS.

3.5 Pension and Benefit Costs

There are a number of differences that will result from adopting IFRS for defined benefit pension plans and other employee benefits.

3.5.1 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 based on either the fair value or a market-related value (moving average not exceeding a period of five years) of the assets. MH currently 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 based on the fair value of assets at the beginning of the period.

3.5.2 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.

3.5.3 Discount Rate

GAAP CICA section 3461.063 states that "*the discount rate used to determine the accrued benefit obligation shall be the interest rate determined by*

a) market interest rates at the measurement date on high-quality debt instruments with cash flows that match the timing and amount of expected benefit payments; or

b) The interest rate inherent in the amount at which the accrued benefit obligation could be settled.

MH determines its annual discount rate through consultation with its external actuary, as well through the review of discount rates used by other Canadian utilities and the Civil Service Superannuation Board. The discount rate currently determined by MH under GAAP involves a weighting of interest rates on high quality debt instruments along with the expected return on fund assets (consistent with part (b) of 3461.063) as determined by its actuary.

Under IFRS, IAS 19.83 states that, *"the rate used to discount post-employment benefit obligations (both funded and unfunded) shall be determined by reference to market yields at the end of the reporting period on high quality corporate bonds. In countries where there is no deep market in such bonds, the market yields (at the end of the reporting period) on government bonds shall be used.*"

The determination of the discount rate under IFRS for MH will be lower than the discount rate determined under GAAP as the expected return on fund assets will no longer be included in the determination of the rate. The reduction in the discount rate will result in an increase in the pension obligation balance which will be recognized as a transitional adjustment to AOCI upon conversion to IFRS. This transitional treatment is consistent with the requirements of the amended IAS 19 standard where actuarial gains and losses are recognized in Other Comprehensive Income.

3.5.4 Amended IFRS for Employee Benefits (IAS 19)

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 did not require significant changes to the measurement provisions, but proposed significant changes to the recognition, presentation and disclosure of defined benefit plans. In June, 2011, the IASB published the amended standard on employee benefits; effective for annual periods beginning on or after January 1, 2013.

In addition to the fore-mentioned differences between IFRS and GAAP for pension accounting, the significant changes introduced by the amended standard that impact MH are as follows:

- That entities recognize re-measurements (actuarial gains and losses) 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 actuarial 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. The amended standard eliminates the corridor calculation.
- The discount rate used to measure the defined benefit obligation will also be used to calculate the expected returns on plan assets. 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 that focuses on the characteristics of defined benefit plans and the risks associated with the plans.
- That the IFRS 1 exemption allowing an entity to adjust all unamortized actuarial gains and losses to retained earnings upon transition be eliminated.

3.5.5 Transitional Requirements (IFRS 1 – Amended IAS 19)

The amended IAS 19 is effective for MH for the 2013/14 fiscal period, but early adoption is permitted. MH is adopting the amended IAS 19 upon transition to IFRS and its April 1, 2012 cumulative unamortized experience gains and losses will be reclassified to Accumulated Other Comprehensive Income at that time.

3.5.6 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.

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.

The following table identifies the consolidated transitional adjustments associated with employee benefits:

Table 3.5.1 Transitional Adjustments – Employee Benefits

(In millions of dollars)

Item	Retained Earnings
Unamortized Past Service Amendments for Retiree Health Spending Account	(12)
Recognize Unvested Sick Leave liability	(5)
Recognize Unvested Severance liability	(5)
Increase (Decrease)	**(22)**

3.6 Financial Instruments

For the most part, GAAP is substantially harmonized with IFRS with the introduction of standards 3855 Financial Instruments – Recognition and measurement and 3865 Hedges, 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.

3.6.1 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.

3.6.2 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.

3.6.3 IASB Project

The IASB is currently working on a project to replace IAS 39, Financial Instruments: Recognition and Measurement with a new standard, IFRS 9. The objective of the project was to improve the usefulness of financial statements by simplifying the classification and measurement requirements for financial instruments. Some of the potential impacts to MH from the new standard is as follows:

- Sinking funds would be reclassified from the current available-for-sale category to amortized cost;
- There will no longer be the requirement to recognize changes in fair value due to changes in interest rates for sinking fund assets in Other Comprehensive Income; and
- Hedge accounting effectiveness testing will be more closely aligned with risk management and will be simplified by eliminating the 80% - 125% bright line and retrospective testing.

The IASB has indicated that IFRS 9 will be effective for annual periods beginning on or after January 1, 2015.

3.7 Leases

In general, the principles relating to accounting for leases under CICA standard 3065 Leases 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.

3.7.1 IASB Exposure Draft on Leases

In August 2010, the IASB issued an Exposure Draft on Leases. The Exposure Draft was 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 have impacted 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; and
- The Lessor would recognize an asset representing its rights to receive lease payments and, depending on the circumstances of the lease, recognize a lease liability while continuing to recognize the underlying asset or de-recognize the portion of the underlying asset that is transferred to the lessee.

In general, the feedback received on the ED indicated that the proposals were overly complicated and would be costly to implement. As a result, The IASB is developing some simplifications to the ED with the intention to re-expose the lease accounting project by the second half of 2012.

3.8 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 energy distributor 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) from MH. 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.

3.9 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, 2014. 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, 2013, it will be necessary to prepare and present a comparative opening balance sheet under IFRS as at April 1, 2012. 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 re-measuring 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. This will require the retrospective adjustment of accounts. However, there are certain exemptions and/or elections to this general principle which allow prospective application. In addition, IFRS 1 prohibits retrospective application in certain areas.

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 considering in the various sub-sections of this report.

4.0 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.

4.1 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.

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.

4.2 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 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.

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.

4.3 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.

5.0 Key Systems & Processes

As identified early in the 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 2012/13 comparative 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:

5.1 Componentization of Property Plant & Equipment

This change will require that capital project forecasts and expenditures be further delineated into constituent components. The SAP system is capable of providing the framework necessary to facilitate these changes. Fixed Asset ledgers have been updated with new component groupings. There will be a large element of change management and training to ensure that new requirements are properly understood and adhered to across the organization.

5.2 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 PP&E Net Book Value (NBV) at transition be used as the basis for depreciation calculations. In addition, the depreciation method must switch from the average service life method to the equal life group approach. The SAP asset management system is capable of providing the framework necessary for this work as new opening component balances are being determined and depreciation calculation processes utilizing the ELG approach have been put in place. There will be a significant effort to transfer existing assets and ongoing projects into their new components. New routines will also be developed to ensure that asset retirements are identified and processed in more detail than previously required under GAAP.

5.3 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 labour rates used for capitalization, as well as changes to overhead rates and internal cost allocation routines. It will 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. There will be 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.

Work to allow for the accounting of capitalized costs in an IFRS compliant manner will be completed for implementation in fiscal 2012/13 to allow for comparative year reporting.

6.0 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, 2014). 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, 2012. 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 2013/14. However, there are significant changes to IFRS that were published in 2011 which may have an impact to MH and there are several active projects of the IASB that may have implications to MH post transition to IFRS.

Set out below is a summary of recently issued IFRS that may be relevant to MH:

Table 6.1 Relevant IFRS Changes

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. Exposure draft for general hedge accounting issued in December 2010. The proposal attempts to: - Align hedge accounting more closely with risk management - Simplify effectiveness testing by eliminating the 80% - 125% bright line test.	To date only the phase to address the classification and measurement of financial assets and liabilities has been completed and the new standard has been issued. a) IASB extended the effective date for IFRS 9 to Jan 1, 2015. b) Based on comments received to past documents, IASB continues to work on a general impairment model for financial assets. c) Re-deliberations on general hedge accounting were completed in September 2011. Re-exposure will not be necessary. Draft on final requirements is being prepared.

Topic	Issues	Timing
Fair Value Measurement Guidance	New standard (IFRS 13 Fair Value Measurement) issued by IASB in May, 2011. IFRS 13 defines fair value and sets out in a single standard a framework for measuring fair value. Describes how to measure fair value when another IFRS standard requires fair value.	To be applied prospectively for annual periods beginning on or after January 1, 2013, with early application permitted.
Consolidations	New standard (IFRS 10 Consolidated Financial Statements) issued by IASB in May, 2011. IFRS 10 does not change consolidation procedures. It provides guidance on whether an entity should be consolidated by revising the definition of control. Establishes one control model that applies to all entities. December 2011, IASB issued an Exposure Draft re: proposed amendments to IFRS 10 to clarify the transitional requirements.	IFRS 10 and the amendments to IAS 27 are effective for annual periods on or after January 1, 2013 and must be applied retrospectively. If adopted early, must be adopted with IFRS 11 (Joint Arrangements) and IFRS 12 (*Disclosure of Interests in Other Entities*).
Disclosure of Interests in Other Entities	IFRS 12 *Disclosure of Interests in Other Entities* was issued by the IASB in May 2011 and requires increased disclosure of relationships with subsidiaries. Expands disclosure requirements as parent now required to disclose summarized financial information for each subsidiary that has material non-controlling interest.	Effective for annual periods beginning on or after January 1, 2013, with earlier application permitted.
Presentation of Financial Statements	In June, 2011, the IASB issued amendments to IAS 1 *Presentation of Financial Statements* to change the grouping of items in OCI. Current and future changes to IFRS will result in increased recognition of items in OCI (eg. IFRS 9 Financial Instruments, IAS 19 Employee benefits). Items that could be reclassified to profit and loss at a future date (i.e. recycled) are to be classified separately from items that will never be recycled.	Amendments are effective for annual periods beginning on or after July 1, 2012.

Set out below is a summary of IFRS projects that may be relevant to MH post transition to IFRS:

Table 6.2 Relevant IFRS projects

Topic	Issues	Timing
Leases	IASB and FASB are reconsidering the accounting for leases. Proposals were issued in August 2010 which included the elimination of operating and finance lease classifications. Comments on original ED indicated the proposed amendments were too complex. The IASB will be proposing significant changes to original ED proposal including clarification over the issue of control over an asset.	Expect to issue revised ED second half of 2012.
Revenue Recognition	Develop a single comprehensive set of principles for revenue recognition on when and how revenue should be recognized; to improve comparability over a range of industries / companies and countries. Exposure Draft was issued in June 2010. Comments on original proposal found it too complicated. Re-Exposure Draft was issued in November 2011. Comments are due March 2012.	Comment letters on November 2011 Exposure Draft will be reviewed in Q2 2012. Expect final standard later in 2012 or 2013.

7.0 Next Steps

The next steps in the project will focus on ensuring that key systems and processes meet the accounting and reporting requirements for the 2012/13 comparative year and forward. This work will be performed with the assistance of MH's internal IT staff.

7.1 Advancing Topics to Phase 4 - Implementation

Most topics are nearing the end of the solution development stage where conclusions are being reviewed, recommendations drafted, and implementation plans are being developed. 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. Detailed discussions with MH's external auditor Ernst & Young to obtain confirmation that MH has interpreted and applied IFRS consistent with their interpretation are ongoing.

7.2 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 5.0 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 current focus is 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.

7.3 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.