MANITOBA PUBLIC UTILITIES BOARD

Re: MANITOBA PUBLIC INSURANCE COMPANY (MPI)
GENERAL RATE APPLICATION
FOR 2011/12 INSURANCE YEAR

Before Board Panel:
Graham Lane - Board Chairman
Len Evans - Board Member

HELD AT:
Public Utilities Board
400, 330 Portage Avenue
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Pages 1055 to 1297

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--- Upon commencing at 9:02 a.m.

THE CHAIRPERSON: Okay. Good morning, everyone. And welcome to the new witness for today. Ms. Kalinowsky, first of all, I think you've got some new undertaking exhibits to file.

MS. KATHY KALINOWSKY: Yes. Good morning, Mr. Chair, member of the panel, Mr. Evans, and others. Prior to the commencement of the direct examination of Mr. Olfert I'd like to file Undertaking number 16, which is the KPMG review of the allocation methodologies. And I've passed that out to Mr. Simonsen, and I understand from speaking with Mr. Simonsen that it should marked as MPI Exhibit number 13.

THE CHAIRPERSON: Thank you.

--- EXHIBIT NO. MPI-13: Response to Undertaking 16

THE CHAIRPERSON: So welcome, Mr. Olfert. Mr. Simonsen, if you wouldn't mind swearing in Mr. Olfert.

MPI PANEL 2:

RICHARD OLFERT, Sworn

THE CHAIRPERSON: Thank you. You can start your direct examination at any time.

MS. KATHY KALINOWSKY: Good morning. I'd also like to introduce not only Mr. Richard Olfert, who the Board is familiar with, but to his immediate right is Mr. Steve Martens, also of Deloitte, to assist. And also Ms. Rohini Halli, on the far right, also of Deloitte. They will not be witnesses, but they're kind of -- they are here in respect of a back row support, even though they have moved to the front row since it's a bit crowded. But it's not the intention to have them as witnesses.

THE CHAIRPERSON: That's fine. Thank you.

EXAMINATION-IN-CHIEF BY MS. KATHY KALINOWSKY:

MS. KATHY KALINOWSKY: Mr. Olfert, you've testified previously before the PUB on the expense allocation methodology, didn't you?

MR. RICHARD OLFERT: Yes, I have.

MS. KATHY KALINOWSKY: And can you give some -- the Board just a brief synopsis of the background with respect to your professional qualifications?

MR. RICHARD OLFERT: I'm a Chartered accountant in Manitoba, a partner with Deloitte and

Touche since 1995, and awarded the Fellow of the Institute of Chartered Accountants in 2005.

MS. KATHY KALINOWSKY: And are -- you were one (1) of the authors of the expense allocation methodology that MPI's proposing for use in its 2012/13 rates?

MR. RICHARD OLFERT: That is correct.

MS. KATHY KALINOWSKY: I'm going to talk now -- direct examination is going to be divided into three (3) different areas. First is the asset and liability allocation methodology, followed by the cost allocation methodology update from last year, and finishing off with IFRS.

First with respect to the asset and liability allocation methodology, Mr. Olfert, you're one (1) of the authors of the Asset and Liability Allocation Methodology Report, is that correct?

MR. RICHARD OLFERT: Yes, I am.

MS. KATHY KALINOWSKY: And that report is filed at AI.19 of the Corporation's filing.

Can you give us an -- tell us what is the scope and purpose of the report that was prepared by Deloitte.

MR. RICHARD OLFERT: The mandate which we were provided is summarized on page 2 of that report, and that mandate was to review MPI's existing asset and liability allocation methodology, and to develop either a new or revised allocation methodology that could be used now, and could continue to be used into the future as MPI makes its planned operational and service deliver integration changes.

In particular, we reviewed the current asset and liability allocation methodology that is in place. We conducted a review of asset and liability allocation practices among other industry participants. We sought to define each asset liability account and we identified and defined appropriate allocators for those accounts and ultimately prepared a report on our findings and our recommendations.

MS. KATHY KALINOWSKY: Just a general level, but what are the assets and liabilities that MPI is seeking to allocate through this report?

MR. RICHARD OLFERT: The purpose of the report is to assist MPI in allocating all of its assets and all of its liabilities and all of its equity accounts that sit on its balance sheet between its lines of business. More specifically, if one looks at the assets, there are three (3) key types of assets.

The first and the largest is the Corporation's investments which comprise almost 80 percent of the assets at February 28th, 2010, which is the balance sheet that we worked with.

The second type of asset is a series of -- I'll call them working capital items, that arise because there's a difference in timing between when a transaction occurs and when it's settled in cash, and that comprises about 13 percent of the assets.

And the third type of assets are the long-term assets of the Corporation that are used over time, and those include property and equipment, deferred development costs, and the deferred acquisition costs which comprise about 7 percent of the assets.

Now, in terms of asset allocation, that's an interesting mix because, unlike many other organizations, the level of investments is very high because of the nature of the business, and the level of property and equipment and long-term assets is generally lower compared to other organizations.

In terms of liabilities, there's also three (3) key types. The first is the provision for unpaid claims, which is almost 70 percent of liabilities.

The second type is the liabilities associated with employee benefits, including pension plans, and that comprises about 10 percent of the liabilities. And then, again, there are working capital items arising from the timing of business transactions, which include unearned premiums, accounts payable, and amounts that are due to other insurance companies for roughly 20 percent of the liabilities. And a very high proportion of those liabilities, as you will see in a moment, are related specifically to individual lines of business.

And then, lastly, the equity accounts are to be allocated. These are comprised of the rate stabilization reserve, the retained earnings, and the Extension Development Fund, all of which are tracked by line of business, and, also, the accumulated other comprehensive income, which will need to be allocated in the process of the methodology.

MS. KATHY KALINOWSKY: Mr. Olfert, when I was reviewing the asset and liability allocation I noticed that there's a lot of similarities to the expense allocation methodology. Can you explain how this methodology builds upon the previous expense allocation methodology that Deloitte had worked on.

MR. RICHARD OLFERT: The asset and liability allocation study and methodology were deliberately undertaken in a manner which is consistent with the expense allocation work. And there are two (2) dimensions to that similarity or that deliberate linkage of the two (2). The first is the approach that we took to our work, and secondly is the use of common and related allocators wherever possible.

So let me address those two (2) items individually. First, in terms of the approach to our work, there were a number of common elements to both studies and to both methodologies. The first is that they are both founded on an understanding of the operations. And so we assessed to be -- we assessed to determine any differences that arose in operations from when the time that the expense allocation methodology was developed in 2009 and when the asset liability allocation methodology was developed in 2010. And we updated that understanding for new information, and that -- the new information effectively related to the ongoing transition of claim centres into service centres and the closing of the -- virtually all of the driver testing locations and shifting those functions to service centres.

Another common element between the two (2) studies was the research into comparators. There was research done on both primary comparators and secondary comparators. On the primary comparators, this was principally SGI and ICBC, and the secondary compare -- comparators were industry associations, professional literature, the work of review panels, and the submissions by regulated entities.

And coming out of the research into comparators there were similar conclusions between the two (2) studies. The primary comparators were helpful but not directly comparable for a variety of reasons, and the secondary comparators provided a small amount of helpful information.

Both studies are also built on the same set of five (5) guiding principles. The -- the methodologies are both intended to be fair and reasonable, both intended to be practical and efficient, both intended to be flexible and adaptable for the future, both intended to be acceptable in a regulatory context, and both consistent with Industry standards.

There was a new principle adopted for the preparation of the asset liability allocation methodology, and that was the principle of symmetry. And that was so that we would have a deliberate intentional link with the expense allocation study, and that principle of symmetry recognizes that many of the assets and liabilities that are to be allocated are either related to, or created by, particular revenues and expenses. And so when an asset, or a liability, such as property, is directly related to an expense, such as depreciation and the operating costs of that property, from the -- the principle of symmetry would have the same allocator used to allocate both items.

Two (2) other areas of similarity between the -- the two (2) methodologies: The first is that we applied the same conceptual approach. You will recall that in the expense allocation study, we needed to determine whether the incremental approach, or the pro rata approach would be used. In both, the expense allocation and the asset liability allocation, the pro rata approach is used because of the advantages with -- which it offers. And from an asset liability allocation point of view, having selected it for the expense allocation, it was logical and consistent, and appropriate, to use the same basis for the asset liability allocation.

And then the final similarity is that we identified that it would be preferable for accounts that are to be allocated -- that -- that accounts that need to be allocated to lines of business would first be assigned where possible, and that assignment of accounts would be maximized, and then remaining accounts would be allocated.

And as I mentioned, the second overall linkage between the two (2) is the effort to use similar allocators based on that concept of symmetry.

MS. KATHY KALINOWSKY: Thank you for that explanation. I'm going to ask you to proceed with another explanation, and that is to explain the asset and liability allocation methodology.

MR. RICHARD OLFERT: Let me begin with an introduction, and then I will ask you to refer to the methodology document itself.

The first step in the process was to assess the base of information that would need to be allocated. And so when we looked at the asset, liability, and equity accounts of the Corporation, there are approximately two hundred and sixty (260) general ledger accounts. And when we reviewed them, we first sought to see whether purification adjustments might be appropriate as they were when the expense allocation methodology was prepared.

And our conclusion was that the concept still applies; where purification could be done, it would be helpful to do so. However, in looking at the construct and the contents of the general ledger accounts, it was our conclusion that no purification adjustments are required at this time.

So the conclusion for the asset liability study was to deal with those accounts on an account-by-account basis. And simply by way of contrast, that differs from the expense allocation where we used cost categories, and that's a function of the fact that when the expense general ledger accounts are reviewed, there are literally thousands of them, and for practical purposes MPI groups them into accounting units, and for further practical purposes they were grouped into cost categories. And so, because of the limited number of accounts, we chose to deal with things on an account-by-account basis.

The second key element in the planning for the allocation methodology was to use a similar approach that was used in the expense allocation of working off a decision tree basis, but our conclusion was that because of the limited number of accounts, and because of the principle of symmetry, we could streamline the decision tree so that it didn't have as many levels to it as the expense allocation methodology does.

And so if I can ask you to turn to page 27 of the asset liability allocation report, at the top of that page is a decision tree which outlines the concepts behind the allocation methodology.

So the first stage in the allocation process is to identify those accounts that are directly related to a line of business so that they can be directly assigned to that line of business.

And so, for instance, if you look for some examples in terms of asset categories, there are basic amounts due from other insurers that would assigned to Basic. There are SE -- SRE payments due from brokers that are assigned to the SRE line of business and reinsurer's share of unpaid claims can also be tied to individual lines of business, so accounts like those are assigned. From an asset point of view, that is a small portion of the assets, only 5 or 6 percent, because the largest block of the assets, being the investments, are held for all lines of business.

When one looks at the liabilities for some examples, about 85 percent of the liabilities can be directly assigned at Stage 1. And for an example, there are forty-six (46) general ledger accounts for unpaid claims, and each of those is identified by the line of business to which it relates, and so assignment can be done. In terms of the equity accounts, the rate stabilization reserve and the various retained earnings accounts and funds can be assigned, whereas the accumulated other comprehensive income cannot.

So those general ledger accounts that cannot be directly assigned go into a Stage 2 assessment. And at Stage 2 each of those as yet unallocated accounts is assessed to determine what gives rise to the balance in the account, and then to study what the right allocator would be.

So, for example, there are several accounts to be allocated that related to employee future benefits, so our assessment was that those accounts relate to the Corporation's employees. And we know from the cost allocation work that employee payroll costs are assigned and allocated in that methodology. And so the conclusion for employee future benefits, was to use the ratio of payroll costs to si -- to allocate the employee future benefits.

Another example would be service centres, where we -- or we -- where we are able, in the course of the expense allocation, to assess where the accupant -- occupancy costs and the depreciation are allocated, and then that ratio of property costs is used to allocate the asset.

So if I can also ask you then to turn over a couple of pages to pages 30 and 31. You will see a list, and in a chart that continues between the two (2) pages of all of the allocators that are used at Stage 2, and that -- there's a list of fifteen (15) or so of them. But a key point to be made when you look at these allocators, is that there are fundamentally four (4) of them that allocate most of the dollars.

So by way of illustration, the total dollars that are allocated when you add up asset, and liability, and equity accounts is just over $3 billion. There are four (4) ratios that allocate 96 percent of those dollars. The first one, which allocates the most, is the investment ratio, which allocates about 2.3 million -- 3 -- $2.3 billion of assets. The second one is the property cost ratio, which allocates about 4 percent of the allocated dollars. The third one is the payroll ratio, which allocates about 8 percent of the allocated dollars. And the last one is the top one on page 31, which is the PWFC-F allocator which allocates about 8 percent of the allocated dollars, principally, a very large accounts receivable account.

And the last comment I'll make with respect to the functioning of the methodology is that at Stage 2 the allocators are used to allocate all of the assets and all the liabilities and the accumulated other comprehensive income except the investment ratio. And with those accounts -- sorry, except the investment accounts. With those accounts then being allocated and that being combined with the accounts that are assigned, there are partial balance sheets for each of the lines of business, and the investment ratio is the ratio that's required to have each of those balance sheets balance, so that for each of the lines of business the balance sheet abides by the required accounting formula of assets equalling liabilities plus equity.

MS. KATHY KALINOWSKY: At this stage I'm going to file an exhibit for Mr. Olfert to explain the next part of the cross-examination. So I'll just hand it over to Mr. Simonsen, but I believe it would be marked as MPI Exhibit number 14, and it's the asset/liability allocation methodology applied to February 28th, 2010.

THE CHAIRPERSON: Thank you.

--- EXHIBIT NO. MPI-14: Asset/liability allocation methodology applied to February 28th, 2010

MR. RICHARD OLFERT: If everyone's received that exhibit, let me walk you through it.

At February 28th, 2010, the balance sheet of Manitoba Public Insurance can be summarized with the figures that are in the box in the top right-hand corner: total assets of nearly 2.8 billion, liabilities and equity totalling the same.

At Stage 1, each of the two hundred and sixty (260) general ledger accounts that comprised those asset, liability, and equity totals are analysed to determine which are directly assignable. And so if you follow through Stage 1 in green, through the directly assignable box, you can see that all of the figures that appear in green rows are the balances of accounts which are assigned.

So in the case of the assets, as I described earlier, the dollars that can be assigned are relatively small, in large measure because the single largest asset, being investments for 2.2 billion, needs to be allocated.

In terms of the liabilities, by way of contrast, almost $2.1 billion can be directly assigned: 1.8 billion to Basic insurance, 106 million to Extension insurance and so on.

And similarly, with the equity accounts, the rate stabilization reserve can be directly assigned to Basic insurance and the various retained earning accounts and fund accounts can be directly assigned to the other lines of business.

Those of the general ledger accounts that cannot be assigned need to be allocated, and they follow through the subject to allocation box into Stage 2. And based on the allocators that we just reviewed on pages 30 and 31, those general ledger accounts are allocated between the four (4) lines of business, and in each case, those are the rows in blue.

And so you'll see under the assets that there's a total of $2.6 billion that are allocated to the lines of business, according to the figures that you see there, and as I said earlier, the largest part of that is the investments. A much smaller portion of the liabilities need to be allocated, and that's done to the total of $333 million. And in terms of the equity, the other -- the accumulated other comprehensive income of $40 million is to be allocated, and it is, according to the figures that are there.

That allocation approach then -- then having placed assets, liabilities and equity by way of assignment, and allocation into each of the lines of business produces the balance sheets for each of the individual lines of business. And so under Basic insurance you see the numbers in purple representing the total assets of 2.3 billion, total liabilities of 2.1 billion, and equity of 260 million. And that's the balance sheet of Basic insurance and it similarly works its way across the page for the various lines of business.

So that's the application of the methodology to the February 28th, 2010 balance sheet.

CONTINUED BY MS. KATHY KALINOWSKY:

MS. KATHY KALINOWSKY: Thank you very much for those comprehensive responses and explanations, Mr. Olfert.

I'll change gears a little bit here, but what attributes have been incorporated into this methodology to mitigate the risk of it becoming overly complicated?

MR. RICHARD OLFERT: The risk of over-complication is one (1) of the potential disadvantages that has been identified for the pro rata approach. And from our perspective that risk is caused principally by the potential for excessive use of allocators that require considerable judgment.

And so the mitigating actions in this situation to prevent over-complication, are very similar to those that were put in place for the expense allocation. So those would be first, to maximize the assignment of accounts where possible and to minimize allocation. Secondly, to purify accounts wherever possible, and, if not thought necessary at February 28th, 2010, to monitor the contents of general ledger accounts into the future to determine whether fur -- further purification would be beneficial.

Another action that's required is continued diligence, on the part of the Corporation, to update the methodology for changes in circumstances to ensure that those accounts which are assigned remained pure and appropriately assigned to individualize the business.

Another action is to adopt objective allocation measures where possible and to be highly reluctant to adopt highly subjective allocators.

Maintaining symmetry is another important aspect of preventing over-complication in our view.

And the last one that we would highlight is that, from our perspective, it's important when looking at potential allocators to do a cost benefit on the quantum of the dollars to be allocated, versus the increase in precision that a more complex or subjective allocator might provide.

And so a great deal of subjectivity could create a more precise allocator, but is the additional subjectivity worthwhile given the potentially small balance of an account to be allocated?

MS. KATHY KALINOWSKY: And can you also provide a comparison to both SGI and ICBC, in terms of what they do for their asset and liability allocations?

MR. RICHARD OLFERT: Let me deal with

those two (2) separately.

First, SGI. SGI manages a wide variety of insurance services across Canada, and one (1) of the insurance services that it manages is the Saskatchewan Auto Fund, which is a fund of the Province of Saskatchewan. And the operations of the Saskatchewan Auto Fund also include the driver and vehicle licensing functions.

In the case of SGI, all of the assets and liabilities are self-contained within the independent fund that is accounted for, and so there is no allocation that is required to generate the balance sheet for the basic operations of the Saskatchewan Auto Fund.

In the case of ICBC, ICBC's basic insurance includes personal injury and third party liability coverage, but it excludes core collision coverage. And, in addition, ICBC's basic insurance provides the driver and vehicle licensing functions.

Consequently, the significant allocation for ICBC is the allocation between the basic and the competitive lines of business, and allocation of balance sheet to non-insurance operation is not contemplated in that methodology.

So with respect to the asset and liability allocation at ICBC, there's only one (1) allocation that's done, and that is to allocate the investment assets between the basic and the competitive lines. And that allocation is done using a composite ratio that's comprised of unearned premiums, unpaid claims, and retained earnings for those two (2) lines of business, and then that same composite ratio is also used to allocate investment income.

So ICBC does not prepare a fully allocated balance sheet for in -- any individual line of business, and that approach to allocation has been applied consistently since it was first filed in 2003.

MS. KATHY KALINOWSKY: At the end of the day, can you explain what is the financial impact of adopting the new methodology, as compared to the previous methodology.

MR. RICHARD OLFERT: To assist in responding to that question, I will direct everyone to page 4 of AI.19.

And that page, prepared by the Corporation, highlights the balance sheet of the Corporation at February 28th, 2010, according to the existing asset/liability allocation methodology which the Corporation employs, in the left-hand column. And the middle column is those same -- is the -- is the allocation of the same MPI, February 28th, 2010 balance sheet, according to the methodology that we've propose. And these figures, in both cases, represent the balance sheet for the Basic line of business.

And there are five (5) key financial impacts from the application of the new methodology.

The first relates to, and I'll follow them in the order of the -- of the note numbers. The first one relates to a shift in the allocation of accounts receivable. The accounts receivable account in question is compli -- comprised of amounts due from customers for Basic premiums, Extension premiums, driver licensing fees, and registration fees.

And the current allocation reflects the inclusion of the Basic premium and the Extension premium in the allocation; it does not incorporate the incluse of the other fees. And so the revised allocation which we've proposed contemplates the inclusion of those items, which shifts receivables out of the Basic line of business.

The second significant change comes in the property and equipment asset category, and this is fundamentally a shift of assets out of the Basic balance sheet, on account of the allocation of service centres, and the increasing allocation as service centres are put into use.

The third difference of significance relates to accounts payable, and that difference relates to two (2) specific accounts where our view was that the -- there was a preferable allocator in one (1) case, directly assigning an account to non-insurance; and in another case, suggesting that the account should be based on the expense distribution ratio rather than being directly assigned to Basic.

The fourth significant difference comes in the provision for employee benefits. And this occurs because the allocator which we are recommending is the payroll ratio, which in our view is the best allocation of the employee future benefits across the employee group, and that has the impact of shifting a larger portion of that liability to other lines of business.

And the fifth area of significant difference is in the cash and investments line, and due to the way that investment ratio works that is the amount that's required to balance the adjustments so that the assets and the liability equity side of the balance sheets are similarly adjusted.

MS. KATHY KALINOWSKY: Mr. Olfert, can you explain what is the impact on investment income.

MR. RICHARD OLFERT: The study which we provided focussed on the asset and liability allocation, and the allocation -- the change in the allocation of investments will have a -- a resultant impact on investment income.

We have not quantified that, nor been engaged to do so.

MS. KATHY KALINOWSKY: In conclusion, what is your opinion on the current and the proposed asset and liability allocation?

MR. RICHARD OLFERT: Our views on the current and proposed allocation methodologies are set out at the bottom of page 34 of our report, under the heading, "Concluding Remarks," and let me summarize those.

The asset and liability allocation methodology that MPI is currently using is sound, and it's based on the same principles that we are advocating in our report. The methodology which is proposed incorporates much of the existing methodology, and many of the existing allocators, and for those accounts which required allocation, there was a readily identifiable allocation which could reasonably allocate the account balance across the lines of business, as required. And for certain accounts there was, in our view, a requirement for an adjustment to the allocator, and we've made those recommendations.

MS. KATHY KALINOWSKY: Thank you for that, Mr. Olfert. I'm going to move now into the next area of my direct-examination, and that is in regards to the expense allocation.

Deloitte last year had done work on the expense allocation methodology. Can you explain what Deloitte was engaged to undertake for the methodology for this year.

MR. RICHARD OLFERT: In short, we were engaged to assist the Corporation in responding to PUB Order 161/09.

MS. KATHY KALINOWSKY: Can you provide a summary of the work completed by Deloitte.

MR. RICHARD OLFERT: There were a number of elements to that work, all of which were undertaken in collaboration with MPI. The first broad area was to do further research on the expense methodology, and that was done principally by comparing and contrasting the methodology as it applied to the 2009/10 year, which work appeared in our report of a year ago, and to compare that to the application of the methodology to the budgeted amounts for the 2010/2011 year.

So that work incorporated a number of components. The first was to assess the 2010/11 plans for any changes in the operation that would affect the methodology. The second component was to review those purification adjustments which we had proposed for 2009/'10, to determine whether they were still appropriate, and then to determine whether additional purification adjustments -- opportunities might be available for 2010/2011. A third component of the work was calculate the allocators for 2010/11 and to compare them for '09/'10. And as a result of all of that work, several minor items were identified and adjusted in the methodology.

The second broad area of work related to recalculating the allocation of expenses for the 2010/2011 budget. And that was done employing the refinements that came out of the first part of the work and incorporating Directive 6 from last year's Board order around the allocations of costs at Level D. And that work identified that the percentage of costs allocated to each line of business were largely consistent with the results for 2009/2010.

That was the work we undertook with respect to Directive 4. With respect to Directive 6, the directive was that premiums written, rather than claims incurred, should form the basis of the allocation at Level D of the cost allocation methodology, and that revised allocator was used in the recalculation of the

'10/'11 expense budget allocation.

MS. KATHY KALINOWSKY: Thank you, Mr. Olfert. After you testified last year and the Board issued its Order 161/09 and we had -- the Corporation sent a copy of that order to you, have you reviewed that order?

MR. RICHARD OLFERT: Yes, I have.

MS. KATHY KALINOWSKY: And can you -- and can you state whether the methodology and application is in compliance with Order 161/09?

MR. RICHARD OLFERT: In my view it is.

MS. KATHY KALINOWSKY: Can you state what the financial impact is of Order 161/09?

MR. RICHARD OLFERT: To describe that impact, it is easiest if I refer to page 10 of TI.6, and the comparison you've asked me to make I will do on the basis of the 2010/2011 figures. And you can see there that allocation of costs at Level D changes from 86.9 percent to Basic, according to the methodology as originally proposed, and it shifts to 82.4 percent, based on the PUB's directive.

If we translate that into dollars, the impact is approximately a $6 million shift out of Basic, about four point eight (4.8) of that to Extension, and about one point two (1.2) to SRE.

MS. KATHY KALINOWSKY: Thank you. I'll move on now to the final area of my direct examination, and that is with respect to IFRS.

Can you explain the nature of your -- of Deloitte's engagement with MPI with respect to IFRS, including the time spent, the meetings Deloitte had with MPI management, meeting with the Audit Committee, and the duration of Deloitte's engagement with MPI.

MR. RICHARD OLFERT: Deloitte was engaged to assist MPI with a number of aspects of the implementation of IFRS. We were engaged to assist in the development of a plan for transition to IFRS. We were engaged to lead the execution of that plan in collaboration with management of MPI. We were engaged to identify the key decisions and elections that MPI would need to make. Also, to assist in the training and learning of the Corporation's people and management and Audit Committee, and to provide advice on the preparation of financial statements in accordance with IFRS.

The engagement began in November of 2008 and a significant amount of work has taken place since then, and the current engagement continues until the first set of IFRS compliant financial statements are prepared in the spring of 2011.

As to the nature of the work that's been done, there has effectively been two (2) streams to that work. The first is the execution of that mandate in collaboration with management, and I'll describe that in more detail in a moment. And the second stream of activity has been to communicate with and report on progress to MPI's audit committee. Again, I'll comment on that in a moment.

So with respect to the collaboration with management that began in November of 2008, when there was an initial scoping workshop held over a period of two (2) days, the purpose of the workshop was to review the -- to review, in broad terms, the requirements of IRFS and to identify the primary and secondary issues of importance that MPI would need to deal with in the transition. And then we worked at setting a schedule for a -- for tackling those issues.

For the period from December of 2008 to April of 2009, this was a time period in which there was further analysis and information gathering on the primary issues, and there was agreement on the process by which information would be gathered for the preparation of position papers, which was a key part of the work that's been undertaken.

From April to August of 2009, the focus was on the primary issues, undertaking the technical analysis that was required, and preparing the position papers to support MPI's proposed accounting treatment. And then from August to September of '09, similarly, technical analysis was done and position papers were prepared for the issues that have been identified as secondary.

And by October of 2009, draft position papers had been completed and delivered to MPI, which then left MPI in a position to assess the impact of IFRS and allowed the Corporation to frame the key corporate decisions that would need to be make to -- need to be made and the elections.

In December and January there was some further analysis on areas of ongoing discussion and in the summer of 2010 consideration was -- consideration of the issues inherent in the expanded disclosure in the financial statement presentation were considered.

Regarding the interaction with the audit committee, we've met with the audit committee on nine (9) occasions since we were engaged. The first two (2) meetings in the first half of calendar 2009, were effectively status reports from ourselves to the audit committee with an update on the progress that had been achieved to date.

Then from October of 2009 through to the end of February, we were present at the audit committee for presentations which management made on the issues that were identified in the course of the transition work. Ultimately, the translation of those issues into the policy decisions and elections that would need to be made culminating in the approval of the Corporation's positions with respect to IFRS.

And then in the summer and early fall of this year, we've spent two (2) more occasions with the audit committee, on both occasions looking forward. One (1) talking about the impact that IFRS will have on the presentation of the financial statements, and on another occasion overview of the potential implications of the revisions that are contemplated to IFRS-4 on insurance contracts.

MS. KATHY KALINOWSKY: And I know that Deloitte has prepared sixteen (16) position papers on IFRS for MPI. Can you explain the process used to develop the position papers.

MR. RICHARD OLFERT: The work that began in November of 2008 identified those IFRS standards that would have an impact on MPI. Those -- excuse me, those standards were then sorted into primary and secondary categories, and that classification simply affected the order in which the work was undertaken.

For each of the position papers that's been prepared, there was a period of gathering initial background information from MPI. Our staff then drafted position papers, and in the course of drafting those papers had ongoing conversations, including question and answer discussions with MPI as necessary, to round out the first draft of the papers.

Upon completion of the first draft by our staff, there was a technical review of those papers, either by personnel in Winnipeg, or for most of the position papers by persons in our national office. Once that technical review had been completed, and any questions arising from it had been addressed, the position papers were delivered to MPI and they remained with MPI, who would then have an opportunity to respond to those position papers with their comments and questions. And once those comments and questions were ready, we would meet, consider them, and update the draft if necessary.

And throughout that process MPI also independently engaged with its auditors, KPMG, to obtain their comments on the position papers, and those comments were incorporated into the comments and questions, which MPI discussed with us prior to the completion of each draft position paper.

MS. KATHY KALINOWSKY: Thank you. So in terms of the transition for MPI to IFRS, really, there were only three (3) major policy decisions to be made by the audit committee of MPI's Board of Directors?

MR. RICHARD OLFERT: Let me put that question of major policy decisions into some context. At the time an organization tran -- transitions into IFRS, there are often adjustments required at the transition date, and those adjustments arise from one (1) of two (2) factors. The first is that in order to ease that burden of transition, financial statement preparers can take advantage of a series of elective exemptions and exceptions. These are the items that you referred to a moment ago.

And then there's a second type of transition adjustment that may be required, which is if the accounting policies that are currently employed under Canadian GAAP differ from those that are required under IFRS, an adjustment must be processed to reflect the IFRS policy, as if it had always -- as if it had always been in place.

So the question you asked relates to the first type of transition adjustment, which is the decision making on the elective exemptions and exceptions. And, indeed, there were three (3). The first was related to the option in IFRS to use the fair value of capital assets as the opening balance sheet deemed cost, and MPI opted not to take advantage of that election. Or better said, not to employ that election.

The second area was in employee benefits, where the accounting for employee benefits can be altered, and MPI opted not to employ that election and to continue with its current practice.

And the third area of elective exemption related to the opportunity to redesignate previously designated financial instruments. And in this case, MPI elected to do so, and it redesignated its fixed income available for sale investments as held for trading or fair value through profit and loss, so that the unrealized gains and losses associated with those investments would flow through the income statement, rather than through other comprehensive income.

There are a whole other series of elective exemptions that would be available, but which are not applicable to MPI's situation, and so they did not need to be considered.

(BRIEF PAUSE)

MS. KATHY KALINOWSKY: Mr. Olfert, could

you just mention the financial implications of each of those three (3) major policy decisions that you just spoke about.

MR. RICHARD OLFERT: With respect to the first two (2) on fair value as deemed cost and employee benefits, because the election was not taken, there's no financial -- there's no impact on the financial statements. And with respect to the redesignation of financial instruments, the impact would be in aggregate to shift $24 million out of accumulated other comprehensive income, into retained earnings or other equity accounts, twenty-one (21) of that twenty-four (24) being related to Basic.

MS. KATHY KALINOWSKY: And can you possibly go through some of the non-discretionary items that also require changing under IFRS, so they recognize that you have mentioned those at a higher level.

MR. RICHARD OLFERT: These are the second type of transition adjustments, that is those which arise simply because there are differences between the existing Canadian GAAP, and the requirements of IFRS.

There were two (2) that were identified. The first one relates to the requirement of IFRS for Manitoba Public Insurance to accrue short term employee benefits that are non-vesting. And these are not current accrued under Canadian GAAP, and as a result, the sick leave entitlement that exists must be recorded, and MPI has currently estimated that that amount would be $3 million.

The second item that was considered relates to the componentization of fixed assets, where an analysis was done that identified that although a difference between the requirements of Canadian GAAP and IFRS existed, that difference was not material, so an adjustment would not be processed.

MS. KATHY KALINOWSKY: So then to summarize: The transition to IFRS has had very little financial impact on the financial results for MPI now, other than the $21 million change on the redesignation of financial instruments, and the $3 million for sick leave, with respect to Basic?

MR. RICHARD OLFERT: Those are the two (2) impacts on the financial statements of the -- on the opening balance sheet financial statements of MPI, as a result of the transition, yes.

(BRIEF PAUSE)

MS. KATHY KALINOWSKY: Changing slightly the cross-examination -- the -- the direct examination here with respect to IFRS, Mr. Olfert, you're familiar with the concept of an onerous contract. Can you provide examples.

MR. RICHARD OLFERT: An onerous contract is a concept within IFRS that's contained in Standard IAS-37, on Provisions, Contingent Liabilities, and Contingent Assets. And an onerous contract is defined as:

> "A contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it."

So the onerous contract applies to a situation where there's a contractual arrangement, and the standard specifically describes that the onerous contract provisions do not apply to normal operating losses.

In terms of examples, I would offer two (2), the first relates to a contract that might exist for revenues. So for instance, if there was a long term contract for the construction of a property, and the contract to provide that property had a thousand dollars ($1,000) of revenue remaining to the end of the contract, and it was ascertained that the cost of completing the building, including the costs of materials that might have escalated in the meantime and been purchased, and those costs are unavoidable and fixed at eleven hundred dollars ($1,100), that means there's an inherent loss in the completion of that contract of a hundred dollars. And that loss, over the balance of the contract, would be accrued under IFRS as an onerous contract.

And the second example reflecting a cost of an organization would be if there's a lease for property for five (5) years at two thousand dollars ($2,000) a year, and after the third year there's no requirement to use that property any longer, the organization would continue to have costs to the end of the lease for the remaining two (2) years at two thousand dollars ($2,000) each, which would provide a cost of four thousand (4,000). The organization would likely seek to mitigate that loss, and would try and sublet their property, and if it could be sublet for fifteen hundred dollars ($1,500) a year for those two (2) years, that provides revenue of three thousand dollars ($3,000). Nonetheless, as a result of having that lease contract, there would be a loss of a thousand dollars ($1,000) incurred, and that loss would need to be present valued, and accrued as an onerous contract loss.

MS. KATHY KALINOWSKY: Mr. Olfert, I know that you're familiar with the decision paper of -- of Deloitte's on provisions for contingent liabilities, and contingent assets, and that has an appendix on onerous contracts. It's located at Tab 13 of the filing. Do you want to turn to that, and please comment. And I also recognize that you have an exhibit that we'll file partway through your comments.

(BRIEF PAUSE)

MR. RICHARD OLFERT: Just to correct your question, the exhibit that you're referring to is in response to a subsequent question.

On your question with respect to the reference to the paper on IAS-37, the appendix to that document, on pages 26 and 27, contains an onerous contract analysis. To place this analysis in context, this position paper was prepared in April and May of 2009. The cost allocation study work had not yet been completed so there was no updated view on what costs might be attributable to any particular line of business, and the paper was prepared by accounting staff who were not participating in the cost allocation process.

So the appendix that you've asked about has -- has three (3) components to it. The first is some background information, and the background information is an effort to explain why this is a matter for analysis. In the course of our conversations with MPI there was reference to the fact that attention had been drawn to this contract and a question as to whether it might be an onerous contract, and I believe that initial question came out of the original KPMG scan of IFRS issues.

So the team responsible for preparing the paper gathered information, including a recent analysis available at that point in time of the facts related to the contra -- to the arrangement, and that information was laid out to assist in the analysis that will be required.

The second part of the paper, on the bottom of -- of the appendix on page 26 and 27, provides excerpts from IS-37 which are relevant to the discussion.

And then the third part of the appendix outlines the analysis that was done. And the analysis that Deloitte did focussed on whether or not a contract per se exists, and our conclusion was that it did not. We reflected on MPI's obligation to provide driver and vehicle licensing services, and that obligation arises as a result of the provisions of the Drivers and Vehicles Act, including its regulations. And the details of that obligation, an obligation which is indefinite, are set out in a master agreement which governs the relationship between MPI and province.

We believe, having reviewed that material, that the obligation to provide these services flows from one (1) of MPI's legislated operational mandates, and that this is not a contractual situation. When the arrangement was entered into, MPI did not have the same latitude as it might have had in the regular arms-length commercial situation, to refuse or negotiate certain terms, or to negotiate the consideration, or to establish a fixed timeframe.

And so our conclusion was that this was not a contractual obligation, that the carrying on of these activities was part of its mandated operations, and so that there was not an onerous contract in this situation.

MS. KATHY KALINOWSKY: Since this is a hearing for Basic rates, am I correct in understanding that Deloitte was unable to identify any onerous contracts then at MPI?

MR. RICHARD OLFERT: The assessments we made were for MPI as a whole and we did not identify any onerous contracts at MPI.

MS. KATHY KALINOWSKY: The International Accounting Standards Board recently issued its exposure draft for insurance contracts.

Are you familiar with the exposure draft and when it will be implemented?

MR. RICHARD OLFERT: I have some familiarity with that exposure draft. And it addresses the recording of liabilities that arise from insurance contracts. And the results that are expected from the Application of IFRS-4, the exposure draft, if adopted as exposed, the expectation is that they would be considerably different recor -- cal -- calculation of liabilities under the new IFRS provisions than under existing Canadian GAAP. And that results from the fact that the calculation of the amount of the liability required by the exposure draft would introduce several new factors into that calculation that don't currently exist.

In addition to the calculation of the amount of liabilities from insurance contracts, the exposure draft would also significantly change the presentation of the -- of aspects of the financial statements that relate to insurance contract liabilities and costs, and that will be particularly prevalent in the income statement, and, finally, there would be a significant increase in disclosure related to insurance liabilities.

As to the timetable, the exposure draft has been issued and comments are due by the end of November of this year. The proposed timetable would have the standard issued in June 2011, and would apply first to those years that begin on or after January 2014, but the material accompanying the exposure draft, or rather -- better said, those who are reading the exposure draft believe that the International Accounting Standards Board has a plan to align the effective date of this standard with other standards, so that's quite possible that effective date could get changed.

MS. KATHY KALINOWSKY: Still on the topic of IFRS. Can you explain the possibility of a deferral of IFRS implementation for a rate regulated entity, and its applicability to Manitoba Public Insurance.

MR. RICHARD OLFERT: Canadian standard setters have considered easing the burden of transition for those enterprises that are rate regulated, and those that have -- or those that recognize regulatory assets and regulatory liabilities. So the transact -- the transition adjustment that you're referring to would provide an option to preparers of such financial statements, to defer the implementation of the standards so that they could more effectively deal with the provisions of IFRS that will not permit the recognition of regulatory assets and regulatory liabilities.

At its most recent meeting in September, the Accounting Standards Board concluded that it would permit a one (1) year deferral only. That is those rate regulated enterprises that qualify could implement IFRS for the years beginning on or after January 20 -- January 1st, 2012. And the Accounting Standards Boards also concluded that the deferral would be limited to entities that have activities that are subject to cost base regulation, and those entities that recognize regulatory assets and regulatory liabilities.

So in assessing the applicability of those provisions to MPI, those two (2) criteria need to be separately considered. The first criteria is whether MPI has regulatory assets and regul -- and/or regulatory liabilities. And it's our conclusion that that criteria is not met, because under existing Canadian GAAP, there's requirements that those entities that have -- those rate rela -- regulated entities that have regulatory assets or liabilities must disclose the nature and amount of those assets and liabilities, and MPI's financial statements contain no such disclosures.

The second criteria is whether MPI is subject to cost base regulation, and in that respect there are two (2) criteria. The first is that a regulator establishes the price that the entity must charge its customers for the services that the entity provides, and that price then binds the customer. That sub-criteria would be met.

The second sub-criteria is that the rate that's established by the regulator is designed to recover specific costs the entity incurs, to provide the regulated services, and to earn a specific return. And as the regulation of MPI is not focussed on the specific return to MPI, it's our belief the second sub-criteria is not met.

So that overall criteria is not met, thus resulting in our conclusion that the potential deferral for rate regulated enterprises does not apply to MPI.

MS. KATHY KALINOWSKY: You're familiar with the response given to the inter -- inf -- Information Request of PUB number 1-76. You've also reviewed the transcripts on the cross-examination conducted by Board coun -- counsel, Ms. Candace Everard. Can you provide any comments to clarify the meaning of that particular paragraph?

MR. RICHARD OLFERT: So the reference you make to Information Request 176, is an information request in which one (1) -- a one (1) paragraph excerpt from the tenth page of a forty-five (45) page position paper on the application of the impairment standards is set out. And that standard applies when assets, in this case that are carried on MPI's balance sheet, are recorded at an amount which exceeds their value.

The paragraph that's cited is part of a larger section that addresses the question of whether the assessment of impairment should be made for individual assets, or whether it should be made for groupings of assets.

And the paragraph in question is preceded by a decision tree that concludes that in some circumstances, but certainly not all, this assessment of impairment must be done based on a grouping of assets. And that grouping of assets, for IFRS purposes, is known as a cash generating unit, or abbreviated as a CGU.

So the paragraph in question is the discussion of a third possible -- third possible alternative for determining how to group assets into CGUs. And ultimately, this third alternative was the one that was selected.

So my first overall observation with respect to the paragraph in question is that its context is a con -- is in reaching a conclusion for the narrow -- very narrow scope of assessing impairment in certain circumstances.

A second observation that I would make relates to some questions that have arisen related to the accuracy of the wording, particularly from an operational or a legislative perspective. And as the material was prepared, it was prepared and reviewed by persons whose intent it was to understand the essence of the operations, but it is evident that they did not state that understanding in a way that's entirely consistent with the operations and the legislation.

So there are several corrections that I would suggest, and I actually have a replacement page which I will suggest be incorporated. So let me describe the corrections and then we can hand out the exhibit.

The first is that the paragraph should indicate that MPI is the sole provider of universal compulsory auto-insurance. And then there are two (2) references in that paragraph that seem to imply that the work that MPI does with respect to driver/vehicle licensing is related to the basic insurance work, by way of one (1) being conditional on the other, and that is not the case.

And then finally, as the analyse was be -- analysis was being compared, it is clear that the lines of business are linked by similar legislative mandates, but it's equally important to recognize that the services required to fill those mandates are provided from integrated facilities and in an integrated manner.

So since the papers are still in draft and I think the proceedings have identified the need for clarification, I'm going to suggest revised wordings for that paragraph, which you have to present as an exhibit.

MS. KATHY KALINOWSKY: And I have that right now, and I'll pass it over to Mr. Simonsen to assist me in distributing. But I would believe that it would be marked as MPI exhibit number 15 for the purposes of the record.

--- EXHIBIT NO. MPI-15: Workstream, Impairment of Assets, IAS-36

THE CHAIRPERSON: Thank you. We have it.

MR. RICHARD OLFERT: By way of explanation, on the material that's been handed out, there are two (2) pages, the page that's labelled "page 10," the two (2) paragraphs at the bottom of the page replace the single paragraph that was in -- that was cited in IR-76. And page 11 is provided simply because material that used to be on page 10 now flows over to the subsequent page. So the new material is at the bottom of page 10.

So to make the corrections that I've referred to, those paragraphs should now read:

"Although MPI monitors its product lines separately, there is another issue that must be considered that is unique to MPI. By legislation, MPI is the sole provider of universal compulsory auto-insurance in the Province of Manitoba. In addition, MPI takes on additional product lines, like driver licensing functions that are required, and extension insurance that is permitted by Manitoba legislation. Consequently, it could be argued that the net cashflows, after expenses, that are generated from all product lines that are part of legislated mandates, are not independent cashflows. The net cashflows are interdependent in part because MPI does not have the ability to choose whether or not to exit any of its mandated lines of business. In the same way that MPI is obligated by legislation to provide driver licensing, it is obligated to provide

Basic insurance. MPI does not have the option to choose to discontinue either service.

In addition and equally important, the services required to fulfil all mandates that are required or permitted by legislation are provided from integrated facilities in an integrated service delivery manner. Particularly because of the extent of shared costs that are required to deliver on these mandates, cashflows of these activities cannot be independently determined."

And I should not that the replacement of the one (1) paragraph with these two (2) changes neither our analysis nor our conclusions.

CONTINUED BY MS. KATHY KALINOWSKY:

MS. KATHY KALINOWSKY: Thank you. Still proceeding with the direct examination on IFRS, can you state the complexity of conversion to IFRS for MPI?

MR. RICHARD OLFERT: There are several perspectives with respect to that question. The first perspective relates to the work effort which MPI must employ, which is required to be significant. There are forty (40) or so IFRS standards to be reviewed for applicability, there are transition rules to be assessed, and there is a large effort required to assess the differences between IFRS and Canadian GAAP, and that large effort can be judged by the extent of the output from MPI's work.

A second perspective on the complexity would be to compare Manitoba Public Insurance to other preparers of financial statements. For those preparers that are outside of the financial services industry there would have been a much, much higher effort generally required, related to property, plant, and equipment.

And those preparers that are public companies, in addition to being publically accountable, they have a variety of unique issues, like stock based compensation and interim reporting, that MPI does not have. But, as a financial services institute -- as a financial services entity, MPI has generally significantly more work to do on financial instruments than other preparers.

When MPI is compared to other large insurers, the other large insurer situations would be considerably more complex. While those preparers and MPI would share the future uncertainty related to IFRS-4, which will indeed make the transition more complex when those standards are finalized, MPI does not need to address a variety of issues that the other large insurer -- that larger insurers in Canada generally need to.

MPI is a single corporation, versus others that have up to as many as several hundred subsidiaries, often internationally. There are no foreign subsidiaries. MPI's investment assets do not need to be valued extensively using valuation models. There are no business combinations or acquisitions to account for. There's a single line of auto-insurance with various options as opposed to a wide variety of insurance contracts that other insurers deal with. No income taxes. No public reporting. No significant related party transactions. No issues associated with goodwill.

So, in summary, MPI has a very significant effort to adopt IFRS. The amount of work which MPI has had to do cannot be understated or underestimated. However, compared to other insurance companies, MPI's conversion effort has been relatively straightforward.

MS. KATHY KALINOWSKY: In terms -- sorry, in terms of the process and state of readiness for IFRS implementation, how would you classify MPI?

MR. RICHARD OLFERT: Based on my personal experience in the Manitoba marketplace and based on my exchange of views with my colleagues nationally, I would say that MPI's process to transition to IFRS is among the most advanced, in terms of the progress that has been made. Some might be marginally farther ahead because they have all of their opening day adjustments quantified, and some may have prepared their first set of pro forma financial statements.

But, in general terms, MPI is in a very favourable position. It's ahead of most. It has two (2) more months to prepare than most financial statement preparers, and it has no outstanding significant issues.

MS. KATHY KALINOWSKY: At the end of the day, from your position as an IFRS consultant to MPI, having worked with MPI management, having worked with the auditors of MPI, having attended the Audit Committee meetings in which IFRS was discussed, would I -- would I be correct in saying that two (2) of the big four (4) accounting firms, namely, Deloitte and KPMG, the auditors, and also the Officer of the Auditor General of Manitoba have expressed no concerns with regard to MPI's transition plans to IFRS?

MR. RICHARD OLFERT: We at Deloitte have no concerns. With respect to the others that you had mentioned, we have not had specific discussions with them. However, we've been at at least nine (9) Audit Committee meetings with both KPMG and the Office of the

Auditor General, and in those meetings no concerns have been expressed, and when asked by the Committee about their views on the matters discussed, they have concurred. And further, we're advised that KPMG has given its approval on MPI's position papers, elections and policy decisions.

MS. KATHY KALINOWSKY: In a previous order of the Public Utilities Board, they stated that:

"There are potential negative implications for the Corporation's financial position related to the IFRS in respect of pension liabilities, deferred charges [et cetera]."

And that's a quote that I'm going to end there.

Can you state, indeed, whether there are any potential negative implications for MPI with regards to IFRS?

MR. RICHARD OLFERT: From my perspective it's important to differentiate between the underlying economic situation and the way that economic situation is reported. The underlying economic situation does not change, because the standards for how that situation is reported change. Only the rules reflecting that situation -- sorry, only the rules for how that situation is reflected on paper have changed.

In terms of what that financial position looks like, I think in your quote you cited two (2) specific items, being pension liabilities and deferred charges. And with respect to those items, there would be no expectation of any change in the stated financial position because of the implications of IFRS.

There are two (2) areas in which the implications of IFRS will have an impact on the stated financial position, and those have already been mentioned. The first being the recording of the sick leave, for an aggregate of about $3 million, and the redesignation of certain investments res -- resulting in a shift of about $21 million from accumulated other comprehensive income to the rate stabilization reserve for Basic operations.

MS. KATHY KALINOWSKY: Thank you, Mr. Olfert. I'll just ask for one (1) minute to confer on one (1) matter before I proceed.

THE CHAIRPERSON: Sure.

(BRIEF PAUSE)

MS. KATHY KALINOWSKY: Thank you for that moment to confer. That concludes my direct-examination.

Now if Mr. Olfert -- he is ready for cross-examination, of course, but given the hour -- hour right now, I don't know whether it's the Board's intention to take a break now or not.

THE CHAIRPERSON: I think to make the most use of Mr. Olfert's attendance, we'll take the break now. Thank you.

--- Upon recessing at 10:20 a.m.
--- Upon resuming at 10:43 a.m.

THE CHAIRPERSON: Welcome back, everyone. Ms. Everard, it's your turn.

MS. CANDACE EVERARD: Thank you, Mr. Chairman.

CROSS-EXAMINATION BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Mr. Olfert, I'm going to begin by -- or with a few questions for you relating to cost allocation, or expense allocation. And I'll refer the group to TI.6, which is filed at Tab 2 of the Board's book of documents.

We know, Mr. Olfert, that last year a major expense allocation study was submitted to the Board having been prepared by your office.

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: And we know that additional work was undertaken this year following on the Board's order, and that Deloitte assisted the Corporation with that additional work.

Is that right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And if we look at TI.6, page 1, we see under Section 1 that the first step taken with respect to this additional work was for the research, which included three (3) principal steps, and those steps are listed at the bottom of page 1.

Is that right?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: And we see that there were three (3) significant changes identified with respect to accounting units. This is at the bottom of page 2 of TI.6, and those three (3) changes are listed at the top of page 3 of TI.6, and -- and you wouldn't be aware of this, but we heard a bit of evidence on those changes yesterday.

Do you see what I'm referring to?

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: And was it the case that these -- the three (3) changes listed at the top of page 3 were identified by MPI, and reviewed by Deloitte, or were they identified in some other way?

MR. RICHARD OLFERT: It would be more in the nature of our analysis identifying these items for discussion with MPI.

MS. CANDACE EVERARD: So the changes then, in your view, are consistent with the allocation methodology proposed by Deloitte.

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: Under the heading of, "Purification Adjustments," on the same page, we see again a list of three (3) bullet points reflecting purification adjustments that flowed from an analysis.

Were those Deloitte's -- or were those identified by Deloitte, or identified by the Corporation?

MR. RICHARD OLFERT: They would have been identified by Deloitte.

MS. CANDACE EVERARD: And I take it that Deloitte agrees with therefore the appropriateness of those adjustments, and believes them to be consistent with the methodology.

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: If we go to page 4, there's some evidence reflected with respect to allocators, and we note at the Level D chart a change in one (1) of the allocators from net claims incurred to gross premiums written, and that's obviously per the Board's order.

Does Deloitte have a view on the appropriateness of using gross premiums written as that allocator?

MR. RICHARD OLFERT: When the original expense allocation work was done, we weighed those two (2) alternatives, and concluded at that time that we believed that the claims allocator was a -- a better allocator.

MS. CANDACE EVERARD: So does Deloitte have the view that gross premiums written is an inappropriate allocator?

MR. RICHARD OLFERT: It was one (1) of the options that we considered, so we wouldn't consider it improper. We would, in our judgment, view the original suggestion as the better allocator.

MS. CANDACE EVERARD: If we look at Exhibit 2 of TI.6, we see the methodology having been applied to the budget of MPI, and we -- if we also look at 1-50, posed by the Corporation, we see a revision with some additional information, so I'll ask everyone to go to that.

(BRIEF PAUSE)

MS. CANDACE EVERARD: We have that in the book of documents at Tab 25, and as well it's in the filing. The difference being at Tab 25 of the book, 1-50(b), we have the percentages being allocated reflected, whereas in the TI.6 exhibit those percentages don't appear.

Was the schedule in TI.6 at Exhibit 2 prepared by Deloitte, or prepared by the Corporation?

MR. RICHARD OLFERT: There's a little bit longer answer required on that one, in that it was in part by both. In the initial research work that we did we provided some calculations based on the version of the 2010 budget that was available at that time. Subsequent to that, the budget information was updated and MPI had some other adjustments in its budgeting process, and so these documents would have been prepared by MPI as a follow-on to the earlier Deloitte activities.

MS. CANDACE EVERARD: I take it though that Deloitte would be satisfied that these documents to which we're referring before the Board do represent the application of the methodology, including the changes that were proposed.

MR. RICHARD OLFERT: We've not tested the numbers individually, but the -- as they are presented are consistent with what we would expect.

MS. CANDACE EVERARD: You have no reason to think that there's anything incorrect in the numbers?

MR. RICHARD OLFERT: We do not believe that.

MS. CANDACE EVERARD: Okay. If we go back to TI.6 -- and we will come back to 1-50(b), so you might want to hold the page. We see at TI.6, page 11, a summary that's been provided or a narrative of the basic steps of the cost allocation methodology. And although this was discussed last year, I'd -- I'd ask you to just in a summary way explain that methodology for the benefit of the Board.

MR. RICHARD OLFERT: The cost allocation methodology which we proposed starts with a Level A decision as to which cost categories can be assigned directly to one (1) of the three (3) insurance lines of business, or the non-insurance category of business. For those cost categories that cannot be assigned at that level, there's a Level B determination to det -- to assess whether the cost category can be assigned directly to the insurance category of business, or to the non-insurance category of business.

Some accounts are allo -- or assigned in that way, and there other cost categories that cannot be assigned in that way. And so at Level C those common costs are allocated between the insurance and the non-insurance categories of business. And then, at Level D both the assigned and the allocated costs to the insurance category of business are then -- I'm sorry, at Level D, those costs that are allocated to the insurance category of business are allocated to the three (3) insurance lines of business where they're summed with those costs that were previously assigned.

MS. CANDACE EVERARD: Thank you. And if we turn back to page 6 -- or -- or turn to page 6 of TI.6, we see in the top chart on that page, the application of the methodology that you just described in numbers to the -- the 2010/'11 normal budget, and this is just sort of the summary of it without the detail.

Is that right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And so we see, if we go back to 1-50(b) at Tab 25, which is the more detailed version of the allocations and includes percentages, we see that under the expense allocation methodology as amended there's being proposed a -- under the "Injury claims management" line, a 90.4 percent allocation to Basic and 9.6 percent to Extension.

That's right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And under "Driver records," which is a few lines down, it's a 50/50 allocation that's being proposed --

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: -- to insurance and non-insurance. And the third one that I would draw your attention to is the "Accounting and finance" line, which is about halfway down the page, reflecting a 75.7 percent allocation to Basic. And then the remainder is split along the other three (3) lines of business -- or categories of business.

MR. RICHARD OLFERT: Agreed.

MS. CANDACE EVERARD: Does the methodology that we've been discussing, as amended, allow for allocations to third parties, like an example being the government?

MR. RICHARD OLFERT: The methodology contemplates that all costs incurred by MPI and recorded as its costs are allocated to the -- one (1) of the three (3) insurance lines of business or to the non-insurance category.

MS. CANDACE EVERARD: So, no -- the methodology does not contemplate allocations to third parties?

MR. RICHARD OLFERT: There's no -- that is not contemplated.

MS. CANDACE EVERARD: And, Mr. Olfert, do you have a view on whether it's fair from a regulatory standpoint to allocate costs under the methodology, for which the underlying quantum has not been reviewed for reasonableness?

MR. RICHARD OLFERT: I'm not sure I understand your question.

MS. CANDACE EVERARD: Do you have any comment on whether the allocation of costs, pursuant to the methodology that we've been discussing, is fair or appropriate if the underlying quantum of costs has not been revused -- reviewed for reasonableness?

MR. RICHARD OLFERT: It would be impossible to prepare results of the cost allocation methodology without the preparer of the results looking at the costs that have been incurred. And so for MPI to prepare this, they would need to have a line of sight to the costs.

MS. CANDACE EVERARD: Would you agree that for the Board to review that work, it would have to have a line of sight to the costs?

MR. RICHARD OLFERT: Not to pursue on

behalf of the Board, my observation would be, though, that that's fundamentally a question about what level of assurance or comfort is desired on the information that's presented.

And there all -- are alternative ways to obtain that assurance and comfort; one (1) is to look at the numbers, the other is to rely on an audit opinion on the numbers.

MS. CANDACE EVERARD: Okay.

(BRIEF PAUSE)

MS. CANDACE EVERARD: When you refer to the audited or an auditor's opinion, you're referring to what's typically put forward by an auditor that what's contained within the financial statements has not been materially misstated.

Is that the typical test?

MR. RICHARD OLFERT: That is indeed an assessment that the auditor would need to make. I would also suggest, in reference to my earlier question and thinking about my response as you prepared the subsequent question, there is a third alternative. When information is presented there's an option to rely on the good faith of management as well.

MS. CANDACE EVERARD: Okay. I'd like to get into then the asset and liability methodology study, which, as we know, is found at AI.19 of the filing. And you've already reviewed, Mr. Olfert, in your direction evidence -- although, I don't know that the section number was mentioned, so I'll just confirm that. You spoke about page 2 in -- in the scope and purpose of the report. And it's Section 1.2 that contains a bulleted list of what it was that Deloitte was asked to do by the Corporation.

MR. RICHARD OLFERT: Could you repeat those references again, please?

MS. CANDACE EVERARD: Sure. AI.19.

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: Page 2. You referred to the page number but I just wanted to have the -- the actual paragraph reference.

MR. RICHARD OLFERT: I see. You're referring to page 2 of the report itself?

MS. CANDACE EVERARD: Yes.

MR. RICHARD OLFERT: Okay.

MS. CANDACE EVERARD: Yeah. Page 2 of your -- of the Deloitte report, Section 1.2. And you - you gave this evidence, it's just it wasn't specifically tied to this. So that --

MR. RICHARD OLFERT: Indeed it was Section 1.2.

MS. CANDACE EVERARD: And that -- those five (5) bullet points reflect the details of what Deloitte was asked to do by the Corporation?

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: Now, if we go to page 4 of the report, we see in Section 2.1 in the second paragraph, Deloitte has stated in the second sentence:

"In 2004, MPI and Manitoba entered into an agreement to transfer certain responsibilities of DVL to MPI and Manitoba agreed to compensate MPI annually to administer the driver licensing and vehicle regulation programs formerly undertaken by DVL."

That, I take it, reflects Deloitte's understanding of that merger, or that arrangement.

Is that fair to say?

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: And if we carry onto page 5, which is the next page over, we see Deloitte has said in the second full paragraph, for the purposes of the report, that you have cat -- categorized MPI's services into two (2) categories of business, insurance and non-insurance. And then with -- within each category of business you have further identified three (3) lines of business.

And that's, I think as you mentioned in your direct, is the similar categorization used in the expense allocation methodology.

Is that right?

MR. RICHARD OLFERT: Yes, it is.

MS. CANDACE EVERARD: And we see listed on page 5 the lines of business contained within the category of business, the three (3) lines of business within the insurance category of business being Basic coverage, Extension coverage, and SRE coverage?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: And the non-insurance category of business including the lines of business of driver licensing, vehicle regulation, and identification services.

MR. RICHARD OLFERT: Correct.

(BRIEF PAUSE)

MS. CANDACE EVERARD: And the last paragraph on page 5 reflects that the report does not in -- contemplate any allocations among the lines of business within the non-insurance category of business.

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: We go to Section 4 of the report, which commences on page 21. We see a reflection of the guiding principles that Deloitte adopted, and as well the attributes that Deloitte considered in doing its work. And I know you mentioned in you direct that these were the same as what Deloitte considered in the expense allocation methodology.

What I'd ask you to do is, and we -- we see there's a -- a small paragraph here on each of the five (5), and then you gave evidence that there was a sixth one that was added. For the moment, let's focus on the five (5) that were the same as expense allocation, and if you can jut paraphrase for the Board what they are, and what each of those guidelines refers to.

(BRIEF PAUSE)

MR. RICHARD OLFERT: The first principle is the principle of fair and reasonable, and that principle suggests that we want to be sure that costs that can be identified with a particular line of business indeed are. And so the costs that are ultimately assigned need to be fairly reflecting the cost of the service, and they need to yield reasonable results.

And so in essence it's essentially a -- a common sense test. And then there we look to see whether the relationships between the -- the relationship between the allocation and the underlying activity is causal, and fair and reasonable is also about making sure that the activities of the Corporation are transparently reflected in the allocators.

With respect to --

MS. CANDACE EVERARD: Sorry, just before you go onto the next one. It's reflected on page 21 under the -- the little fair and reasonable section that sometimes these concepts can be vague, and what is fair and reasonable may be subject to opinion.

Is there anything further that you can comment on with respect to that aspect of it, that I -- I take it would relate to the -- the common sense test that you mentioned?

MR. RICHARD OLFERT: The statement in the report that what is considered to be fair and reasonable as -- as being potentially a matter of opinion, that stands. And for the purposes of preparing our report, our intent was to ensure that the explanations that are provided for the choices that are made in the methodology present our perspective on what's fair and reasonable.

With respect to practical and efficient, the focus there is to ensure that the development of -- that the methodology itself is -- can be -- can be developed in a way that is reasonable, in a way that reflects an appropriate amount of effort, and where allocators can be developed with less effort rather than more. That would be advisable, or that would be appropriate.

And so this is really a question of being able implement the methodology. Can it be done practically, and can it be done efficiently without causing undue burden, given the importance of the results that are going to be presented?

With respect to flexible and adaptable, this principle is in place because there's a recognition that an organization's activities generally evolve over time. And so the principle would have a methodology -- would view a methodology most favourably if it applies to today's circumstances and can then accommodate those evolutions and the business which occur, rather than a brand new methodology having to be developed as a result of a change in the underlying business.

MS. CANDACE EVERARD: Just before you go on to the next one, I do have a couple of specific questions on that one. We know that there have been a number of changes that have taken place within the Corporation over the last number of years.

How has Deloitte designed the methodology to reflect the post-business process review changes?

(BRIEF PAUSE)

MR. RICHARD OLFERT: The -- a couple of comments. The first comment is that we have endeavoured to understand the future states to which the Corporation will evolve over time. And so recognizing what the end-state will be, or better said, recognizing what those end-states will be as the evolution occurs, we've tried to contemplate those situations.

So the best example of that would be the purification adjustments, which are an effort to say, today things are accounted for in a particular manner. But what will be important in the future is isolating this block of information or that block of information. And so in developing the methodology, we have extracted information from MPI's current system and handled it in a manual fashion in the calculations, so that those changes that are coming are contemplated and can be easily followed.

And then secondly, we have strongly

encouraged MPI to continue to monitor its operations so that it can adjust the accumulation of the underlying cost data so that it reflects the principles -- so that it -- so that it accurately reflects the underlying business and the costs are accumulated in a way that abides by these principles, including the follow-on principle that we want to maximize assignability and minimize allocations.

MS. CANDACE EVERARD: So you don't expect that when the business process review is complete, the Corporation will have to undergo another allocation review exercise?

MR. RICHARD OLFERT: We would anticipate that with appropriate periodic assessments and updates, a brand-new methodology would not need to be constructed.

MS. CANDACE EVERARD: Thank you.

MR. RICHARD OLFERT: The fourth principle is the principle of being acceptable in a regulatory context. And that's fairly straightforward in that the principle use of the cost allocation methodology is to satisfy the requirements of the Board for information on the Basic line of business. And so it would be unacceptable for a methodology to be prepared in a way that isn't generally accepted in a regulatory context.

And so, based on the regulatory research that was done at the time this report was prepared, and similarly, for the asset allocation, we have endeavoured to suggest a methodology which is built on precedent and practices that are accepted by regulators.

The fifth principle is consistent with industry standards. The principles were set prior to the commencement of the work. And at the time they were set it was recognized that it would be highly desirable for the methodology and the allocation practices, which MPI employs, to be aligned with are consistent with those used by other organizations in similar circumstances.

Ultimately, the research that was done, did not provide a significant amount of guidance in that respect, but that remains a guiding principle to be consistent with those in similar situations.

MS. CANDACE EVERARD: And you're referring to the -- Section 3 of the report, which reflected the research that was done. And I believe the conclusion was reflected on page 20 that Deloitte did not find the -- really any information or guidance through its research that would assist. But Deloitte also states that the allocation approach selected for MPI is consistent with that accepted by the regulator in Alberta.

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: Okay. So those are the fiv --

MR. RICHARD OLFERT: If I may -- if I may add to that. That -- that conclusion is best understood as relating to both the regulatory context principle and the industry standards.

MS. CANDACE EVERARD: Having discussed those five (5) principles that are similar to the ones used in the expense allocation, let's talk about the new principle of symmetry or, as -- as listed on page 22 of the report, symmetric.

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: What's reflected here is that many assets and liabilities are created by or directly related to specific types of revenue and expenses. And the example that's provided at the end of this paragraph is that:

> "When a specific expense item creates a specific liability it is reasonable to expect that an appropriate allocator for the liability should be consistent with the allocator for the related expense item."

Is that correct?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And can you explain for the Board how Deloitte applied symmetry in the selection of allocators within this methodology?

MR. RICHARD OLFERT: That can best be done by using two (2) examples from amongst the four (4) that I gave on the direct when I highlighted the four (4) allocators that had the most significant impact at Stage 2 of the methodology.

The two (2) examples that illustrate the concept the best are first related to the allocation of employee future benefits, which is a liability reflected on MPI's balance sheet, to quantify its obligation over the long-term to provide long-term benefits to its employees.

And so we reflected on the work that had been done in the expense allocation study and identified that in the course of that work the costs -- the annual salary and benefit costs of all of the organization's employees had been either allocated or assigned to lines of business. And since those employee future benefits are provided for that same group of employees, it seemed to us logical that the allocation of the liability would follow the same allocation as the allocation of the salary and benefit costs, hence, the use of the payroll cost ratio on employee future benefits.

Similarly, when it comes to the property asset which MPI holds, in the expense allocation study there had been significant effort expended identifying direct costs that could be assigned to lines of business and determining the most effective way to allocate common property costs to lines of business. And so the conclusion was if that a significant amount of effort had gone into identifying the appropriate allocation of the annual costs associated with operating the property, it would make sense for that property also to be allocated on the same basis.

MS. CANDACE EVERARD: Thank you. The list of guiding principles that we've discussed, they appear in the report, not in alphabetical order. Is there anything that -- that the Board can attribute to the order in which they were raised in terms of the relative importance that Deloitte places on each of the guidelines or factors?

MR. RICHARD OLFERT: As we endeavour to apply them, I think it's most fair to say that we gave them equal weighting.

MS. CANDACE EVERARD: So the order in which they're listed is of no moment?

MR. RICHARD OLFERT: There's no message in the ordering.

MS. CANDACE EVERARD: Okay. You spoke in your direct evidence about the incremental approach versus the pro rata full cost approach, and these are discussed on pages 22 and 23 of the report. We understand that these are the two (2) options that were considered and that ultimately Deloitte recommends the pro rata full cost approach.

So that the Board has an understanding of the incremental approach as compared with the pro rata full cost approach, can you describe the incremental approach. And in particular, we see at the top of page 23 there are some advantages and disadvantages listed with respect to that approach.

If you could review those pieces, it would be appreciated.

(BRIEF PAUSE)

MR. RICHARD OLFERT: The incremental approach works on the basis that an asset or a liability would be allocated effectively, based on the order in which that asset or liability is used.

Using the example of the -- of the building that's described there. If a building has a particular use, and is attributable to a particular line of business, and then new activities are done in the building, or the investment increases in the building, the question is, What additional costs, or what additional -- better said, What additional investment is made in that property to achieve, or to perform those new functions?

And if there is no additional cost, then there's no -- no additional investment -- I'm sorry, then there is no asset value attached to the line of business which is most recently adopted.

The advantages of that approach, as we identify them on page 23, was that in -- in light of the changes that MPI has made, that incremental approach would leave the insurance business as it is, and there would be no asset or liability amounts allocated to non-insurance operations which are now being folded into the facilities that are being used for dual purposes. And that would also align with management's view that there is efficiencies to be gained by providing both services from a single location.

There are some substantial disadvantages in that approach, in that as -- in that as you contemplate how the incremental approach would apply to one (1) change, when you being to contemplate multiple changes that might occur over a period of time, understanding what that original base asset is that's to be allocated becomes more of a challenge because you've got more and more increments of both investment and service to allocate.

It's, in our view, going back to the principle of being flexible and adaptable becomes difficult to maintain that approach if there are evolutions in the business, and evolutions in the use of the facility. It would be a highly complex, and in our view, subjective way to allocate asset and liability amounts.

And finally as we had assessed initially on the expense allocation, and now again on the asset allocation, the incremental approach is not one that we've seen commonly used in regulatory scenarios.

MS. CANDACE EVERARD: And did Deloitte run any kind of analysis, financially based, on the incremental approach --

MR. RICHARD OLFERT: We did not.

MS. CANDACE EVERARD: The next section in the report, 4.3.2, relates to the pro rata full cost approach, and gives a description of what that approach entails, and then again has a list of advantages and disadvantages.

Can you explain, as is reflected here,

what that approach entails, and -- and then as well the advantages and disadvantages that are referenced?

MR. RICHARD OLFERT: The pro rata approach is based on the notion of if an asset or a liability supports two (2) services, or two (2) lines of business, then those lines of business that share that asset or liability would also share the allocation of the asset or liability in proportion to their usage or relevance to that asset or liability.

The advantages of that are that it reflects MPI's go-forward position of providing multiple services in an integrated fashion, and so it -- it shares, in proportion, the total cost amongst the activities that are being undertaken. It reflects, in our view, a linkage between the assets and liabilities, and the underlying activities that they're used for. We think that approach is adaptable, and can be adjusted year-to-year to reflect the changes in the Corporation's operations, and that is the approach that is most widely accepted in the regulatory environment.

MS. CANDACE EVERARD: Just before you go on, is -- is that Alberta, or are there other jurisdictions that you can advise us of?

MR. RICHARD OLFERT: There's really two (2) aspects to responding to that question. The first is, in our view, it's virtually impossible to speak about asset and liability -- the asset and liability determination of incremental versus pro rata, without reflecting on the fact that there's a very significant starting point, which is an expense meth -- expense allocation methodology which has been built on the pro rata basis. And so using our principle of symmetry, it would be significantly at odds for the -- the asset allocation methodology to be done on any basis other than the pro rata approach, which is employed in the expense allocation.

So the reflection on the regulator's comments is in part a reflection back to the acceptability of the pro rata in the expense allocation situation.

With respect to the comment here directly as it relates to assets and liabilities, it is conceivable that that point is somewhat overstated given my earlier comments about the SGI and the ICBC situation where there's not a full allocation of assets done, this would al -- apply to the Alberta situation.

MS. CANDACE EVERARD: So I believe then that that covers off the advantages that are listed. Can you -- let's get into the disadvantages and maybe I'll take you through that a little bit.

There are two (2) disadvantages referenced here in the report. One (1) is that:

"The assets and liabilities allocated to insurance operations would be reduced as a result of certain shared assets and liabilities not being allocated to DVL, while the quantum of insurance provided to Manitobans has not changed."

And the second is that:

"The methodology has the potential to become overly complicated."

Am -- am I right so far?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: The Board asked an IR on that -- on these points, which is 2-55. It's not in the book of documents but let's go there.

(BRIEF PAUSE)

MS. CANDACE EVERARD: So 2-55(a), do you have that in front of you?

MR. RICHARD OLFERT: I do.

MS. CANDACE EVERARD: So it asks the Corporation to elaborate and discuss the disadvantages of the adopted pro rata approach. And as indicated on the face of the response, this was prepared by Deloitte on behalf of the Corporation, and Deloitte has given us two (2) bulleted sections within that response, one (1) relating to each of the disadvantages.

Can you either read in the replies or explain the substance of the replies for the Board?

MR. RICHARD OLFERT: I'll read that in.

"With respect to the first bullet point, one (1) disadvantage identified is that the pro rata approach will result in a reduction in the allocation of an asset or liability to an existing service, with the addition of a new service provided from that asset, even when no change in operations of the existing service has taken place, and the new service does not require any additional investment in the existing asset or change the original cost. The original service, or line of business, provided from that asset will merely see the portion of the asset attribute --- attributed to it decline, even though the level of that service provided has not declined. An example would be the conversion of a claims centre to a service centre.

The introduction of non-insurance services provided from an existing claims centre building does not change the cost of the building, yet post-introduction of the non-insurance service under the pro rata approach a portion of the original building will be allocated to the non-insurance service, thereby reducing the amount allocated to the original insurance services provided from that building.

The amount of asset attributed to the original insurance service is reduced even though the original service has not changed. Some would suggest the application of the pro rata approach in this example inappropriately reduces the asset base providing the same insurance services. On the other hand, others would feel this reduction is appropriate on the basis that more benefits can now be derived from the same asset."

MS. CANDACE EVERARD: Just before you go on to the second one, I'll just stop you there. I do have a couple of follow-up questions.

So does what you've just read in mean that assets which were allocated to insurance operations and paid for by revenues raised through insurance operations, could now be allocated to DVL or the non-insurance line, even though the nature of the insurance business hasn't changed?

MR. RICHARD OLFERT: Could you repeat the question again?

MS. CANDACE EVERARD: Sure. Does what you've just read in mean that assets that have been allocated to insurance operations and paid for by revenue raised in insurance operations, would now be allocated to non-insurance category of business, otherwise known as DVL, even though the nature of the insurance business piece has not changed?

MR. RICHARD OLFERT: So a comment before I answer your question. Your comment presumes that assets that were previously allocated to the insurance operations were paid for by insurance revenue. And I'm getting territory here that I'm not all that familiar with, but I will speculate that the insurance revenue for

Basic is based on the cost attributed to the Basic service, which would include the annual depreciation associated with the buildings.

So it would be inappropriate to presume that all and -- all assets attributable to the insurance line of business would already have been paid for from insurance revenues because the undepreciated portion will be allocated in the future.

Having said that, once the allocation of an asset changes, then the depreciation that at one time might have gone directly to insurance would now be allocated to multiple lines of business, because they are benefiting from the use of that property.

MS. CANDACE EVERARD: So with the caveat, I think, that -- that you mentioned at the outset, I think the answer to the question is "yes".

MR. RICHARD OLFERT: Not to split hairs, but I heard two (2) things in the question. I think if your question is fundamentally about due costs that would have at one time in one (1) year been allocated to insurance, can those be allo -- would those be allocated to other line of business subsequent, based on a change in use of the asset, the answer is yes.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Mr. Olfert, I understand that there is no debt reflected on the Corporation's balance sheet, and, therefore, insurance premiums have in fact funded the acquisition of the Corporation's buildings.

Would you agree with that?

MR. RICHARD OLFERT: Would agree, with the caveat that I think there's a difference between funding and who ultimately pays for it in that the recovery of the cost of the -- sorry, the recovery of the investment of the property will occur over time as rates are established. In the short-term, the Corporation's cash, which is largely generated by its insurance operations, would have funded the investment in the property.

MS. CANDACE EVERARD: Okay. So the second disadvantage that was referenced in the report and is elaborated upon at the answer to PUB/MPI-2-55(b) -- or (a), pardon me, relates to the potential for this approach to become overly complicated.

Can you read in the explanation that Deloitte has provided at that IR.

MR. RICHARD OLFERT:

"A second disadvantage is the potential for the approach to become overly complicated. While the risk exists, particularly given the large number of accounts which require allocation, we believe this potential can be mitigated.

We hold the view that the pro rata method itself is not inherently susceptible to the risk of becoming overly complicated over time. The risk is more appropriately linked to the use of allocators that require considerable subjective judgment. We believe that this risk can be minimized and mitigated through methodology designed, and have outlined certain actions in the response to Part B below."

MS. CANDACE EVERARD: Thank you. And you did touch on this in your direct evidence, which is the answer to 'B' and the steps, or the strategies that Deloitte has considered with respect to mitigating this potential issue of over-complication.

What I'd ask you to do is review the bullet points. There are seven (7) of them that were put forward in response to Question B, 2-55(b), and if -- if you wish to read them in or elaborate on each of the points, that -- that would be appreciated.

(BRIEF PAUSE)

MR. RICHARD OLFERT: I will read them in again, though I made reference to them in my -- in my direct. And I will also offer a comment at the end.

So the actions associated with minimizing complication, are to -- first to:

"Focus on maximizing the assignment of accounts and minimizing the requirement for allocation of costs."

Secondly:

"Potential account purification to maximize account assignment."

Third:

"Continued due diligence on the part of MPI management to ensure assigned accounts remain pure and assignable."

Fourth:

"The adoption of objective allocation measures whenever it reasonable to do so."

Fifth:

"A reluctance to adopt subjectively

developed allocators when other options exist."

Sixth:

"Continued effort to maintain symmetry between balance sheet and related expense account allocators."

And 7:

"For each account, consideration of the magnitude of the account balance and the cost benefit of developing and adopting an additional more complex allocator which might result in an increased, though perhaps only marginally so, level of accuracy."

The additional comment that I'll offer is that these actions apply both to the expense allocation methodology and the asset allocation methodology. In the asset allocation methodology, because of our emphasis on maintaining symmetry with the expense allocation approach, most of the significant allocators tie back into the expense allocation approach. And so the risk of over complication in the asset study, for that reason, is substantially less, in my view, than it would be in the expense allocation study.

MS. CANDACE EVERARD: As you've

testified, and as is reflected in the written report, Deloitte recommended the pro rata full cost approach. And the idea of the ament -- incremental approach was abandoned as a -- an option for the -- the reasons cited.

Is that fair to say?

MR. RICHARD OLFERT: That is correct.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Could the incremental approach be undertaken once the whole of the business process review is complete, and then undertaken every time there's a major change in the business?

MR. RICHARD OLFERT: I guess in the category of never say never, I would be reluctant to say it could never be done. I think the -- the disadvantages, which we outlined, related to the incremental approach would make that a cumbersome and likely unwise approach.

MS. CANDACE EVERARD: And I take it then, as well, that you would not support the idea of using the incremental approach for the balance sheet while maintaining the current approach for expense allocation?

MR. RICHARD OLFERT: That is correct.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Okay. Let's turn then to page 25 of the report, where Deloitte gets into the actual allocation methodology. In the section entitled, "5.1 Overview," Deloitte has stated that:

> "In developing an overall approach to the review of MPI's asset and liability allocation methodology, we first considered the nature of MPI's core business, even though MPI has in recent years become a provider of other services, MPI is at its core a provider of compulsory automobile insurance products to Manitobans. Other services provided are complimentary in that they leverage existing MPI customer records, and customer points of contact."

That's correct? That's what --

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: -- Deloitte has reflected? And I take it that that reflects Deloitte's view of MPI's business, having had discussions with MPI, and -- and knowledge from previous work done about what the nature of MPI's business is.

Is that fair to say?

MR. RICHARD OLFERT: It does.

MS. CANDACE EVERARD: Now, we see on page 27 of the report a schematic that reflects the allocation methodology that you've already testified about, reflecting stage 1 and stage 2 of the proposed methodology.

Is that right?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: And in general terms, stage 1 deals with direct assignment of assets and liabilities, stage 2 deals with allocations that are required.

MR. RICHARD OLFERT: Also correct.

MS. CANDACE EVERARD: And under section 5.4, now dealing with stage 1, it's reflected in that first paragraph that, as is noted elsewhere, there are approximately two hundred and sixty (260) active asset, liability, and retained earnings accounts, as of February 28th of this year.

Is that right?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: Section 5.4.1 of the report, which commences, or -- and is contained on page 27 of the report at the bottom deals with purifying accounts.

And you, I believe, indicated earlier this morning that at the end of the day no purification of accounts was required.

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: Can you explain, though, since this is part of the methodology what the purification process would entail if it were needed?

MR. RICHARD OLFERT: The purification process is intended to identify accounts that by their existing nature would need to be allocated because in the case of an -- in the case of an asset, the asset is derived by several lines of business. So a good example might be an -- an accounts receivable from a customer is for different types of insurance, and for different types of fees.

So the purification process asks whether there is a practical way to break out those amounts so that the assets associated with individual lines of business can be isolated.

It becomes a more involved process on the balance sheet allocation because the balance sheet accounts represent, I'll call it, the end landing point for the way in which MPI's systems capture the transactions, and record them.

And so the suggestion of a purification entry around an asset account, generally, would involve more system requirement changes than it would in terms of an expense account allocation. And so the practicality of a purification adjustment also needs to be considered.

So when we looked at the streams of transactions as they are currently reflected, and contemplated the practicality of any purification adjustments, it was our view that none were advisable.

MS. CANDACE EVERARD: Okay. Thank you. In section 5.4.2, which is on page 28 of the report, it's reflected that on the basis of Deloitte's detailed review of the accounts, a hundred and twenty-two (122) of the approximate two hundred and sixty (260) accounts were identified as directly assignable, that is, to a specific insurance line of business, or the non-insurance category of business.

That's right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And those -- the stage 1 assignments are reflected on page 29 in the chart that appears there.

Is that right?

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: Just a moment, Mr.

Chairman.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Okay. Now we see if we look at the chart on page 29 that the first item on the -- or the first line item entitled "Cash and Investments" is almost wholly subject to allocation, and that relates to the content of the Corporation's investment portfolio.

That's right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: Now we do see a couple of relatively small amounts that were assignable to SRE and then the non-insurance category of business.

Can you explain how those particular items were able to be directly assigned as opposed to the balance of that line item?

MR. RICHARD OLFERT: Certainly. The line item is entitled "Cash and Investments" and so there are several bank accounts that are included in that line. And in several cases, the bank accounts are specifically dedicated to the activities of an individual line of business, or category of business in the case of non-insurance, and those accounts are assigned directly to those lines of business.

MS. CANDACE EVERARD: And that detail, I believe, is reflected at the appendix to the report on page 35, which contains a breakdown for each of the line items on page 29, that we're just reviewing, and reflects --

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: -- the details of what you've just described?

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: If we go back to page 29 and the table that appears, we see with respect to accounts receivable, which is the third line item that, again, almost the whole of that amount is subject to allocation rather than direct assignment?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: And we see if we go back to the appendix for a moment, under the heading of "accounts receivable," which appears on page 36, that one (1) of the items or one (1) of the accounts that was able to be directly assigned was account 120113, which relates to receivables from brokers specifically for the SRE line of business. Is that right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: Would it be

possible in this vein to -- for the establishment of separate general accounts for receivables from brokers on the other lines as well? And their -- if that were done, would that be able -- or would that enable the avoidance of some of the allocation in this line item?

MR. RICHARD OLFERT: There are quite a number of dimensions to answering that question fully, some of which I think should be put to the Corporation in terms of the -- the systems implications of doing so.

The one (1) observation I would make is that what differentiates this account from others is that when you look at the amount that's due from a customer, the entire amount that's due from that customer relates to SRE with respect to that invoice or that particular transaction.

In the case of most of the transactions that the Corporation undertakes with Manitoba residents, when you make a payment it incorporates Basic insurance and Extension insurance and there's registration fees, driver registration fees and vehicle registration fees, all from the same customer.

And so the challenge in the system's point of view would be to take a single transaction with one (1) customer and differentiate it into its components while still trying to collect one (1) amount.

MS. CANDACE EVERARD: Thank you. If we continue with review of some of the content of the chart on page 29, we see at the line item entitled "Property and Equipment" that the whole of that amount is subject to allocation, some 134.7 million.

Do you have particular detail on the reasons why none of the property could be directly assigned?

(BRIEF PAUSE)

MR. RICHARD OLFERT: Having conferred, could you repeat your question?

MS. CANDACE EVERARD: Sure. The question was with re -- relation to the chart on page 29 and the line item, "Property and equipment," we see that the whole of the amount that's reflected there is subject to allocation and that there are no direct assignments.

And so my question was whether you could tell us why there -- nothing in that line item is -- lends itself to direct assignment.

MR. RICHARD OLFERT: Sure. The answer to the question is that all of the facilities which are owned are -- I'll call them mixed use, that is, they either represent administrative offices of the

Corporation that support all lines of business or they are service centres which support different lines of business or they are other locations that have elements of more than one (1) line of business taking place in that facility.

MS. CANDACE EVERARD: Thank you. The next line item on the chart is entitled, "Deferred development costs." We see there's a balance for the whole of that line item of some 34.6 million. And we see an allocation -- or pardon me, an assignment directly to the Basic line of business, as well as a small direct assignment to non-insurance. And then the balance is subject to allocation.

Can you confirm how it is that we're able to directly assign that 22.6 million to Basic but that there are no amounts for direct assignment to Extension or SRE?

(BRIEF PAUSE)

MR. RICHARD OLFERT: I'll answer your question this way. Virtually all of that amount of 22.6 million is comprised of deferred development costs related to driver safety rating and to PIPP, which would be Basic.

MS. CANDACE EVERARD: And I -- I understand that. But I -- I guess as a followup to that, would there be no business process review projects with deferred development costs then that would be specifically assignable to the other lines?

MR. RICHARD OLFERT: No, there would not.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Mr. Olfert, just to ensure that we understand your evidence and to give you some context of where we're coming from, we have evidence on the record in this proceeding that the Corporation has some fairly significant expenditures for business process review projects in Extension and in SRE, and in some of those projects the costs are wholly assignable to those lines.

I gather then that your evidence is that there was nothing on the balance sheet for deferred development costs relating to those projects that would be directly assigned at the line item that we're concerned with?

(BRIEF PAUSE)

MR. RICHARD OLFERT: A couple of comments. First, I'm not aware of the items to which you refer from earlier in the proceedings.

Secondly, it's unclear to me from your question whether the appropriate accounting treatment for those items would be to capitalize them, and they would be sitting in a deferred development account, or whether they would have been expensed as incurred.

And my third comment would be, when we look at the way in which the deferred development costs attract in the general ledger, there are no individual accounts that can directly assigned because they relate to projects for those two (2) lines of business. There are other items, but they -- as we understand them, they relate to multiple lines of business, and so they're reflected as amount subject to allocation.

MS. CANDACE EVERARD: Okay. Well --

THE CHAIRPERSON: Ms. Everard, should we take our lunch break now, and might want to think about this. We'll come back at one o'clock. Thank you.

--- Upon recessing at 11:51 a.m.
--- Upon resuming at 1:01 p.m.

THE CHAIRPERSON: Okay. Welcome back,

everyone. Just a note, if you don't mind. The Board notes that Mr. Olfert's last answer was given in consultation with Mr. Palmer of MPI, and others, and we would appreciate it if for the balance of the cross-examination Mr. Olfert did not consult with the MPI panel when giving his evidence.

If a question is posed which neither Mr. Olfert nor his colleagues from Deloitte can provide an answer, we ask that he indicate that, and counsel can consider follow-up questions for the MPI panel later. Thank you.

Ms. Everard...?

MS. CANDACE EVERARD: Thank you, Mr. Chairman.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Mr. Olfert, just before lunch we were looking at the chart on page 29 of the asset and liability allocation methodology report. Just a couple of other line items that I'd like to have you confirm.

There's a line item for provision for employee future benefits, which provides for some 226.8 million. And that whole amount is subject to allocation according to this chart?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: And the next line item, "Provision for Unpaid Claims," references an amount of some 1.6 billion, and there are no allocation amounts for that line item. Rather, they are all directly assignable.

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: Okay. Let's take a look at the response to Question 57, posed by the Board in the Second Round, so PUB/MPI-2-57. This was a question referencing the allocation report, and the question was to:

> "Confirm that all of the proposed allocators are based on February 29th, 2010, data. If this is not the case, please identify instances in which such data was not utilized."

And the answer reflects that the proposed allocator values were based on the fiscal year ending February 2009, with some exceptions that were based on 2010/'11 budget data.

Is that right?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: Can you advise of why Deloitte did not use 2010 data, meaning for the fiscal year ending in February 2010.

MR. RICHARD OLFERT: In determining which data to use, we looked at the practice that MPI employs with respect to its asset allocation methodology, and in any given year, as it calculates its -- as it determines its monthly financial position, and then prepares its year-end financial statements, in order to avoid the fluctuations that would come from using current year data, the practice is to use the allocator based on the information from the prior rear.

And so, when we performed the calculations on the '10/'11 budget we followed the same practice except for those allocators which had not been determined in that way, and so we used current year data as it was the most readily available to get the indicative allocators.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Okay. Next I'll ask you to go to 2-56, just the IR immediately prior to the one that we were looking at. This was a question that was posed by the Board to:

"Please indicate the accounts for which there was no suitable allocator such that a new allocator was developed. In each instance, please indicate why the current allocator was not suitable and why the developed allocator was deemed appropriate."

And the response was prepared by Deloitte on behalf of the Corporation. In the second paragraph Deloitte has indicated that it revisited each account and evaluated whether based on its understanding the account balance and use and MPI operations -- or sorry, based on the understanding of the account balance and use and MPI operations the existing allocator was still appropriate, whether another might be appropriate, or whether the development of a new one would be appropriate.

Is that right?

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: And we see in the next paragraph that Deloitte identified a limited number of accounts for which they believed that the methodology could be improved upon with the development of a new allocator, and there are then five (5) groups -- or five (5) accounts categories that are reflected.

Is that right?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: And if we --

they're listed there in bullet points at the bottom of page 1. And then if we turn to page 2, for each of those account categories there's some further detail, which we're going to go through.

The first one relates to land and buildings. Those are the capital asset accounts for real property. And can you describe to the Board the rationale for the change, with respect to this particular account category?

MR. RICHARD OLFERT: On this account category we looked at the existing allocator and concluded that the principle of symmetry that we were wanting to abide by would suggest that the allocation of the costs of operating land and buildings should be allocated similarly as the land and buildings themselves. And so our recommendation is that the allocation of land and buildings be done using the property cost ratio which provides that linkage or symmetry into the expense allocation work that's been completed.

MS. CANDACE EVERARD: And it's reflected in the analysis column, which is the third column of information here on page 2 near that bottom of that first row, that under the -- the previous allocator, or the current allocator, the relationship -- sorry, that the current approach did not recognize that DVL services were being delivered from service centres.

That's right?

MR. RICHARD OLFERT: That's fair, yes.

MS. CANDACE EVERARD: And it's further reflected here in that column that the relationship between the head office property and operating expenses was questioned. Can you just elaborate on that comment a little bit.

(BRIEF PAUSE)

MR. RICHARD OLFERT: That sentence is a reference to the second allocator that was listed under the existing methodology, being the expense distribution ratio, which was used as the allocator on the -- on office property.

And so, in our view, when we assessed the connectedness of the use of office property with overall operating expenses, we asked whether that was as close a link as could be established, or whether a closer link could be derived. Hence our recommendation to use the property cost ratio.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Now, do you have a sense of the difference in application, in terms of the numbers between the allocators that were used previously, and that proposed by Deloitte, the property cost ratio?

(BRIEF PAUSE)

MR. RICHARD OLFERT: We do not have that information at that level of detail.

MS. CANDACE EVERARD: We'll continue then with PUB/MPI-2-56, page 2, and look at the next row of information which relates to the capital accounts -- or capital asset accounts for furniture, and non-information technology equipment. It -- as reflected here, the previously used allocator was the expense distribution ratio excluding DVL.

That's right?

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: And again the analysis column reflects that:

> "The relationship between the furniture and equipment was the distribution -- the relationship between the furniture and equipment [I think that should probably be, "to"] the distribution of

operating expenses was questioned."

Can you expand on that, it -- that issue?

MR. RICHARD OLFERT: Again, in search of the best linked allocator to the asset that was being allocated, we had certain furniture and equipment that was being used by the Corporation's employees that was being allocated based on operating expenses.

And in assessing whether that was an appropriate allocator, it was our view that furniture and equipment is used by the employees, and so a measure of the effort of the employees, hence the payroll ratio, would be a better allocator of the usage of the furniture and equipment.

MS. CANDACE EVERARD: And as you've stated, Deloitte's proposal is that the payroll ratio be used as the allocator for this category.

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: And does this mean, and -- and have reference to any part of this row as you may need to, but does this mean that non-DVL furniture or equipment have now been allocated to DVL?

(BRIEF PAUSE)

MR. RICHARD OLFERT: At the time that the original allocator was developed by MPI, DVL functions were separate and apart, and so the furniture was separate and apart. As the integration of the operations has occurred, some of that furniture would have moved. And facilities that were once dedicated to insurance have now become service centres, where both functions are applied.

And so all of the furniture and equipment has been dealt with together, and the implication of that would be that -- that aggregate costs are spread across all lines of business. And so not being able to see exactly how the dollars track I would anticipate that you're correct.

MS. CANDACE EVERARD: Thank you. The third row of this document relates to capital asset accounts for information technology equipment. And again we see the expense distribution ratio excluding DVL having been used previously.

That's right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And I take it from the language in the sec -- or the next column relating to analysis, that the same type of analysis was done for this category as for the previous --

MR. RICHARD OLFERT: That's --

MS. CANDACE EVERARD: -- that you described?

MR. RICHARD OLFERT: -- also correct.

MS. CANDACE EVERARD: And so I -- I take it that the information technology cost ratio, or ITCR, was developed, and that is what Deloitte is recommending on a go-forward basis?

MR. RICHARD OLFERT: That is correct. Again, we work to apply the principle of symmetry that said, How are the operating costs allocated? And it would follow that the capital equipment that's being operated with those costs should be allocated in the same proportion.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Are you in a position to comment on the appropriateness, from the standpoint of the Board, of allocating the IT equipment on the basis of the proposed allocator, when the details underlying the IT costs for the whole of the Corporation are not before the Board?

MR. RICHARD OLFERT: Can you ask the question again, please?

MS. CANDACE EVERARD: Sure. Are you in a

position to comment on the appropriateness of the perspective of the Board in having to decide on this, the appropriateness or applicability of this allocator, in the absence of the details of the underlying IT costs for the whole of the Corporation?

MR. RICHARD OLFERT: I'm not sure I'm in a position to respond to that.

MS. CANDACE EVERARD: So -- so no, you're not --

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: -- in a position to comment?

The fourth row of the document relates to information technology deferred development costs. And again we see the previous allocator being the expense distribution ratio.

That's right?

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: And again, we have an analysis by Deloitte of the relationship between the -- the costs and the distribution of operating expenses?

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: And we see that Deloitte is proposing the ITCR, information technology cost ratio, that we discussed at the last item, due to the direct relationship between IT operating costs and the deferred IT development costs.

Is that right?

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: And just while we're speaking about this allocator, I'm going to ask you to go back to Tab -- or page 29 of the report, which is of course at AI.19. We see -- you know what? Scratch that question.

If we go to page 32 of the report, just a few pages hence from where we were, we see that, in the Stage 2 phase, the allocation phase, for defer -- deferred development costs, there's some 11.5 million to be allocated, and we see that, to the non-insurance category of business, there's about 1.7 million proposed.

Are you with me?

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: And one (1) of the allocators utilized, with respect to that allocation, is the ITCR ratio that we were discussing from the other document. That's right?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: Can you tell us to what extent Deloitte was able to determine the nature and quantum of non-Basic business process review expenditures undertaken in coming up with the methodology?

(BRIEF PAUSE)

MR. RICHARD OLFERT: So to be sure I answer your question specifically, could I ask you to repeat it?

MS. CANDACE EVERARD: Sure. My question was: To what extent Deloitte was able to determine the nature and quantum of non-basic business process review expenditures undertaken by the Corporation when coming up with the methodology?

MR. RICHARD OLFERT: The first comment is I think we need to be careful to sort out that expenditures -- when an expenditure is made it has to be determined whether it gets recorded as an expense or whether it gets reflected in here. And so this would be an analysis only of those costs that have been capitalized.

Having said that, when we investigated the individual general ledger accounts that support this balance, it was our assessment from that inquiry and that analysis that the individual accounts contained costs that affected each of the lines, with the exception of those accounts that are allocated using the other

EDR-EXSRE ratio that's identified here.

MS. CANDACE EVERARD: So was Deloitte given a listing of all business process review expenditures by the Corporation?

(BRIEF PAUSE)

MR. RICHARD OLFERT: So the work that was done with respect to these individual accounts was to inquire as to the nature of the costs that were incorporated into each, and to ask supplementary questions based on that. We did not trace these back to source costs.

(BRIEF PAUSE)

MS. CANDACE EVERARD: And can you explain how the methodology that's been put forward, ensures that deferred development costs related to non-Basic lines of business, do not result in an allocation of deferred development costs to Basic?

MR. RICHARD OLFERT: Any account that's identified for allocation, by its nature relates to several lines of business. And so the question is what's the best allocator to suggest that you can -- one can precisely parse those dollars into individual components wouldn't be correct, because if it was, then there would have been a pur -- a purification entry suggested and then there would have been assignment.

And so the -- the contents of those accounts by their nature are for several lines of business, and the question is what's the best allocator to get the best indication of their underlying purpose.

MS. CANDACE EVERARD: And Deloitte's recommendation with respect to the deferred development costs, certainly for an -- information technology is the ITCR?

MR. RICHARD OLFERT: Absolutely correct.

MS. CANDACE EVERARD: Okay. If we go back to PUB/MPI-2-56, page 2, there's one (1) more row on the chart that we haven't spoken about. That's the one that deals with the account category relating to payroll, such as employee related receivables and payables, and short and long-term employee benefit liabilities.

Again, we see, previously being used, the expense distribution ratio. And Deloitte's recommendation now is the payroll ratio.

Is that right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And the payroll

ratio, as stated here:

"Reflects the ratio of payroll costs allocated to line of business, or category of business in an integrated business environment as per the cost allocation study from 2009. The payroll ratio was developed as it reflects the direct relationship between payroll related asset and liability accounts and payroll activity."

Is that right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: So, in other words, Deloitte feels that this particular allorcator -- allocator provides for a more direct relationship or cost causation approach?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: In other words, a more direct linkage between the nature of the expense and the liability?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: Okay. I'm going to ask you to turn to 2-58, posed by the Board, and, in particular, the schedule that we see in the answer to (b). And what -- what asked of the Corporation at 2-58(b) was to provide a schedule detailing the determination of each balance sheet account listed on pages 5 and 6 of AI.19, and -- as opposed to the Deloitte report, and to please provide detailed calculations and narrative supporting the selection of allorcator -- allocator by each of the respective general ledger accounts.

And we've received, in answer to (b), a table detailing the specific general ledger accounts which comprise each balance sheet account listed on pages 5 and 6 of AI.19. The amount allocated to Basic is determined by the applying the allocator noted in the table to the total. Allocator values are provided, as noted in Part A.

That, I gather from the face of this answer, was a reply that was provided by MPI as opposed to Deloitte, just because it doesn't say it was provided by Deloitte, as they seem to, and that's the case.

MR. RICHARD OLFERT: That would have been a joint effort.

MS. CANDACE EVERARD: And the table that's provided at pages 2 and 3, would that be the same reply, that it was prepared jointly between the Corporation and Deloitte?

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: Now, we see under the -- if we look at page 2, which is the first page of the chart, we see the first entry under the heading of "Cash and Investments," relates to general ledger account 100011, which is a corporate deposit bank account. It's currently allocated on the basis of the investment ratio, which I -- is I believe what IR stands for there in the far right-hand column, is that right?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: And the proposal is that it now be allocated on the basis of the expense distribution ratio, or EDR?

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: And the dollars that we're dealing with here is about eleven point three (11.3) in total, which would result in an allocation to Basic of just under 8 million.

MR. RICHARD OLFERT: Also correct.

MS. CANDACE EVERARD: Now, I gather that the rationale for the change is because this is an operating account.

Is that fair to say?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And can you explain why, for this particular item, the expense distribution ratio is more appropriate than the investment ratio?

MR. RICHARD OLFERT: In analyzing the accounts which comprised the total of cash and investments, it was our conclusion that this particular asset was different from the others, in that the others represent part of the investment base of the Corporation, and those investments are made according to the investment strategy.

The GL account to which you referred relates to the operating bank account which fluctuates in balance depending on the timing of revenues and expenses. And so it's operated based on the working capital and expense and revenue requirements of the Corporation, rather than being tied to its investment strategy.

And so it was our view that it should be allocated differently. And our view was that the expense distribution ratio most appropriately reflected the composite activity of the Corporation, which is the best allocator for a working capital account of this type.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Thank you, Mr. Chairman.

We stick with PUB/MPI-2-58, page 2, we see under the heading of, "Accounts Receivable," in the next section of the document reference to general ledger account 120117, which is accounts receivable customers.

Now, this is -- this account is currently allocated between Basic and Extension on the basis of premiums ratio for those two (2) lines of business. And I'm just getting that from the far right column.

Is that right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And Deloitte proposes to allocate now on the basis of the premiums written, and fees collected ratio.

Is that right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And the rationale for that, I gather, is that the non-insurance fees should be allocated to Extension which provides the financing services for non-insurance fees?

MR. RICHARD OLFERT: That is it, in part. The other element in the recommendation is that the existing ratio ignores the fact that the balance includes receivables for driver licence fees and registration fees.

MS. CANDACE EVERARD: And those are

remitted to the province on behalf of the Corporation?

MR. RICHARD OLFERT: It's slightly more complicated than that. Those are -- those amounts are collected from customers on behalf of the province, but where customers opt to pay those amounts over time, the Corporation still has an obligation to settle with the province immediately. And so the receivable from the customer MPI holds, notwithstanding that it has settled on the customer's behalf with MPI already -- with the government already.

(BRIEF PAUSE)

MS. CANDACE EVERARD: And are you familiar with whether MPI pays to brokers fees, either on a percentage basis or a flat fee, with respect to those registration and licensing fees?

(BRIEF PAUSE)

MR. RICHARD OLFERT: There is a fee structure by which MPI pays the brokers for services rendered. I'd need to consult that table to tell you precisely what fees are paid associated with which transactions.

MS. CANDACE EVERARD: Are -- are you prepared to do that?

MR. RICHARD OLFERT: I don't have it here.

MS. CANDACE EVERARD: Maybe you can tell me without seeing that, where those fees are assigned. And I -- I appreciate I am deviating a little bit from the asset and liability allocation, but for cost allocation purposes, where are those fees assigned?

MR. RICHARD OLFERT: They're directly assigned to the line of business to which they apply.

(BRIEF PAUSE)

MS. CANDACE EVERARD: And do you know -- scratch that.

(BRIEF PAUSE)

THE CHAIRPERSON: When you say it's charged to the line of business, you mean charged against non-insurance services?

MR. RICHARD OLFERT: When that's the nature of the underlying service, yes.

THE CHAIRPERSON: Thank you.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Now, we see reference in Deloitte's report on -- again, coming back to asset and liability allocation at page 25. Feel free to -- to go to page 25, if you wish. This is under the Section 5.1 of "Overview". We looked at a different part of the overview earlier. In the third paragraph, Deloitte has stated:

> "MPI also collects the fees related to driver licensing and vehicle registration. However, amounts collected are not considered revenues of MPI, nor are the amounts remitted to Manitoba considered expenses."

You're with me there?

MR. RICHARD OLFERT: I am, yes.

MS. CANDACE EVERARD: Given that this is the case, as reflected on page 25, should these amounts be included in the allocator of customer receivables?

MR. RICHARD OLFERT: From our perspective, notwithstanding that revenues and expenses are not recorded, MPI still holds a receivable on account of those transactions from its customers, because the customers opt for time payment. And so, if that is the circumstance which gives rise to the asset, then, in our view, it should be included in the allocator.

MS. CANDACE EVERARD: Thank you. If we continue at 2-58, we've spoken about receivables. There's a section on page 3 entitled "Property and Equipment, Cityplace," and we see, under that section, in the again far right-hand column, that these accounts are currently allocated by the Corporation on the basis of the expense distribution ratio.

Is that right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And Deloitte proposes to use the PCR, or the property cost ratio, which represents the ratio of property operating costs allocated to all lines of business?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And I asked you an earlier question on one (1) of the allocation changes, whether you had a sense of the dollar difference in allocation between the proposed allocator and the one that was being used, and you didn't have that information handy.

Do you have that information for this item?

MR. RICHARD OLFERT: Not readily at hand, no.

MS. CANDACE EVERARD: We'll continue, then, on page 3. The section at the bottom of the page is entitled "Provision for Employee Future Benefits." Again, it's reflected here that these items were currently allocated on the basis of the expense distribution ratio, and the proposal is to use the payroll ratio, which reflects the payroll expenses allocated to both line of business and non-insurance category of business.

Is that right?

MR. RICHARD OLFERT: That is correct.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Would you agree that, while the allocator may be appropriate, the proportion ultimately allocated, in -- in dollar figures, could be inappropriate if the expenditures allocated to the non-competitive lines, or Basic, was overstated or unreasonable?

MR. RICHARD OLFERT: Can you repeat that question, please?

MS. CANDACE EVERARD: Sure. Would you agree that, while the allocator, the -- the proposed allocator, meaning the payroll allocator, may be appropriate in and of itself, that the actual amount allocated could be inappropriate if the expenditures being allocated were overstated or unreasonable?

(BRIEF PAUSE)

MR. RICHARD OLFERT: Let me respond to your question this way: In a sense, I think the question is unduly speculative because the payroll ratio is derived from the analysis which takes place in the expense allocation process.

When we look at the payroll costs that are allocated in the expense allocation process, there is -- there are payroll costs that are directly assignable, and then we're left with the age old question of shared costs, what's the right way to allocate them.

And so to suggest that there is a hundred percent correct way, and a hundred percent wrong way, isn't oversimplification because the allocator by its nashur -- nature is intended to be indicative of the appropriate sharing. And so the rigour of the work that generates the allocation -- assignment and allocation of the payroll costs dictates the appropriateness of that allocation, and that in turn drives the payroll ratio.

MS. CANDACE EVERARD: So at the end of

the day, the dollar is allocated, or as good as the rigour of the work that's done to consider those allocations?

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: Can you tell us how the methodology deals with staffing and payroll related to non-recurring, or one (1) time projects, such as the business process review projects.

(BRIEF PAUSE)

MR. RICHARD OLFERT: As we described when we reviewed the expense allocation here a year ago, the methodology was derived to allocate non-BPR costs with a recommendation that there be a separate approach for BPR costs, acknowledging that those would decrease over time. And so the payroll ratio, as it's suggested here, does not incorporate BPR costs.

(BRIEF PAUSE)

MS. CANDACE EVERARD: The Corporation has provided to the Board an overview of the changes proposed, and that's at AI.19, page 1. This is part of the Corporation's filing, and is, I believe, intended as a -- a summary of the difference between the current methodology and the proposed methodology, and I just would like to run through those with you.

The first one is listed in a bullet item at the bottom of page 1, AI.19. It reads -- I'll -- I'll read the preamble as well. It reads:

"The primary differences between the proposed asset and liability allocation methodology, and the current methodology that impact Basic, are as follows:"

First Bullet:

"The allocation of customer time payments, account receivable, AR. Currently this allocation is based on direct premiums written for Basic and Extension. The Deloitte report allocates these accounts receivable using direct premiums written for Basic and Extension, plus registration fees and driver licence fees collected. The portion related to register fees and driver licence fees is not allocated to Basic."

I take it that Deloitte would agree with the substance of that summary?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: The next bullet summary item is on page 2, which reads that:

"The allocation of service centre property and equipment for the February 2 -- 28, 2010, balance sheet was based on the January 2009 approved policy. At the time of the policy approval, January 2009, the new service centres were not constructed, and therefore not required to be allocated. The January, 2010 asset allocation policy was updated to include the service centre allocation, based on the expense distribution ratio, and is applied effective March 1st, 2010. The Deloitte report proposes to allocate service centre property and equipment based on the property cost ratio as set out in the Deloitte expense allocation methodology, and has applied this to the February 28th, 2010, balance sheet."

Again, I'm assuming that, from Deloitte's perspective, that the substance of that is accurate?

(BRIEF PAUSE)

MR. RICHARD OLFERT: So with respect to this bullet point -- just a small point of clarification -- the material that you read in the first six (6) or seven (7) lines, to the end of sentence, that finishes March 1, 2010, is a description of what MPI had done on its own prior to our involvement. The material thereafter relates to the work from the Deloitte report.

We believe the first part to be correct, and the second part is correct.

MS. CANDACE EVERARD: Thank you for that -- clarifying that nuance. The third bullets reads:

"The proposed asset and liability allocation uses allocators determined by the Deloitte expense allocation methodology. The Deloitte expense allocation methodology produces a revised expense distribution ratio which in turn results in revisions to the asset and liability allocators. These results -- this results [I think] in changes -- [or] in changes in

allocations to numerous accounts,
including impacts to Cityplace
building, accounts payable, and
employee current and future benefit
allocations."

Deloitte would agree with that?

MR. RICHARD OLFERT: Just to confirm -- so, in short, yes, with the addition that the impacts on employee current and future benefits and so on are coming from allocators that Deloitte is suggesting, though those are not in all instances the expense distribution ratio.

MS. CANDACE EVERARD: Thank you clarifying that.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Mr. Olfert, continuing on page 2 after the bullet points, the Corporation has put forward a paragraph that contains some dollar amounts reflecting the result after the changes in allocation that we've been discussing.

Are those numbers that Deloitte has had occasion to review or has -- has Deloitte not taken that analysis?

MR. RICHARD OLFERT: So our study was

based -- was focussed on the asset and liability allocation. These are allocations of revenues, and we've not done any work with respect to allocation of revenues.

(BRIEF PAUSE)

MS. CANDACE EVERARD: If we turn over the page in AI.19 we see the balance sheet for Basic, as filed by the Corporation.

Has Deloitte had occasion to review those figures as presented, or had -- did Deloitte have any input into those figures as presented?

MR. RICHARD OLFERT: You're referring to page 4?

MS. CANDACE EVERARD: Yes.

MR. RICHARD OLFERT: The Deloitte column comes directly from the work that we did. The actual came from MPI.

MS. CANDACE EVERARD: Thank you.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Okay. I'll ask you to turn, Mr. Olfert, to 2-59. This was a question posed by the Board in the Second Round. And I'll read the question in at 2-59(a). The Board asked that:

"The Corporation please explain the appropriateness of utilizing the expense distribution ratio for the allocation of enterprise-wide accounts, given the guiding principle of fair and reasonable allocations in the context of the Corporation's refusal to provide information to the PUB, which would allow it to review the quantum and reasonableness of expenditures of Extension and DVL."

The Corporation provided a response at A(1), and Deloitte provided a response at A(2), which appears at the bottom of page 1 and -- and carries over.

And if we review that response, Deloitte has stated that:

"In the review of general ledger accounts, certain accounts were identified as containing balances reflecting a variety of activity from all lines of business or category of business.

More specifically, for these accounts, no line-of-business or category-of-business specific transaction stream was identified which would account for a specific portion of the account balance or account activity.

Consequently, these accounts were determined to be enterprise-wide accounts, as they are general working capital accounts, widely used across all lines of business of categories of business.

As these accounts contained a broad mix of balances and activity, we looked to an allocator which incorporated a broad mix of transactions to arrive at a fair and reasonable allocator.

The expense distribution ratio is based on expense data which reflects a broad mix of expenses, after excluding significant line-of-business specific expenses such as claims expense, premium taxes and commissions."

Is that right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: Are you in a position to comment on specific aspects of that answer?

And, firstly, I would ask you to comment on the part of that answer that appears at the bottom of page 1 and on to the top of page 2, where Deloitte has stated that:

> "For certain accounts, no line-of-business or category-of-business specific transaction stream was identified which would account for a significant portion of the account balance or account activity."

Can you explain what Deloitte means by that?

MR. RICHARD OLFERT: Certainly. If, for example, you consider the cash account that you asked questions about earlier, that account will have transactions related to the receipt of cash from all lines of business. Payroll amounts will be paid out of the cash accounts, and of course those payroll amounts cover all lines of business.

And so, to look into those cash accounts and think that we can say that there's any analysis that can be done to say how much of the ending cash at a given point in time, how much that relates to any particular line of business, simply doesn't recognize the reality of the situation. And so there needs to be some broad-based way that reflects corporate activity to allocate that account.

MS. CANDACE EVERARD: Thank you. And with respect to the balance of the answer that I read in, would it be fair to say that basically what Deloitte is saying is that, in its view, the expense distribution ratio is fair because it's based on a broad mix of expenditures?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: Okay. I have a few additional questions for you with respect to the expense distribution ratio. I'm going to ask you to go to the answer at 2-3 posed by the Board.

(BRIEF PAUSE)

MS. CANDACE EVERARD: I'm sorry. I have a note that -- it's actually 11-3, but I thought it was Roman numeral II. It's an eleven (11). Pardon me. Yeah. No laughing, Mr. Williams. 11-3.

Okay. So that's the question and answer at pre-ask 3, which has been entered on the record as Exhibit 11-3.

(BRIEF PAUSE)

MS. CANDACE EVERARD: And this was a pre-ask reply that the Corporation put on the record yesterday, I believe.

Mr. Olfert, do you have a copy of it in front of you now?

MR. RICHARD OLFERT: I have a copy. It's the first time I'm seeing this.

MS. CANDACE EVERARD: That was going to be my next question.

(BRIEF PAUSE)

MS. CANDACE EVERARD: I'll -- I'll take you through this a little bit and then ask you the -- the first question that I want to ask you.

So this was a question that the Board posed of MPI as a pre-ask. The question was to:

> "Please provide a schedule detailing all of the expenses that underlay the allocations to Basic from other lines of business, including a five (5) year historical analysis, and a three (3) year projection through 2012/'13, and to please provide commentary on the changes."

So the Corporation said in reply:

"Refer to attached schedule 1."

Which we'll go to in a moment. Then it said:

"Basic's ratio declined in 2008/'09, and 2009/'10, as total corporate expenses rose due to increased costs required for non-Basic initiatives. Basic's ratio will decline in the projected years because previously total corporate expenses used as the denominator in the ratio were net of the recovery from the province of Manitoba. Beginning in '11/'12, total corporate expenses will not be net of the recovery."

So that was the narrative answer. And then if we go to the schedule on the reverse side of the page, we see that the Corporation has provided information from 2005/'06 through to '09/'10, and they've given us a note, that the corporate amount was net of the $21 million recovery.

Then they've given further information for '10/'11 through to '12/'13, again noting at the bottom that that corporate amount was not net of the $21 million.

And so my question for you, Mr. Olfert, with respect to this document is whether Deloitte reviewed this change with respect to the determination of the ratio.

(BRIEF PAUSE)

MR. RICHARD OLFERT: We were -- we were aware from the initial analysis that we did of the existing asset liability allocation that the 20 million -- $21 million was reflected as a reduction in the calculation of the expense distribution ratio.

As we prepared our suggested methodology, we held the view, which we communicated to MPI, that since we were allocating -- so that -- since the expense distribution ratio was to be a ratio of expenses, our view was that aggregate expenses in total should be used in that ratio, and the $21 million should not be netted against it.

So this is consistent with the view that we've taken in the methodology.

(BRIEF PAUSE)

MS. CANDACE EVERARD: So Deloitte is aware that prior to the year ending '09/'10, and including that year, the expense distribution ratio was calculated net of the $21 million figure.

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: Can you tell us whether this change, dealing with the $21 million, is referenced anywhere in Deloitte's report that we have in this filing?

I don't think that it is, but if -- if we're wrong, and it's referenced somewhere, then please let us know.

(BRIEF PAUSE)

MR. RICHARD OLFERT: So in the report, we've defined how the expense distribution ratio is to be calculated, and there's no mention in that of a netting of the recovery.

But the report does not describe that that's a difference in the calculation of the expense distribution ratio from MPI's current methodology to the one (1) that's been proposed.

MS. CANDACE EVERARD: Okay. I'm going to ask you to go to 2-51, so 2-51, and I'm -- I'm sure that it's a two (2) this time, posed by the Board. This was a Second Round question, in particular, I'm looking at sub-question B.

The question was for -- of the Corporation:

"With respect to the allocation of service centres for 2009/'10 being based on the expense distribution ratio, please provide supporting calculations, therefore, including adjustments to comply with PUB Directive 5 from Order 161/09."

Which was, of course, last year's Order following on the GRA. And we see in the reply to 'B', there's a narrative explanation provided by the Corporation -- at least, it's not indicated that that sub-reply was provided by Deloitte.

Do you know if Deloitte had input into the narrative reply at 'B'? Was it a joint reply?

MR. RICHARD OLFERT: We had no involvement in that response.

MS. CANDACE EVERARD: Together with the narrative -- and I won't take you there, to the narrative itself, we have an attachment from the Corporation at page numbered 1, and it's entitled "PUB/MPI-2-51B

Attachment," which provides, for 2010/'11, the percentage used to allocate service centres, land buildings, and land improvement.

Do you have that?

MR. RICHARD OLFERT: I do.

MS. CANDACE EVERARD: And are you familiar with this calculation?

MR. RICHARD OLFERT: We were not involved in its preparation.

MS. CANDACE EVERARD: Have you seen this before just now?

MR. RICHARD OLFERT: We received the IRs in advance and read them, but there's been no research or analysis done on them, either with MPI or subsequently.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Thank you, Mr. Olfert, for your evidence to this point on the -- the issue of the expense distribution ratio, and I think we'll ask whatever additional questions we have of the panel. You've given the evidence with respect to the recommendation that Deloitte made to the Corporation about the $21 million change, and we've spoken about that, and we'll -- we'll leave it at that for the moment.

Now, that doesn't mean I'm done on the whole; it just means with respect to that issue.

So I have a follow-up question on the exhibit that you filed, the really nicely coloured one, which is good, because it's easy to spot amongst all our seas of paper that we have. This is MPI Exhibit 14, the chart provided by Mr. Olfert this morning.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Okay. So the question with respect to Exhibit 14 relates to the column entitled "Non-Insurance," with the black printing. And we see that, under the column of "Non-Insurance" and, in particular, the equity category, we see a negative $28 million assignment.

Have I read that correctly?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And do you know if this is an amount due by government to the Corporation?

MR. RICHARD OLFERT: As an equity account, it would reflect that until February 28th, 2010 the expenses of non-insurance would have exceeded the revenues by $28 million.

MS. CANDACE EVERARD: And do you know if

that's due by government, or if that 28 negative number is just going to sit there?

MR. RICHARD OLFERT: It's -- it's -- it is a reflection of the operations to date. There's no receivable for that amount recorded.

MS. CANDACE EVERARD: Do you know whether that ultimate assignment figure of 28 million, which is a negative as we've discussed, is net of an -- an annual payment received by government into the non-insurance category of business?

(BRIEF PAUSE)

MR. RICHARD OLFERT: So you said received by government; I presume you mean received from government.

MS. CANDACE EVERARD: Yes, received by the Corporation from government, is what I meant.

MR. RICHARD OLFERT: So my understanding, and we haven't gone in and verified the historical buildup of the equity, is that that would represent the costs of non-insurance net of the recoveries revenues that have been received from the province.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Now, we have some evidence on the record with respect to cumulative losses sustained in the non-insurance category of business, as a result of a shortfall over a period of years for payments from government. Can you -- and -- and the evidence is, if -- if you're not aware of it, that the extent of that shortfall is -- is over $80 million.

I'm happy to give you a reference, and refer you to that, if that would be helpful for you.

But my question is whether you can comment on why the deficit in this category, and as reflected on the document, is a $28 million deficit rather than something much more substantial, like in the $80 million range.

MR. RICHARD OLFERT: I'm not familiar with the previously filed material, and I don't know the answer to the question.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Just following on that answer, Mr. Olfert, the reference that I was referring to is 1-78, posed by the Board, and it is in the book of documents at Tab 33.

(BRIEF PAUSE)

MS. CANDACE EVERARD: This is a document that was put on the record, and -- and the MPI panel has spoken to it in their oral evidence as well, based on questions asked.

Would you be in a position to review this document, and perhaps that will enable you to answer some questions on the -- the line that I was previously pursuing say after the afternoon break?

MR. RICHARD OLFERT: To respond to your question, we would need an opportunity to ask questions about this, as it's the first time we've seen it. And I'm not certain whether in the course of a break we could gather enough information to respond to the question.

(BRIEF PAUSE)

THE CHAIRPERSON: Just to consolidate where the matters are proceeding, we might as well take our break right now. That'll give you a chance to think about it, and counsel a change to take a look at what other questions that she may have.

So we'll take a break right now.

--- Upon recessing at 2:08 p.m.
--- Upon resuming at 2:26 p.m.

THE CHAIRPERSON: Okay, Ms. Everard.

MS. CANDACE EVERARD: Thank you, Mr. Chairman.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Mr. Olfert, I have a few questions in the area of IFRS, which I appreciate you've already given evidence on. As we know, Deloitte assisted or prepared the IFRS position papers that are included in the GRA filing, that's right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And I heard your evidence this morning that Deloitte had occasion to attend the approximately nine (9) meetings of the Audit Committee.

And do the external auditors for MPI attend those meetings as well?

MR. RICHARD OLFERT: Yes, they do.

MS. CANDACE EVERARD: And other than in the context of those committee meetings, did Deloitte have any conversations with MPI's external auditor with respect to the position papers?

MR. RICHARD OLFERT: None formal. I had one (1) informal conversation with the managing partner, the KPMG office, just to ask whether everything was in order from their perspective, and he indicated they were.

MS. CANDACE EVERARD: And that was, I take it, after the position papers had been drafted?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And what's his name, for the record?

MR. RICHARD OLFERT: Austin Abas.

MS. CANDACE EVERARD: Now, we know that first drafts of the position papers were provided to the Corporation that was, I believe, on the record and you testified to that this morning.

Did I get that right?

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: And have there been second drafts of the position papers prepared?

MR. RICHARD OLFERT: As a result of the conversations that would have ensued between MPI and ourselves, as they reviewed those drafts, there would have been occasion where some of the papers would have been amended for those conversation and a second draft would have been prepared and submitted to MPI.

MS. CANDACE EVERARD: Can you tell us how the position papers may have changed relative to the major policy adjustments from first draft to second draft?

(BRIEF PAUSE)

MR. RICHARD OLFERT: There would have been no amendments to the papers on account of those major policy decisions.

MS. CANDACE EVERARD: And when MPI reviewed the first drafts that were provided, did it bring to Deloitte's attention any inaccuracies as -- that you can recall, in the drafts provided?

(BRIEF PAUSE)

MR. RICHARD OLFERT: The changes would have been principally editorial in nature.

MS. CANDACE EVERARD: So Deloitte was not advised of any inaccuracies in -- in the substance of the documents?

MR. RICHARD OLFERT: There was one (1) item of -- of significance related to the accounting for certain equity investments and the foreign exchange component on them.

MS. CANDACE EVERARD: With respect to the draft version of the -- versions of the position papers, the Board posed a question of the Corporation in the First Round at number 69, if you have that handy. I don't know if you necessarily need to look at it, but fee -- feel free to do so.

The question of the Corporation was to:

"Please indicate the date of the draft position papers and file copies of all previous drafts in electronic format with tracked changes, including all comments."

And the reply, which, on its face, was prepared by the Corporation was that:

"The draft position papers were prepared throughout 2009. There are no drafts available since the papers were updated as they were prepared in consultation with Deloitte and KPMG."

Do you see that answer?

MR. RICHARD OLFERT: I do.

MS. CANDACE EVERARD: And is -- my understanding of that answer is that the position papers were obviously prepared electronically and were updated in the same version of the electronic document so that the previous drafts are not available.

Is that the same way that you read that?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: And that's your understanding of what happened?

MR. RICHARD OLFERT: Yes.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Do you know how the first drafts were delivered to MPI; was it electronically by email or by some other method?

MR. RICHARD OLFERT: They went electronically by email.

MS. CANDACE EVERARD: And do you know to whom they were sent within MPI?

MR. RICHARD OLFERT: They would have gone to Ottmar Kramer.

MS. CANDACE EVERARD: Thank you. Okay. In your direct evidence, Mr. Olfert, you gave some information to the Board with respect to the onerous contract analysis that we --

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: -- have in the filing. That is, of course, part of AI.20, and we have it at the book of documents at Tab 14, an excerpt and, in particular, that analysis appears at pages 26 and 27.

(BRIEF PAUSE)

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: Can you tell us, in conducting this review of whether, in Deloitte's view, there was an onerous contract, whether it reviewed the historical funding and operating deficit with respect to DVL?

(BRIEF PAUSE)

MR. RICHARD OLFERT: Sorry. We reviewed the annual information that was provided to us at the time that's outlined here and did not reflect significantly on the other factor you've just described.

MS. CANDACE EVERARD: And the -- the historical piece I -- I had referred you to earlier, it was 1-78, posed by the Corpora -- or posed by the Board, pardon me, of the Corporation is at Tab 33 of the book of documents. This was the IR that reflects the chart showing a net loss of over 80 million over the years. I -- you looked at it --

MR. RICHARD OLFERT: I did look at it, yes.

MS. CANDACE EVERARD: -- briefly?

Now, we see, if we continue with page 26 of the onerous contract analysis, that the net margin shortfall reflected about halfway down the page, after the -- the calculation that's shown, is some 8 million.

Do you see that?

MR. RICHARD OLFERT: I do.

MS. CANDACE EVERARD: And this -- can you tell me who prepared this calculation? I -- I appreciate the preamble says:

"A recent analysis was conducted by MPI to determine the cost of administering a licencing program."

Then it says:

"The following was determined."

And there's a series of calculations. Whose are those? Are they MPI's or Deloitte's?

(BRIEF PAUSE)

MR. RICHARD OLFERT: The numbers which are here and used in this analysis came from MPI.

MS. CANDACE EVERARD: And I take it that

-- so -- so, in other words, this -- these five (5) lines of words and numbers were provided in this way to Deloitte by the Corporation, or did Deloitte make any changes to it?

MR. RICHARD OLFERT: I don't know the answer to that question without checking with the person who drafted this.

MS. CANDACE EVERARD: That's neither of the colleagues --

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: -- that are with you?

MR. RICHARD OLFERT: Correct.

THE CHAIRPERSON: Just to get rid of one small point, do you know, in the cost element of that chart, it includes commissions or fees with respect to monies paid to the brokers for fees flowing to the province?

MR. RICHARD OLFERT: We don't know beyond the numbers that were provided here.

THE CHAIRPERSON: Thank you.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Did Deloitte do any kind of evaluation or analysis of these numbers for reasonableness or otherwise?

MR. RICHARD OLFERT: No.

MS. CANDACE EVERARD: If we look at page 27 of the onerous contract analysis, we see that Deloitte states, under the -- the heading of "Analysis," as follows:

> "The fact that the province mandated, through legislation, that MPI administer the licencing program is really not a contract, given that one counterparty - MPI - did not have an option of whether or not to execute. This supports that this arrangement is not a contract but merely an addition to operations."

That's what's reflected there?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: Can you supplement that commentary with any further elaboration, or detail, for the Board?

MR. RICHARD OLFERT: I can take you through the material that I did on the direct this morning, if you wish. It's the -- that those comments were intended to be the elaboration on this.

MS. CANDACE EVERARD: Why don't you refer us to what you're speaking about, and we'll go from there.

MR. RICHARD OLFERT: Sure. When we analysed this circumstance for whether or not it was an onerous contract, we first needed to assess whether it was a contract, and so we reflected on the agreements, or requirements that were in place by which these services were to be provided.

That obviously leads to a review of the requirement to provide driver vehicle licensing services, as required by the Drivers and Vehicles Act, including its regulations.

And then we are also aware that there was a master agreement that governs the relationship between MPI and the province, and our assessment of that was that it simply set out terms of the way the legislated responsibility was to be managed.

And so our assessment was that MPI has an operational responsibility by legislation to provide the services, and we then asked ourselves whether that was a reasonable conclusion.

And in so doing, we said had this been a contractual arrangement it likely would have had a term on it. There would have been an opportunity for MPI to negotiate the quantum of compensation and there would have been an opportunity to refuse or negotiate certain terms.

And as we understand it, the mandate was provided to MPI without those opportunities and, therefore, our assessment that this was not a contractual obligation, and it fell into a normal operations kind of situation.

THE CHAIRPERSON: Mr. Olfert, were you aware that that agreement, if I recall it properly, it's been years since we addressed it directly, had a provision in it that allowed for amendments if they were significant new demands of the Corporation that arose after it was signed, and wasn't it -- wasn't it signed by MPI as well as the government?

MR. RICHARD OLFERT: As I understand it, it was signed by MPI. I had not recalled the provision to which you refer.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Mr. Olfert, do you -- I -- I take it from your answer that you actually had an opportunity to review the document itself?

MR. RICHARD OLFERT: The agreement? I've not looked at it personally. I believe our staff did.

MS. CANDACE EVERARD: So somebody at

Deloitte --

MR. RICHARD OLFERT: Right.

MS. CANDACE EVERARD: -- reviewed the -- the actual document. Okay. You've described the -- the reflection, and ana -- and analysis that Deloitte undertook.

Did it seek any kind of legal advice with respect to its analysis, or --

MR. RICHARD OLFERT: It did not.

MS. CANDACE EVERARD: -- did it -- it did not, so it relied on its own reflection, and --

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: -- review of the question?

(BRIEF PAUSE)

MS. CANDACE EVERARD: Is there a particular reason why legal advice was not sought out?

MR. RICHARD OLFERT: We were confident in the conclusion that we had reached, and didn't see the need for it.

MS. CANDACE EVERARD: And I -- I understand that Deloitte did not prepare any form of preliminary analysis of the provision that would be required if this were deemed to be an onerous contract.

Is that right?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: Did the Corporation give Deloitte any instructions with respect to that?

MR. RICHARD OLFERT: No.

(BRIEF PAUSE)

MS. CANDACE EVERARD: I'd ask you to take a look at the question and answer at 1-79 posed by the Board of the Corporation.

This flows from the onerous contract analysis that we looked at. In particular, I'm looking at 1-79(d), which asked the Corporation to file an analysis to determine the cost of administering DVL which is summarized in Appendix A, and that of course is the -- that appendix is the onerous contract analysis.

We see at the reply to this IR that the whole of the response was prepared by Deloitte; that's on page 2.

Are you with me so far?

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: And we see at (d), Deloitte's response to (d), and I'm paraphrasing, that

Deloitte states there would not be any future funding shortfall if the arrangement were deemed to be an onerous contract.

Is that a fair summary of what's reflected?

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: And as a result of this conclusion, I take it that any losses, if there were any, incurred in the future, would flow from normal operations.

Is that fair to say?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: And in accordance with IFRS, provisions should not be recognized for future operating losses. Is that correct?

MR. RICHARD OLFERT: That is correct.

MS. CANDACE EVERARD: On a -- a different but related question, is Deloitte familiar with the provision under which MPI pays personal injury protection benefits to long-haul truckers?

Is that something that you have any familiarity with?

MR. RICHARD OLFERT: I do not.

MS. CANDACE EVERARD: So I take it that -- by that answer that that was not something that

Deloitte considered in -- in the context of an onerous contract?

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: And the reason that Deloitte would not have done so is because it was not aware of the situation?

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: Just going back for a moment to the -- the onerous contract analysis relating to the DVL issue, I appreciate your evidence about reflecting and analysing the -- the situation and that you didn't feel that legal advice was needed in the -- in the situation.

Would it be fair to say then that the conclusion that Deloitte drew about whether or not a contract exists between the government and MPI was in an accounting context as opposed to a legal context?

MR. RICHARD OLFERT: I would hesitate to call it exclusively an accounting context. I think we tried to provide a business lens on the situation and assess from a business/commercial perspective. Whether that was appropriate, it would be incorrect to say that there was a legal analysis.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Just before we leave IR -- or IFRS, and I do have a -- a couple questions in another sub area. We'll just back up for a moment.

You had given evidence with respect to IFRS in general terms. And you had said in your direct this morning that there were elections required in three (3) areas. One (1) was the fair value of capital assets, one (1) was employee benefits, and one (1) was the redesignation of financial instruments.

Is that a fair paraphrase of that evidence?

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: With respect to the second one that you had identified, you had spoken about the potential election relating to employee benefits, and you had testified that MPI had elected not to take that election.

Can you explain to the Board what the options were that were available to MPI in that context?

MR. RICHARD OLFERT: Let me respond to that question in this way because, technically, there would be five (5) or six (6) options. However, the fundamental choice that's to be made is whether to record expenses for each year's actuarial gains and losses in that year when they occur, or whether to use some other provisions which would permit certain elements of act -- actuarial gains and losses to go unrecognized, based on either a quantitative threshold, and -- well, depending on the period of time over which such gain and losses might be amortized.

Those are the options that exist today. It is anticipated that as IFRS evolves, those options are likely to disappear sometime down the road, although, that is still in the development stage as opposed to being the actual standard.

MS. CANDACE EVERARD: Now, you testified that as a result of MPI not making an election in this category, that there was no financial impact to it.

I -- I believe that that was the evidence that you gave, is that right?

MR. RICHARD OLFERT: That's what I said. What I meant, if it wasn't clear, was that there would be no change from the -- the accounting that's done today.

MS. CANDACE EVERARD: So there may still be a financial impact to the Corporation?

MR. RICHARD OLFERT: Now, to be abundantly clear, as at the date of transition, there's no transition adjustment required. Obviously recording pension costs in accordance with the existing policy, which is permitted under our IFRS is going to have a financial implication.

MS. CANDACE EVERARD: Okay.

(BRIEF PAUSE)

THE CHAIRPERSON: While Ms. Everard is conferring, when you say there -- there would be financial implications, you're suggesting, if IFRS came in, you said the options would disappear.

So there would be a re -- a required approach that would be different than the one that's going on right now?

MR. RICHARD OLFERT: There's changes being discussed with respect to the accounting for employee future benefits which are not in effect yet and only if, adopted, would come into effect in the future.

If those are adopted, as is currently being discussed, then any options that involve anything other than recording all gains and losses in year, those options would be set aside.

THE CHAIRPERSON: Thank you.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Okay. I'd ask you

then, Mr. Olfert, to go to 1-76, which was posed by the Board, and you commented on this in your direct evidence. This is at Tab 32 of the book of documents. Reflects a quote taken from AI.20 dealing with Deloitte's analysis of cash generating units.

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: And I gather -- and -- and I appreciate that a revised version has been filed, and we'll speak about that in a moment. But if we look at the original alternative 3 as filed with the Board, I gather from -- from looking at this alternative 3 and in the larger context of the section in which it appeared in the filing, that it would be fair to say that Deloitte, when it prepared this, would have looked at the underlying realities of the organization in identifying the independent cash generating units; is that correct?

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: Can you just explain why there is a need to identify the independent cash generating units?

MR. RICHARD OLFERT: The impairment provisions of IFRS are designed to have financial statement preparers assess whether the value at which assets are carried on their balance sheet exceeds their fair value.

And in those instances where there's a difference, that is, the fair value is less than the carrying value, there would be a requirement that the asset be written down.

So the context of the analysis and the requirement for cash generating units comes out of the question as to how one makes that assessment of whether or not there is an impairment. And there's, as contained in the paper, a decision tree that one needs to work through to determine whether or not impairment exists.

The obvious and ideal situation is if an individual asset has a value, or has independent cashflows that can be used to establish a value, and you can compare that to the carrying amount and you can make that decision, which one is higher and which one is lower.

And, in fact, for any one of MPI's properties, the first step in the process would be to say what's the market value of that property. And if it could be sold for market value in excess of it's carrying value, the impairment testing is finished. If, however, that's unclear, then one needs to assess whether the cashflows that will be generated by the asset when estimated over time and present valued back to the current day, whether those provide a value that is different from -- or a value that is less than what it's carried at on the balance sheet.

And so the concept in IFRS is to say rather than looking at an individual asset, and then allocating all kinds of revenue and costs, so you have an allocated calculation of cashflows for an individual asset, IFRS says, Instead of doing that, we're going to aggregate to a level where we can make a realistic assessment based on the economics of the situation. And so, the first step in the analysis was to say, Can we do that at the individual asset level? Well, for a service centre, it's going to be difficult to establish independent cashflows for that service centre because it's part of a network of service centres that work together.

Well, then what's the next level of aggregation that's possible? And this was the second option that was considered. And that option was to look at the individual lines of business, and are the cashflows generated by individual lines of business.

But, again, reflecting on a service centre as an example, there are multiple lines of business operated from a single service centre where individual customers come, and there's multiple lines of business revenue generated from those customers. And so the question was: Is there a higher level to which we should be assessing the cash generating unit?

And that was the analysis that was done and lead to Alternative 3, that looked at the mandates and looked at the fact that because all of the operations, apart from the Cityplace property, are part of the same integrated service delivery to the same customers from integrated locations. All of the non-Cityplace operations should form a single cash generating unit.

MS. CANDACE EVERARD: And so would it be fair to say that Alternative 3, as originally drafted by Deloitte, reflected its views of the Corporation, relative to whether or not there are dependent or independent cashflows for the reasons that you articulated?

MR. RICHARD OLFERT: Say that again, please.

MS. CANDACE EVERARD: When Alternative 3 was drafted in its original form --

MR. RICHARD OLFERT: Yes?

MS. CANDACE EVERARD: -- and Deloitte having done the analysis for the reasons that you've just described --

MR. RICHARD OLFERT: Right.

MS. CANDACE EVERARD: -- I take it that Deloitte would have reflected here its views of the Corporation, relative to whether the cashflows were dependent or independent.

MR. RICHARD OLFERT: Yes. So we concluded they weren't independent at the line of business level, so the question was is there a -- is there a subsequently higher level of aggregation wherein the cashflows would work together.

MS. CANDACE EVERARD: And when Deloitte concluded that the cashflows were not independent at that level, it would have formed that view, based on the knowledge that it had at the time about the Corporation?

MR. RICHARD OLFERT: Correct.

MS. CANDACE EVERARD: And did Deloitte review Alternative 3 with the Corporation other than by providing the draft position paper, as was discussed earlier?

MR. RICHARD OLFERT: It would have been handled as the others, provided electronically questions and comments with updates as necessary.

MS. CANDACE EVERARD: And did the Corporation raise with Deloitte any issues or inaccuracies that it felt were apparent in the drafting of Alternative 3?

MR. RICHARD OLFERT: No.

MS. CANDACE EVERARD: Now, in the proceeding today we have filed as MPI Exhibit 15 a revised Alternative 3, contained within the context of AI.20 in which Alternative 3 was originally filed.

Can you tell me who prepared the alternative or the new wording of Alternative 3 that we saw -- saw this morning?

MR. RICHARD OLFERT: I did that.

MS. CANDACE EVERARD: Is it possible for you to provide to the Board a blacklined or a track changes version of Alternative 3, or is that not available electronically, based on the way that this edit would have been done?

MR. RICHARD OLFERT: It is not available. It was -- it was a complete redo. It wasn't an adjustment.

(BRIEF PAUSE)

MS. CANDACE EVERARD: And can you tell us how the revisions to Alternative 3 arose? How it was that you came to revise Alternative 3, as you've described.

MR. RICHARD OLFERT: Certainly. MPI

pointed out to us that there had been considerable discussion earlier on in the proceedings with respect to the wording. And upon reading the transcript of that, it was my view that the choice of words that had been made and documented was causing questions about those words that weren't intended to be raised in the -- in our pursuit of the answer to the IFRS question.

And so my view was that it was appropriate to correct those things that were factually incorrect because it didn't have an impact on our conclusion, and to make clearer with the last four (4) lines that had been added, the points that you've been making with your questions about the integrated mandates reflecting the integrated operations.

MS. CANDACE EVERARD: So are you saying it was your suggestion to re-work the wording of Alternative 3?

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: Now that we have the original Alternative 3 in front of us at 1-76, as well as the revised wording, can you just go through, for the Board, the inaccuracies, or the portions of the original Alternative 3 that were changed. I know I asked for a blackline copy and its not available, so perhaps we can just have you cross-reference between the two (2), and explain the revisions.

MR. RICHARD OLFERT: Sure. The first sentence is unchanged.

The second sentence has been modified to indicate that MPI is the sole provider of, words inserted, "universal compulsory auto insurance."

And in the third sentence of the original, which begins, "As such, they are required," that was inaccurate, based on a review of the legislation, and so the sentence that begins:

> "In addition, MPI takes on additional product lines, like driver licensing functions that are required, and Extension insurance that is permitted by Manitoba's legislation," was inserted.

And then the following -- then the following sentence in the original, which begins with the word, "Consequently", has been modified to add in the words, "net" in front of "cash flows," and the parat -- parenthetical reference "after expenses" behind the term "cash flows."

And then in the following sentence, there's a -- a little bit changed to -- to make sure the reference is clear when the original said "they". So we've added "the net cash flows are inter -- interdependent." And then we've added "in part" because of the addition of the last four (4) lines of the -- of the revised item.

And then the sentence in the original that begins, "MPI provides driver licensing knowing," has been replaced by the sentence:

"In the same way that MPI is obligated by legislation to provide driver and vehicle licensing, it is obligated to provide Basic insurance."

And then this -- the following sentence is the same, and then the -- the conclusion with respect to "as a result the cash flows are not independent" has been adjusted to include the -- the four (4) lines that have been added.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Thank you. Just a follow-up on that. On the fifth line of the new version of Alternative 3, we see the continuation of the sentence that begins, "Consequently, it could," and it says:

"Be argued that the net cash flows after expenses that are generated from

all product lines that are part of
legislative mandates are not
independent cash flows."

The word "net" was added to modify cash flows. What was the particular reason or need --

MR. RICHARD OLFERT: The particular reason --

MS. CANDACE EVERARD: -- to add that?

MR. RICHARD OLFERT: -- for that is, when I explored the revised wording, it became clear, from those that I bounced the -- the potential revised wording off of, that by cashflows they were understanding cash inflows to be revenues, and in fact the term in IF -- IAS-36 refers to net cashflows, net of expenses. So this was an effort to clear up any misconception in advance.

MS. CANDACE EVERARD: And those that you bounced the revised wording off of were people within Deloitte or people from MPI?

MR. RICHARD OLFERT: Both.

MS. CANDACE EVERARD: And who from MPI did you bounce the wording off of?

MR. RICHARD OLFERT: I sent the draft wording to Ms. Kalinowsky, Mr. Kramer and Mr. Palmer.

MS. CANDACE EVERARD: Thank you. Okay. I just have a few lines of follow-up from various pieces of the evidence, so these aren't necessarily down a particular line.

Mr. Olfert, you've suggested in your evidence that the Board can rely on management and/or the Corporation's auditor for assurances as to the appropriateness of the underlying data to which the allocation formula are employed.

That's fair to say?

MR. RICHARD OLFERT: That's correct.

MS. CANDACE EVERARD: What experience with regulated entities and their regulators do you have that guides your view on that point?

MR. RICHARD OLFERT: The most significant experience would be twofold. One (1) is, a number of years back, I had involvement for a period of four (4) or five (5) years with the filings that then Manitoba Telecom Services provided to the CRTC.

And secondly, a little bit differently, but a significant involvement on behalf of the Federal Government in auditing claims that were the subject of a significant agreement between the province and the Federal Government, and so we audited the claims file by the province. Not exactly a regulator situation, but the view held by the government when they received those claims was in that same vein.

MS. CANDACE EVERARD: Now, in terms of the -- your understanding of the purpose of the basic AutoPac audited financial reports, can you confirm that the use thereof is for rate setting from a regulatory standpoint, and considerations from that regulatory standpoint would include, and -- and the statements would be used for, a consideration of useful and prudently acquired, among other details, the overall financial condition of the Corporation?

MR. RICHARD OLFERT: I'm not sure I understand the question. Could you rephrase it.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Mr. Olfert, I -- I apologize for that confusion. Are you familiar with the purposes for which a regulator would use financial statements, as distinct from the purpose that an auditor would look at financial statements?

MR. RICHARD OLFERT: I think the two (2) roles are fundamentally different, in that the regulator would be a user of the financial statements, and the auditor would not be a user, would be one (1) who attests to their fairness of presentation.

MS. CANDACE EVERARD: And you understand

that this Board, in the context of a rate application from the Corporation, is looking at whether the applied-for rates are just and reasonable?

MR. RICHARD OLFERT: That's my understanding, yes.

MS. CANDACE EVERARD: And I -- I think I asked you a question on this earlier this morning in the cross-examination, and I -- I think this goes hand-in-hand with the evidence you just gave about the work that auditors do. But it's my understanding that an external audit is for the purposes of testing whether there's anything materially misstated in financial statements.

Is that your understanding as well?

MR. RICHARD OLFERT: The work of the auditor is to provide an attestation that the financial statements are fairly presented in all material respects.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Do you have knowledge of -- oh.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Do you have

familiarity, Mr. Olfert, with a proceeding that arose before this Board in a -- in a different utility, wherein a position was taken that the Board did not review the underlying data of the utility in a sufficient manner?

Do you have knowledge of that?

MR. RICHARD OLFERT: No.

MS. CANDACE EVERARD: Are you familiar with the legislation that underlies the mandate and responsibilities of this Board?

MR. RICHARD OLFERT: I am not.

MS. CANDACE EVERARD: Are you familiar with the variations between the forecasts of expenses and the actual expense incurred with the Corporation over the last number of years?

MR. RICHARD OLFERT: I'm sorry, could you ask the question again?

MS. CANDACE EVERARD: Are you familiar with the variations between the forecasts of expenses and the actual expenses incurred at the Corporation over the last number of years?

MR. RICHARD OLFERT: I am aware, in general terms, that such variation analysis would have been prepared. I'm not familiar with the analysis themselves.

MS. CANDACE EVERARD: Given that you have some familiarity with the variances, and if you were familiar with the fact that there were variances years -- year-over-year, that is with the actual numbers from prior years being amended into future years, and that this was having an effect on the rate setting of the Board, in that context would you still suggest reliance on management of the Corporation and/or the auditor of the Corporation, with respect to the underlying data of those variations?

MR. RICHARD OLFERT: Let me respond to your question this way: One (1) of my responsibilities is to serve as an audit partner on many audits, including government entities, public companies, large private companies, whose financial statements are used by a wide variety of users. And I cannot think of an occasion, in all of those different audit efforts, where the users of the financial statements have indicated a need to go into the base data of the -- of the reporting entity, after having seen the auditor's report.

There are questions that are asked, but there's -- I have never seen a situation to go back and look at the individual books of account, for instance.

MS. CANDACE EVERARD: So is your evidence that, in your experience, reliance on the report of an auditor has remained constant, has not been questioned?

MR. RICHARD OLFERT: The audit -- the audit reports have been relied upon, yes.

MS. CANDACE EVERARD: Now, we know that MPI has pension obligations.

You're familiar with that?

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: And that it carries those obligations forward on its balance sheet.

Are you familiar with that as well?

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: As well, it's on the record that the Corporation deducts from its investment income what it needs in order to meet the employer pension obligations.

Are you aware of that as well?

MR. RICHARD OLFERT: No.

MS. CANDACE EVERARD: You just aren't aware of that one way, or the other?

MR. RICHARD OLFERT: Well, let -- let me say it this way: I'm -- I'm aware of how the pension costs are accounted for in the financial statements, but the notion of them being deducted from investment income takes me into a territory of the Corporation's operations that I'm not familiar with.

MS. CANDACE EVERARD: Let's assume for

the moment that that is the case, that there are deductions made from investment income to meet the Corporation's needs in terms of pension obligation. In that context, would you agree that Basic insurance may be subsidizing the Corporation's pension obligations?

MR. RICHARD OLFERT: I'm not sure I know enough about the situation that you're describing to make a categorical response on that.

MS. CANDACE EVERARD: But if that situation existed, would there not be a subsidy, as I've described?

MR. RICHARD OLFERT: I would want to understand the situation you're describing better. I'm not sure that I understand it completely.

(BRIEF PAUSE)

MS. CANDACE EVERARD: I'll leave that line of questioning for the moment, and we may need to come back to that. I just have a few more questions, and we'll -- I'll probably need to consult before I close my cross.

Are you familiar with -- whether for a rate regulated entity, a regulator can adopt accounting -- an accounting approach that does not reflect GAAP?

MR. RICHARD OLFERT: Say that again, please.

MS. CANDACE EVERARD: Are you familiar whether in a rate -- for a rate regulated entity, a regulator can adopt account -- an accounting approach that does not reflect GAAP?

MR. RICHARD OLFERT: I am aware of situations where regulators have asked regulated entities to make adjustments to their GAAP results for regulatory purposes.

MS. CANDACE EVERARD: So in your view, it would be within the realm of possibility for this Board to, for rate setting purposes, declare or consider the arrangement between the government and the Corporation to be an onerous contract under IFRS, regardless of the view of the Corporation, or your office, or KPMG?

MR. RICHARD OLFERT: In those situations where I've seen a regulator ask for something to be done differently, it's because the assessment that's made is made for a specific purpose that the regulator has.

In the instance that you describe, you would effectively be asking the Corporation to make an accounting for a different judgment that the regulator has around the application of the same principles that others have argued -- have concluded should be handled differently, and those kinds of adjustments I haven to seen regulators request.

MS. CANDACE EVERARD: So you haven't seen it before, but do you have a -- a view, or an opinion, of whether it can be done?

MR. RICHARD OLFERT: I think whether it can be done is a function of what the Board's jurisdiction is.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Now, there's evidence on the record that the Corporation's rates in Basic are designed to have a break-even result over the long term.

Is that something that you're familiar with?

MR. RICHARD OLFERT: Other than that being - - that's been my presumption as I've reviewed the work that we've done for MPI. I have not discussed that with anyone.

MS. CANDACE EVERARD: I don't think that's -- I don't think anyone would argue with that. I think the Corporation has been very consistent on that point over the years.

Would you agree that that concept or that approach is synonymous with having rates set to recover a return to shareholders for a profit situation?

MR. RICHARD OLFERT: Could you ask that question again, please?

MS. CANDACE EVERARD: Would you agree that the Corporation's approach of breaking even over the long-term is -- probably synonymous is -- is not the best word, but that is the -- the converse, I suppose, would be a better word, of having rates set to recover a return to shareholders in a for-profit situation?

MR. RICHARD OLFERT: It's definitely a different regulatory objective.

MS. CANDACE EVERARD: Mr. Olfert, on a -- on a different bent, would you describe a company in a competitive scenario that has 95 percent of the market as having a near monopoly?

MR. RICHARD OLFERT: It's likely a fair statement, yes.

MS. CANDACE EVERARD: And would you say that that would be particularly so if that same entity had a true monopoly or a 100 percent monopoly of a market that underscores or underlies the competitive market, wherein there's a near monopoly?

MR. RICHARD OLFERT: Again, likely a fair statement, yes.

MS. CANDACE EVERARD: Mr. Chairman, we can either take a very short break in order that I can have some consultation or we can continue. I leave that in your hands.

THE CHAIRPERSON: I think perhaps I have one (1) question here, and then we'll take a short break. And then you can reflect as to whether you have any other questions or not.

Mr. Olfert, while you're here, it's an opportunity to ask a couple of questions that you were speaking related -- to earlier.

You spoke of accepted linkages between asset and liability allocations of revenue and expense allocations.

Am I correct as to the linkages that you were speaking of?

MR. RICHARD OLFERT: Yes.

THE CHAIRPERSON: You also spoke of a need to review allocations on a regular basis.

That's correct too?

MR. RICHARD OLFERT: Correct.

THE CHAIRPERSON: You've also spoken about, in the process of your work, contacts with the auditors of the firm, and, also, with the office of the auditor general

That's true too?

MR. RICHARD OLFERT: I made reference to the fact that we participated in the same meetings. Direct contact was limited to the one (1) informal conversation I mentioned to Ms. Everard.

THE CHAIRPERSON: Thank you for that. You spoke, if I recall properly, to I think it was six (6) criteria by which proper allocations would be judged and determined.

Is that correct?

MR. RICHARD OLFERT: There were six (6) criteria that were used as principles for the establishment of the methodology, yes.

THE CHAIRPERSON: Are you aware that this Board has, among other elements of the evidence, relied on annual and qualified audited Basic financial statements?

MR. RICHARD OLFERT: I am aware of that, yes.

THE CHAIRPERSON: In employing your criteria for what would represent proper allocations, in your view, to what extent do the Basic financial statements filed at -- if you're aware of them -- at previous annual rate proceedings meet your criteria for acceptability?

MR. RICHARD OLFERT: My first response is to indicate that I'm aware of those filings. I have not read them in detail, so that necessarily limits the comments that I could make.

THE CHAIRPERSON: So you wouldn't be able to respond by referring to the various criteria that you mentioned?

MR. RICHARD OLFERT: Not without perusing that material.

THE CHAIRPERSON: Are you aware that this Board has called for regular reviews of the allocation formula a decade or so ago?

MR. RICHARD OLFERT: I'm aware that there have been calls for review. I'm not familiar with the details or the timeframes.

THE CHAIRPERSON: With such a request, given the changes to the Corporation over the years, would you expect an auditor to take note of the request to review the allocation formulas, in your own practice?

MR. RICHARD OLFERT: I think, in -- in part, that would depend on the terms of the mandate, if the -- if the audit report is to make an assessment of compliance with the Corporation's policies as they're stated, then they are stated as they are, notwithstanding the fact that they may not have been updated as frequently as the regulator may have indicated is desirable.

THE CHAIRPERSON: Are you suggesting then you would go year after year applying the same allocations even though you're aware of significant changes occurring to the nature of the Corporation and its operations?

MR. RICHARD OLFERT: I think one would start from that premise, and it would be prudent to inquire whether there's been updates to reflect the -- the changes to the underlying business.

THE CHAIRPERSON: Thank you, Mr. Olfert. We'll take a short break. And Ms. Everard will have an opportunity to review her notes, and then we'll come back. If she has nothing else, we're going to move to Mr. Williams. Thank you.

--- Upon recessing at 3:22 p.m.

--- Upon resuming at 3:34 p.m.

THE CHAIRPERSON: While we're in here the world still moves on. I understand that they have twenty-two (22) of those Chilean miners out, which is a pretty good news story. So they have eleven (11) more miners and two (2) paramedics and two (2) engineers, apparently, and they'll have them all out. It's amazing.

Ms. Everard...?

MS. CANDACE EVERARD: Thank you, Mr. Chairman.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Mr. Olfert, I just have a couple more questions, just following up on some of the earlier dialogue to ensure that the Board has your evidence clear -- clearly.

We know that the Corporation puts forward financial statements to the Board in support of its application, right?

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: And you're familiar with the fact that the forecasts for the whole of the organization have not been provided to the -- to the Board, rather, just the forecast for Basic are provided?

MR. RICHARD OLFERT: Yes.

MS. CANDACE EVERARD: Now from a regulatory standpoint, as opposed to an auditor's standpoint, and the regulatory standpoint being to try to establish just and reasonable rates, would you agree that unless full information is provided to the Board to assess the reasonableness of the Corporation's expenses, that the Board cannot be assured of whether what flows from the cost allocation into Basic is reasonable?

MR. RICHARD OLFERT: First, you're asking me to take a regulator's perspective, which I've never done, so I'm guessing a bit in the answer. But I would -- can I ask you to repeat the question before I make my comment?

MS. CANDACE EVERARD: Sure. The question was: From a regulatory standpoint of trying to set just and reasonable rates, and not an auditor's standpoint, and I -- I took your early -- earlier evidence that you have had some experience in the regulatory arena, whether you agree that unless full information is provided to the Board to allow it to assess the reasonableness of corporate expenses, how can it be assured of whether what flows into Basic under the cost allocation methodology is reasonable?

MR. RICHARD OLFERT: So several perspectives on the response. First, that level of access to all of the Corporation's accounts would be far beyond what I've seen regulators seek in those situations that I've described earlier.

Secondly, with respect, un -- unless there is suspicion that information is being intentionally withheld or improperly provided, I'm not certain as to the need for that. And I'll leave it there.

MS. CANDACE EVERARD: In the experience that you've had in the regulatory arena, and I know you mentioned the -- the CRTC, have you seen certain expenses be disallowed and rates adjusted accordingly?

MR. RICHARD OLFERT: The situations with which I'm familiar are generally rate of return environments, so the larger question is what's included in the investment base. And clearly there's been debate about what should be and shouldn't be in the normal course.

MS. CANDACE EVERARD: So have you -- so you have seen the regulator make adjustments to rates, and you're -- you're talking about an investment context rather than an expense context?

MR. RICHARD OLFERT: Well, there's the -- there's the normal back and forth conversation about what should be appropriately included in the rate base.

Typically those things are defined by methodologies, and unless -- and in those situations that I'm familiar with, unless by policy the regulator has a view that something should be altered from what's been previously agreed, then the precedent that's been established by agreed-upon methodologies is generally followed.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Thank you.

THE CHAIRPERSON: Thank you, Ms. Everard. I just want to clear the deck, so to speak.

Ms. Peters, do you have any questions of Mr. Olfert?

MS. LIZ PETERS: No, not at this time.

THE CHAIRPERSON: Thank you. Then we'll move to Mr. Williams.

MR. BYRON WILLIAMS: Thank you, and -- and good afternoon, Mr. Chairman, and Dr. Evans. I was afraid you'd forgotten -- forgotten me. It's been a few days.

I'd also like to welcome certainly the Deloitte team, the -- the front row, and the supplemental front row: Mr. Olfert, Mr. Martens, and -- and Ms. Halli

And the Chairperson and Dr. Evans will note as well that I'm -- riding shotgun with me today is, at least figuratively, is Ms. DeSorcy from CAC/Manitoba who no -- no doubt will be shouting lines of inquiry at me from the -- from my own back row.

Just to assist the -- the discussion this afternoon, I have three (3) documents that I -- I'd ask the Board's secretary to distribute.

Mr. Chairman, I'm not sure that they're properly marked as exhibits, but I know that's often your practice. The first document is actually already an exhibit. It's the response to CAC/MSOS-2-9, an excerpt from -- it's an excerpt from an Alberta Utility Board decision that was provided by Deloitte.

If -- if the Board is -- is so inclined it might mark that as CAC/MSOS Number 5.

THE CHAIRPERSON: That's fine.

--- EXHIBIT NO. CAC/MSOS-5:
Excerpt from an Alberta Utility Board decision

MR. BYRON WILLIAMS: Item number -- the second item might be a -- a hypothetical. I think at the top you'll see Abby and Bruce, and again I think one might consider it just being marked for identification, but if you want to mark it for -- as an exhibit, that would be CAC/MSOS number 6.

THE CHAIRPERSON: So be it.

--- EXHIBIT NO. CAC/MSOS-6: Hypothetical of Abby and

Bruce

MR. BYRON WILLIAMS: And the third document again is a small one (1) pager, which you may -- may mark if you wish, CAC/MSOS number 7.

THE CHAIRPERSON: Okay.

--- EXHIBIT NO. CAC/MSOS-7:

One (1) page document headlined "Potential Considerations in Evaluating Cost Allocation Methodologies Between Regulated and Unregulated Lines of Business"

MR. BYRON WILLIAMS: Mr. Chairman, I'll just make sure that's distributed, and -- and I -- I think we're looking to give extra dol -- I did provide one (1) copy to MPI previously. We're just waiting to get a few more. I thank Board secretary for -- for the MPI.

(BRIEF PAUSE)

CROSS-EXAMINATION BY MR. BYRON WILLIAMS:

MR. BYRON WILLIAMS: And, Mr. Olfert, just before we start the questions, just by way of preamble to you, I -- I know you've done a lot of line-by-line with My Learned Friend Ms. Everard. I -- I want to assure you that I'm not going to be going through many lines by line. I'm really interested more at a higher con -- higher level, some of the concepts and philosophies that you're -- you're bringing to this discussion.

And I do want to assure you that I've listened carefully to your -- your direct, and, also, your conversation with My Learned Friend Ms. Everard. Right near the start there are going to be a few questions that are -- sound a bit repetitious, but that's not any impoliteness on my own part. It's just for -- for the purposes of setup, okay, Mr. Olfert?

MR. RICHARD OLFERT: (NO AUDIBLE RESPONSE).

MR. BYRON WILLIAMS: Mr. Olfert, and -- and you did speak of this with My Friend Ms. Everard, but it is your view that even though MPI in recent years has become a provider of other services, at its core, it's a provider of compulsory automobile insurance products to Manitobans.

Would that be fair, sir?

MR. RICHARD OLFERT: That is by far the largest part of its business, yes.

MR. BYRON WILLIAMS: It's the core of its business?

MR. RICHARD OLFERT: Yes, which is not to undermine the importance of the other functions it provides.

MR. BYRON WILLIAMS: Okay. And it's also been your view expressed in your -- your report that certain other services of -- provided by MPI are comp -- complimentary to this core service in that they leverage existing MPI customer records and customer points of contact.

Is that correct, sir?

MR. RICHARD OLFERT: That is correct.

MR. BYRON WILLIAMS: And one (1) example of those complimentary services would, of course, be Extension.

Would that be fair, sir?

MR. RICHARD OLFERT: That's correct.

MR. BYRON WILLIAMS: And you are aware, of course, that Basic and Extension, those lines of business are closely integrated with many shared applications, sir?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: And, of course, you're aware that Extension leverages the existing customer records and customer points of contact flowing to MPI through the Basic monopoly. Would that be fair, sir?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: And, again, at the risk of being a little bit repetitious, you reviewed over the past couple years both the cost allocation methodologies of Manitoba Public Insurance, as well as the asset and liability methodology, sir?

MR. RICHARD OLFERT: That is correct.

MR. BYRON WILLIAMS: And in doing your work you have examined key comparators such as ICBC and Saska -- SGI, correct, sir?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: And you've performed secondary comparisons, including professional literature reviews. Would that be fair?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: And you've also reviewed, and it's part of the secondary comparative analysis, submissions to regulators by regulated entities.

Would that be fair?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: In the course of

work or in preparing your work on behalf of Manitoba Public Insurance on those two (2) allocation methodologies, can you indicate whether you examined affiliate relationship codes used by regulators, such as the Ontario Energy Board?

MR. RICHARD OLFERT: Could you repeat that reference, please?

MR. BYRON WILLIAMS: Absolutely. Did you examine affiliate relationship codes used by regulators, such as the Ontario Energy Board?

(BRIEF PAUSE)

MR. RICHARD OLFERT: So by that name, we did no specific study of those matters.

MR. BYRON WILLIAMS: In the course of your work or in preparing your work on behalf of Manitoba Public Insurance in these -- the context again of these cost allocation studies, did you examine the -- any transfer pricing criteria used by regulators to govern the prices charges -- charged for services exta -- exchanged between affiliate organizations and regulated utilities?

(BRIEF PAUSE)

MR. RICHARD OLFERT: It was not a specific area of focus, and we don't recall any specific focus on transfer pricing with affiliated.

MR. BYRON WILLIAMS: In the course of your work, or in preparing work, on behalf of Manitoba Public Insurance, were you asked to calculate or put a price on the stand-alone costs of an unregulated business such as Extension in terms of developing their own information database and building systems?

MR. RICHARD OLFERT: We were not.

MR. BYRON WILLIAMS: I'm not saying I would ask you this. I -- I know it's -- I'm not paying you, Mr. -- Mr. Olfert, but if you were -- were asked, and recognizing that you might require other consultants to assist you, you could calculate the stand-alone costs of an unregulated business such as Extension developing its own information database and building system, correct?

MR. RICHARD OLFERT: One could assemble an estimate of what that would cost.

MR. BYRON WILLIAMS: And one could test that estimate in the fair market, the competitive market, sir?

MR. RICHARD OLFERT: Depending on what you mean by "test," there would be ways of assessing whether the estimates are reasonable.

MR. BYRON WILLIAMS: Thank you. In the course of your work, or in preparing for your work, on behalf of Manitoba Public Insurance, were you asked to calculate or to put a price on the advantages in the competitive marketplace flowing to non-Basic lines of business, such as Extension, from their relationship with the Basic monopoly?

MR. RICHARD OLFERT: We were not.

MR. BYRON WILLIAMS: Now, I think I've -- I've heard your answer to Ms. Everard on this, but I just want to check.

Would it be accurate, in terms of the -- your asset liability cost allocation review, that you did not evaluate the financial implications of applying incremental -- an increment -- incremental allocation to assets and liabilities? Would that be fair, sir?

MR. RICHARD OLFERT: That is correct.

MR. BYRON WILLIAMS: Just very quickly, I'd ask you to turn to what is I believe now marked as CAC Number 5 which is an excerpt from your response to CAC/MSOS, the Second Round Interrogatory number 9.

Do you have that, sir?

MR. RICHARD OLFERT: I do.

MR. BYRON WILLIAMS: And I -- I just note that I only included part of the response for the purposes of this discussion, but you'll -- you'll note that you've attached a decision of the Alberta Energy and Utilities Board. Do you see that, Mr. Olfert? It's probably on the second or third page.

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: And I wonder if you could just assist me for a -- a brief second by turning your attention to page 11 of that document, sir. And in particular, sir, I'm going to ident -- direct your attention to a -- a heading under "Board Findings," and it would be the second line of the second paragraph. And I'll read it to you, and you can confirm whether or not I've read it correctly.

You'll see the sentence starting:

"The Board is always concerned that utility customers receive fair value from utility assets, are provided at least cost, and that there is no subsidization of non-regulated operations by the regulated operations. To that end, it is necessary that all utility transactions are trans -- transparent to regulatory oversight."

Did I read that correctly, sir?

MR. RICHARD OLFERT: Yes, you did.

MR. BYRON WILLIAMS: A rare event. I -- I take it you agree with that statement, sir?

MR. RICHARD OLFERT: We've not assessed agreement or disagreement with that statement.

MR. BYRON WILLIAMS: It's not one that, on its face, is intuitively unreasonable?

MR. RICHARD OLFERT: That's fair.

MR. BYRON WILLIAMS: You'll see at the end of this paragraph, the last sentence, that the Board is pleased -- and I'm just paraphrasing. There's a reference to the applicant's devel -- developing an enhanced code of conduct.

Do you see that reference, sir?

MR. RICHARD OLFERT: I see that, yes.

MR. BYRON WILLIAMS: Okay. Are you aware that in -- whether or not, in certain affiliate codes of conduct, regulated utilities are not authorized to enter into contractual relationships with affiliates unless the -- the contract provides provisions requiring the affiliate to comply promptly with all req -- re -- requests made by -- by the regulator for information with respect to the services under the contracts, or the cost to the affiliate providing those services?

Are you aware of whether or not that's the case, sir?

MR. RICHARD OLFERT: I'm sorry, could you repeat the first part of the question?

MR. BYRON WILLIAMS: I'll -- I'll do my best.

MR. RICHARD OLFERT: Yeah.

MR. BYRON WILLIAMS: Are you aware that in -- whether or not --

MR. RICHARD OLFERT: Okay.

MR. BYRON WILLIAMS: -- in certain affiliate codes of contact, regulated utilities are not authorized to enter into contracts with affiliates unless there are provisions which require them to provide promptly, or to the regulator, certain information?

MR. RICHARD OLFERT: I am not aware of those codes, no.

MR. BYRON WILLIAMS: Okay. Thank you. Just to follow up a couple questions that you -- again, my learned friend Ms. Everard was asking you, you -- you mentioned doing some work with MTS before the CRTC. Is that correct, sir?

MR. RICHARD OLFERT: We provided audit assurance on certain reports, which the company filed with the regulator, yes.

MR. BYRON WILLIAMS: And roughly in what

decade were those reports provided?

MR. RICHARD OLFERT: They would have been provided in the '90s.

MR. BYRON WILLIAMS: And again, you'll be aware that in the -- the 1990s, the CRTC was implementing a form of regulatory oversight, known as the Price Cap Regime, sir?

MR. RICHARD OLFERT: I'm aware that that was the case, yes.

MR. BYRON WILLIAMS: And in that era, you'll agree, the regulatory oversight was considerable less than it would have under the previous form of regulation?

MR. RICHARD OLFERT: You're testing my knowledge of the price cap, but I'm reluctant to make too many statements about it, because my recollection of it is not very good.

MR. BYRON WILLIAMS: You're not disagreeing with my assertion, you're suggesting that you're -- you're knowledge of the regulatory regime in that era is incomplete?

MR. RICHARD OLFERT: I'm not disagreeing, nor am I agreeing.

MR. BYRON WILLIAMS: Fair enough. Again, on -- on a similar point, based upon your -- on your work in regulatory regimes, it would be your experience that in determining just and reasonable rates a central issue for regular -- regulator may be with regard to the question of whether assets are usu -- useful and reasonably acquired.

Would that be your understanding, sir?

(BRIEF PAUSE)

MR. RICHARD OLFERT: So I'm not sufficiently familiar with the regulatory environments to category -- categorically agree or disagree.

MR. BYRON WILLIAMS: It -- it would be fair to say that you're not overly familiar with -- with concepts such as "just and reasonable rates," and concepts such as "useful and reasonably acquired."

Would that be fair?

MR. RICHARD OLFERT: I think it's -- it's fair to say that those are understandable and logical concepts for a regulator to apply. I'm reluctant to describe or comment on how those play out in particular regulatory environments.

MR. BYRON WILLIAMS: And just one (1) more inquiry along this line, sir, and you can -- if you're unfamiliar, that's fine with -- fine with me.

But would it be your experience that when looking at expenditures, as opposed to assets, regulators often use the test of prudent and reasonably necessary expenditures, sir?

MR. RICHARD OLFERT: That would seem to be a fair test.

MR. BYRON WILLIAMS: You're sense is that it -- that it is a fair sense. Are you familiar with regulators employing that concept?

MR. RICHARD OLFERT: As a concept, yes.

MR. BYRON WILLIAMS: And I'm coming from a regulatory field. I'm not very familiar with auditors, sir, so you'll excuse me.

When an auditor looks at a report, and signs off on a report, are they asking themselves questions such as, Are the assets use -- useful and reasonably acquired?

MR. RICHARD OLFERT: The auditor would be assessing whether the asset that was acquired is appropriately recorded and classified. So the answer would, in part, depend on the terms of reference of the audit engagement as to whether or not that specific assessment was part of what was required.

MR. BYRON WILLIAMS: In your experience, was that a frequent occurrence that you would be asked as part of your audit engagement signing off on general financial statements to ask the question: Were these assets useful and reasonably acquired?

MR. RICHARD OLFERT: On general purpose financial statements, the focus would be on whether the asset that is recorded as acquired is recorded at the acquisition amount and to ensure that the asset exists.

MR. BYRON WILLIAMS: So the answer would be, for general purpose financial statements you wouldn't normally be expected to make a determination of whether the asset was useful and reasonably acquired; would that be fair?

MR. RICHARD OLFERT: That's fair.

MR. BYRON WILLIAMS: Likewise, in terms of expenditures, sir, for general purpose financial statements it'll be fair to say that you wouldn't be expected to sign off on expenditures as being prudent and reasonably necessary.

Would that be fair, sir?

MR. RICHARD OLFERT: The focus would be on whether the expenditures as recorded are authorized and appropriately recorded. Prudence would not factor into the assessment.

MR. BYRON WILLIAMS: So just so I'm clear, prudence and nec -- and necessity would not normally factor into the assessment.

MR. RICHARD OLFERT: Correct.

MR. BYRON WILLIAMS: Thank you. You -- you don't need to turn there, but if you're looking for comfort that I'm -- I'm drawing it from your evidence, sir. In your asset and liability allocation methodology paper at pages 22 and 23, you have a discussion about the incremental approach versus the pro rata full cost approach.

MR. RICHARD OLFERT: M-hm.

MR. BYRON WILLIAMS: You remember that, sir?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: And, of course, you discussed it with Ms. Everard so I don't want to trench on it too much, but my understanding is that you ultimately recommend the pro rata approach in the development of the allocation methodology, is that right, for assets and liabilities, sir?

MR. RICHARD OLFERT: That's correct.

MR. BYRON WILLIAMS: And likewise, and if memory serves me right, that would also be the approach recommended with regard to the cost allocation --

MR. RICHARD OLFERT: That's correct.

MR. BYRON WILLIAMS: -- methodology.

Thank you. And certainly it would be fair to say that one (1) of the core guiding principles you followed in your allocation approach and you were looking for was the attribu -- attribute of fair and reasonable.

Would that be fair, sir?

MR. RICHARD OLFERT: Yes, that was one (1) of our stated principles.

MR. BYRON WILLIAMS: And that guided your work both in the asset and liability assessment and also in terms of the cost allocation assessment, correct?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: And I -- I want to explore these concepts with you just for a couple minutes by using a simplified hypothetical, and I'm going to use it from the cost allocation sphere because that's one I'm a little more comfortable with.

MR. RICHARD OLFERT: Sure.

MR. BYRON WILLIAMS: Okay. And I'll -- I'll direct your attention to -- and I hope I haven't given you this hypothetical before. I think I've used it -- something similar in the past, to the hypothetical of Abby and Bruce.

Have you had a chance to review it, Mr. Olfert?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: And just for the benefit of others in the -- in the crowd, I'm just going to walk through the hypothetical with you just to -- to familiarize others, and then I'll -- I'll ask you a few questions.

And I'm asking you to accept, first of all, that the Souris Valley Public Utilities Board is responsible for setting rates associated with the interconnection of water utilities and that its mandate is to charge fair and reasonable rates that are not unduly discriminatory.

Do you see that, Mr. Olfert?

MR. RICHARD OLFERT: I do. I do.

MR. BYRON WILLIAMS: Okay. And I'm going to ask you to assume that there are two (2) adjacent towns in the Souris Valley imaginatively named Abby and Bruce, okay. And I'm going to ask you to assume that for either to provide their own water supply requires well development costs of two thousand dollars ($2,000) per -- per year.

Do you see that, sir?

MR. RICHARD OLFERT: I do.

MR. BYRON WILLIAMS: And I'm also going to ask you to assume that to hook up and provide water to each town requires additional costs of a thousand dollars per year. And I'll suggest to you that we can assume that that's the cost of a main pipe from the well to the town, okay?

MR. RICHARD OLFERT: All right.

MR. BYRON WILLIAMS: I'll also ask you to assume in this simplified hypothetical that a single developed well can provide enough water for both towns and that both towns have similar water requirements.

And I'll ask you to assume that stand-alone costs are three thousand dollars ($3,000) per year for each town, in the case where each develops its own well.

So, Mr. Olfert, again, I'll ask you to assume the total costs of each town, separately developing its own well, are six thousand (6,000) per year, which you calculate by adding three thousand (3,000) and three thousand (3,000).

Okay, sir? You see that?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: Okay. I'll suggest to you as well that if both towns use a common well for their water supply, the total cost is four thousand (4,000) per year. And I'll ask you to --

MR. RICHARD OLFERT: Is that the construction cost or the annual operations cost?

MR. BYRON WILLIAMS: We're focussing purely on -- on -- on construction -- on -- you know what, sir, you've -- you've caught me on that. Let's -- for the simplicity purposes, let's just assume that it's four thousand dollars ($4,000) for construction costs.

Assuming that the Abbey Waterworks Utility goes ahead and develops a well on its own, also incurring costs of three thousand (3,000) -- and we'll stroke out the words "per year" -- let's assume that Bruce approaches Abbey and asks Abbey to -- to hook the Bruce Waterworks Utility up to the developed well, and that the incremental costs of hooking up Bruce is a thousand dollars ($1,000) - and we'll stroke out the "per year" as well, sir. And thank you for that correction.

And I -- just for the purposes of the questions, I want to go to the -- you to help me to understand the concept of fair and reasonable, and also -- but I want to start with -- see if we can agree on a mutual understanding of the term "subsidy" as it is used in the regulatory context. Okay, Mr. Olfert?

Would you agree that a subsidy might exist where a class of consumers is paying more than their fair share of a certain cost with that additional contribution enabling another class of consumers to pay less than their fair share of certain costs?

MR. RICHARD OLFERT: Seems to be a fair definition.

MR. BYRON WILLIAMS: Thank you for that. So that's one we can work with?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: Okay. And would it be accurate to say that from a cost allocation perspective a subsidy would not be fair and reasonable?

MR. RICHARD OLFERT: I'm not sure I understand your question because a subsidy is reflected in rates and you're asking about allocation of costs.

MR. BYRON WILLIAMS: Let me try it, then, on the allocation of costs. Let me try it again.

If we've got -- let -- let's take an example of two (2) utilities, and you -- Utility A is providing a gooder (sic) service to Utility B at a price below the cost of providing the good and service.

Would it be fair to say that ratepayers of Utility A would be subsidizing ratepayers of Utility B?

MR. RICHARD OLFERT: So 'A' is recovering less than its costs from 'B'?

MR. BYRON WILLIAMS: That's right.

MR. RICHARD OLFERT: And your question again was...?

MR. BYRON WILLIAMS: Would it be fair to

say that it's subsidizing the ratepayers of Utility B?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: Alternatively, if Utility B is paying Utility A more than the costs of providing the goods and services to Utility B, would it be fair to say that the ratepayers of Utility B are subsidizing the ratepayers of Utility A, sir?

MR. RICHARD OLFERT: How was that rate between the parties determined?

MR. BYRON WILLIAMS: Fair market value, fully allocated costs -- or, excuse me, let me back up, stand-alone costs.

MR. RICHARD OLFERT: Well, I think if they agree, in normal commercial terms, what the rate should be, then the concept of subsidy wouldn't necessarily apply.

MR. BYRON WILLIAMS: Let's go to the -- the actual example. Would you agree that charging Bruce any less than one thousand dollars ($1,000), the incremental costs, would represent a subsidy to Bruce from the Abbey ratepayers?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: And recognizing that these are rates set in a regulatory process, would you agree that charging Bruce more than three thousand dollars ($3,000), the standalone costs, would result in an unfair contribution from the Bruce ratepayers to the Abby ratepayers?

MR. RICHARD OLFERT: Three thousand (3,000) being equal to what Bruce would have to pay if it constructed its own?

MR. BYRON WILLIAMS: That's right, sir.

MR. RICHARD OLFERT: Again, I would say, yes.

MR. BYRON WILLIAMS: So in the context of this example, it would be a subsidy if the char -- price charged is either less than the incremental cost or greater than the standalone cost, sir?

MR. RICHARD OLFERT: That's the implication of what we have just agreed to, yes.

(BRIEF PAUSE)

MR. BYRON WILLIAMS: Now suppose Bruce is assigned costs through the regulatory process. In terms of its hookup with Abby of a thousand and one dollars ($1,001), to -- to hook up with Bruce, you'd agree that this would be greater than the incremental costs, sir?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: You'd also agree

that by virtue of a regulatory decision such as this, Abby is better off by a dollar ($1)?

MR. RICHARD OLFERT: Being calculated as the proceeds they received from Bruce of a thousand and one (1,001) versus their cost of the line of a thousand (1,000)?

MR. BYRON WILLIAMS: That's right, sir.

MR. RICHARD OLFERT: That's correct.

MR. BYRON WILLIAMS: In your view, is -- is this -- again, we'll move to cost allocation. Would this be a fair and reasonable allocation?

(BRIEF PAUSE)

MR. RICHARD OLFERT: Can I ask you to repeat your question, please?

MR. BYRON WILLIAMS: If a regulator in its wisdom, in looking at this fact scenario, decided to allocate costs to Bruce of one thousand and one dollars ($1,001), would this be a fair and reasonable allocation, using your definition of the word?

(BRIEF PAUSE)

MR. RICHARD OLFERT: Just let me begin my response to that by saying, as I discussed with Ms. Everard, there can be different views on the same situation in terms of what is fair and reasonable. A -- a charge of a thousand and one dollars ($1,001) could be presumed to be fair and reasonable on the basis that both parties benefit from the sit -- from a situation where they would have pursued their endeavours individually.

MR. BYRON WILLIAMS: I just want to walk this around one (1) or two (2) more questions, sir. Another option you -- you would agree, would be an allocation of -- of two thousand dollars ($2,000) per year of costs to -- to Bruce, and two thousand (2,000) to -- to Abby.

That's another scenario that one can look at?

MR. RICHARD OLFERT: That's correct.

MR. BYRON WILLIAMS: In your view, is one (1) of these more fair and reasonable than the other?

MR. RICHARD OLFERT: I think from different perspectives, they can both be considered fair and reasonable, and I think the question is, in part, lacking some longer term information in terms of what happens around operating costs, because by the time water's been pumped through these lines to these two (2) places, over time the initial capital cost may be only part of the -- of the amounts that are charged.

MR. BYRON WILLIAMS: Let's assume that the same mathematical result goes through, sir, that kind of four thousand dollars ($4,000) per year with a thousand and one (1,001) going to -- to Bruce, and the remainder going to -- to Abby.

In -- using that same longer-term perspective, in -- in your view, is one more fair and reasonable than the other?

(BRIEF PAUSE)

MR. RICHARD OLFERT: I think one is more equal than the other, but I think they both have -- judgments could be independently made by two (2) parties that would argue both are fair and reasonable.

MR. BYRON WILLIAMS: Thank you. I'll -- I'll ponder that. And thank you for assisting with that. I appreciate it.

In terms of cost allocation, I take it you would agree that if there is a service which provides a benefit both to Basic and DVL, but whose cost is only allo -- attributed or allocated to DVL, the allocation of all those costs to DVL would not be fair and reasonable?

MR. RICHARD OLFERT: So you're asking

about the cost of a service that benefits both lines of business? Then both lines of business should have some costs allocated to them, yes.

MR. BYRON WILLIAMS: And -- and your answer was yes, sir?

MR. RICHARD OLFERT: Yes.

MS. BYRON WILLIAMS: Okay. And so the failure to recognize the benefit to Basic and to allocate the cost in some proportion, accordingly, would not be fair and reasonable, in your view?

MR. RICHARD OLFERT: I'm sorry, can you repeat the question?

MR. BYRON WILLIAMS: I hope so. You've been doing a pretty good job of repeating my questions for me.

But, in your view, again following along the same scen -- scenario, the failure to recognize the benefit to Basic, and to allocate a portion of those costs at least to Basic, would not be fair and reasonable?

(BRIEF PAUSE)

MR. RICHARD OLFERT: So I think in the scenario that you've described, each line of bene -- each line of business derives some benefit from the cost that is incurred, and so an allocation of that cost to the two (2) lines of business would be fair and reasonable in relation to that -- to the benefit that's achieved.

MR. BYRON WILLIAMS: Thank you. You're familiar with the regulatory concept of cost causality, sir?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: And, for the purposes of our brief discussion, would you be prepared to accept that a central principle of cost causality is that the line of business which caused the cost to be incurred shall be allocated the cost?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: And for discussion purposes, we provided you with a -- really not an exhibit, but it's -- it's a document. I think it's marked as CAC-7, which is headlined "Potential Considerations in Evaluat -- in Evaluating Cost Allocation Methodologies Between Regulated and Unregulated Lines of Business."

Do you see that, sir?

MR. RICHARD OLFERT: Yes.

MR. BYRON WILLIAMS: And the three (3) questions that we've posed, you'll confirm for me are --

the first being, are the allocators used fair and reasonable? Second, does the allocation methodology reflect the cost causality principle? And third, are the benefits received by each line recognized and appropriately reflected in the allocation?

Do you see those questions, sir?

MR. RICHARD OLFERT: I do.

MR. BYRON WILLIAMS: Looking at the big pic -- picture -- and I recognize, in your evidence, you have other criteria as well but, in your view, are any of these criteria not appropriate in evaluating the cost allocation methodology?

(BRIEF PAUSE)

MR. RICHARD OLFERT: My response would be that they're all -- what was it that you asked, if they were reasonable or appropriate?

MR. BYRON WILLIAMS: Either would do, sir.

MR. RICHARD OLFERT: I would -- I would concur that all three (3) are reasonable or appropriate, acknowledging that as they're independently pursued, they may actually result in some conflict between them.

MR. BYRON WILLIAMS: Thank you. Mr.

Olfert, and I'm going to present a bit of an analogy to you. If you're not familiar with the analogy, just stop me right there and I -- I won't pursue it anymore.

But have you ever heard the statement that the constitution of the old Soviet Union one -- was one of the most progressive and liberal in the world?

MR. RICHARD OLFERT: I have not.

MR. BYRON WILLIAMS: It's too bad. It would have been a really good analogy. I was going to make the point that you could have a liberal constitution, but the reality in the gulag was quite different.

But let -- let me go like this. Further to your discussion with Ms. Everard, in terms of various lines of business paying rates that are fair and reasonable, I take it you would agree that it's important to ne -- to -- to not just get the cost allocation methodology right, it's also important get -- to get the numbers that are fed into the methodology right.

Would you agree with that?

MR. RICHARD OLFERT: Without an appropriate and accurate reflection of the costs that are incurred, an accurate cost allocation can't be completed regardless how good the methodology is.

MR. BYRON WILLIAMS: So you could have

the best methodology in the world, but if you input the wrong numbers or if the wrong numbers are in the formula, the rates are -- are not just and reasonable, fair and reasonable.

MR. RICHARD OLFERT: You would end -- you would end up with a reflection of costs coming out of the allocation process that is not fair and reasonable. The determination of rates is a separate decision, I think.

MR. BYRON WILLIAMS: Mr. Olfert, could you just repeat that answer? I apologize. My -- my attention slipped for just one (1) sec.

MR. RICHARD OLFERT: Sure. The -- the -- if the -- if inaccurate information is fed into the best methodology, the allocation of costs would not be fair and reasonable. How those costs are used in rate settings is a separate decision.

MR. BYRON WILLIAMS: Thank you. And that's an important clarification. I appreciate that. It's not a huge point, but you may wish to turn to page 19 of your assets and liabilities report, sir.

MR. RICHARD OLFERT: I have it.

(BRIEF PAUSE)

MR. BYRON WILLIAMS: And directing your

attention specifically to under Section 3.4.4, the third paragraph. You discuss Manitoba Hydro. And to summarize your -- your paragraph, would it be fair to say that you, first of all, note that Manitoba Hydro has two (2) distinct lines of business being electric and gas, but your findings are that there's no allocation of assets or liabilities between the lines of business, rather each line of business is accounted for as a separate entity with its own general ledger?

MR. RICHARD OLFERT: That's correct.

MR. BYRON WILLIAMS: And you note as well, sir, that any assets that are jointly used or minimal kept on the balance sheet for the electricity line of business and a charge levied for the use of that asset.

Would that be correct, sir?

MR. RICHARD OLFERT: That's correct.

MR. BYRON WILLIAMS: And are you aware, sir, whether or not Manitoba Hydro has other affiliates with which it has business arrangements such as Manitoba Hydro utility services?

(BRIEF PAUSE)

MR. RICHARD OLFERT: The information we

have in Manitoba Hydro came from our conversation with them, and our understanding is they are two (2) primary organizations.

MR. BYRON WILLIAMS: So you never explored any of the other subsidiaries of Manitoba Hydro?

MR. RICHARD OLFERT: That's correct.

MR. BYRON WILLIAMS: Assuming that there are any. Thank you.

Are you aware from your research whether certain regulated businesses with affiliated lines of business, or affiliated companies, use a scheme in which one (1) division provides a service to other divisions, but charges a price for each service?

(BRIEF PAUSE)

MR. RICHARD OLFERT: We're certainly aware of that concept and that practice from general knowledge, and generally from the research that was done. It was not explored in detail.

MR. BYRON WILLIAMS: And recognizing that you didn't explore this in detail, you'll stop me if I'm going too far down this line, sir.

Are you aware whether regulators have rules governing the -- the prices set for the exchange of good -- goods and services between a regulated utility and related but unregulated companies or affiliates?

Are you aware of the practice of regulators in that regard?

MR. RICHARD OLFERT: I'm not aware of the practice, but I would expect that, at a minimum, they would have great interest, and that it's likely that they would have some practices.

MR. BYRON WILLIAMS: Thank you.

(BRIEF PAUSE)

MR. BYRON WILLIAMS: You're not aware, in that regard, whether or not they seek to have the regulated utility charge market prices for the services they provide?

MR. RICHARD OLFERT: I am not aware of what the requirements or practices would be.

MR. BYRON WILLIAMS: Thank you. Now, you -- you were here this morning, I believe, when counsel for MPI filed KPMG's review of the allocation methodologies.

There was a document filed this morning, sir?

MR. RICHARD OLFERT: I understand so,

yes.

MR. BYRON WILLIAMS: Yes. Have you reviewed that document?

MR. RICHARD OLFERT: We received a copy several days ago, yes.

MR. BYRON WILLIAMS: And have you had an opportunity to familiarize --

MR. RICHARD OLFERT: I've scanned it, yes.

MR. BYRON WILLIAMS: Okay. There's just a few points in that document that I'd -- I'd like to put to you and -- and if you -- see if you have any comment in terms of their accuracy or whether you --

MR. RICHARD OLFERT: Sure.

MR. BYRON WILLIAMS: Is that fair?

MR. RICHARD OLFERT: Permit me to obtain a copy.

MR. BYRON WILLIAMS: Yeah.

(BRIEF PAUSE)

MR. BYRON WILLIAMS: For others looking, I didn't mark down the exhibit number, but it was Undertaking 16 of Manitoba Public Insurance.

(BRIEF PAUSE)

MR. RICHARD OLFERT: I have it.

MR. BYRON WILLIAMS: And again, I don't think any of these answers will be earth shattering. I just want to -- if you can turn to page 2, sir, you'll see under the word -- under the square or bullet "Symmetric," there's a sin -- sen -- two (2) sentences saying:

> "Among the above principles, fair and reasonable, as defined by Deloitte, captures the concept of cost causality. This means that the allocation of costs should reflect the drivers of costs within the -- the business."

Do you see that statement, sir?

MR. RICHARD OLFERT: Yes, I do.

MR. BYRON WILLIAMS: And in your -- are you -- are you in agreement that the principles of fair and reasonable capture the concept of cost causality, or would you differentiate that -- those two (2) criteria?

(BRIEF PAUSE)

MR. RICHARD OLFERT: I stop to ponder

only because I -- while I agree with the statement, I think we also refer to cost causality in a number of other principles in our report. But I would agree with the statement.

MR. BYRON WILLIAMS: Still on page 2, under "KPMG Findings," the second paragraph -- and I won't read -- read it to you. I'll paraphrase it. But there's the -- KPMG makes the caveat that the process of cost allocation requires the application of judgment. And going down to the second last line of that paragraph there's an element of subjectivity in the cost allocation exercise.

And I'll suggest to you that you -- you would be in agreement with that -- that suggest, sir.

MR. RICHARD OLFERT: I would agree.

MR. BYRON WILLIAMS: Going to page 4 under "Allocation of corporate support functions," you'll see under the bullet "Management" -- first of all, to back up, there's a reference in the middle of the page to about 70 million in costs allocated in Level C. And there's a suggestion in the bull -- in this paragraph under "Management," that:

> "Many of the -- the costs in the above categories associ -- are associated with the overall operations of the

business corporation. It is,
therefore, difficult to establish a
causal link between these activities
and their costs and any particular co -
- COB or LOB."

Are you in agreement with that suggestion, sir?

(BRIEF PAUSE)

MR. RICHARD OLFERT: I would agree with that statement as it relates to direct links between those activities in any cost of business -- or line of business in the -- in the broad -- broadest sense. Clearly, there's causality.

MR. BYRON WILLIAMS: Thank you. Just one (1) more, turning to page 5. And you see a heading, "Work effort," as an allocator. And you see reference in the paragraph under that to allocating certain elements, such as driver records, on a 50/50 ratio. And then there's a sentence starting at page 3:

"De -- Deloitte level -- labels this as
A [in quotation marks] 'work effort'
[end quotation marks] allocation.
Although we believe it would be more

accurately characterized as an equal
sharing of costs, the rationale for
equal sharing is that if operated
independently, each cost -- each COB
would need -- need to maintain this
function on its own.
By sharing costs 50:50, the COB
benefits equally in the savings from
the avoidance of duplication."

So do you see that statement, first of all, sir?

MR. RICHARD OLFERT: I do.

MR. BYRON WILLIAMS: And are you in agreement with this characterization of your analysis?

MR. RICHARD OLFERT: I think it's fair. Whether it's termed a work effort or equalized sharing, to me, I don't see those as being that different but, certainly, the rationale that's described is an accurate summary of the reason for the 50/50 allocation.

MR. BYRON WILLIAMS: And the heart of that is that each COB would need to maintain this function on its own in the -- in the alternative?

MR. RICHARD OLFERT: That's correct.

MR. BYRON WILLIAMS: Mr. Chairman, I just want to review my notes, but subject to any comments from my clients, that will conclude my cross.

THE CHAIRPERSON: Very good.

(BRIEF PAUSE)

MR. BYRON WILLIAMS: Okay, thank you, Mr. Chairman. I have no further questions.

THE CHAIRPERSON: Thank you. Ms. Kalinowsky, do you have any redirect?

MS. KATHY KALINOWSKY: Just one (1) moment. I'd like to confer, please.

THE CHAIRPERSON: Sure.

(BRIEF PAUSE)

MS. KATHY KALINOWSKY: If I could have one (1) re-direct question.

THE CHAIRPERSON: Of course.

RE-DIRECT EXAMINATION BY MS. KATHY KALINOWSKY:

MS. KATHY KALINOWSKY: And it regards to the Abby and Bruce scenario that Mr. Williams just walked us through. But, Mr. Olfert, are there any significant differences between the Abby and Bruce scenario, and that of Mani -- Manitoba Public Insurance to make the hypothetical example not very useful to this hearing for an understanding of allocation?

MR. RICHARD OLFERT: Not necessarily reflecting on the usefulness of the example, but I would point out a significant difference between the scenario -- the hypothetical scenario that was described, and the allocation process that we are working through here.

They hypothetical example contern -- concerned itself with the allocation of capital costs incurred to ratepayers. And as we described when we provided evidence a year ago on the expense allocation, the largest -- by far the largest majority of costs allocated by MPI are operating costs as opposed to capital costs.

And so that would be a significant difference between the scenario and the MPI situation.

MS. KATHY KALINOWSKY: Thank you for that. I have no further re-direct questions.

THE CHAIRPERSON: Thank you. One (1) last question that comes to mind after Mr. Williams' cross and your response. We certainly understand the concept of cost sharing between one (1) part of an organization and the rest. He raises another -- another possibility, which would be sort of the -- which was actually argued in a different regulatory regime that we're involved in, where a couple of parties, Intervenors, argued for another regulated entity, going into another line of business, which was a competitive line of business.

And basically they were seeking the -- the other line of business to be created on a standalone basis so that they -- they could compete with it, in a sense. So that there was no, if you want to call it "advantage" to the -- to the -- the core body, okay, being used by the, if you want to call it, the ancillary operations, okay, which allowed them to have lower costs than they otherwise would have, which made it very difficult for the -- the competitors that were in the market to stay. In fact, one (1) of them left.

Did you consider the concept of what it would have cost to run Extension and SRE if Basic wasn't around?

MR. RICHARD OLFERT: We did not.

THE CHAIRPERSON: And was that a philosophical choice, or was that simply the instructions that were provided?

MR. RICHARD OLFERT: It certainly was not in the instructions that were provided. And from our perspective, in looking at the costs to be allocated once we had made the decision that the pro rata approach was the appropriate methodology, then we proceeded.

THE CHAIRPERSON: Can you see the argument from a -- I'm just in a philosophical discussion mode -- the argument for the standalone approach and with respect to creating or permitting at least a competitive market?

MR. RICHARD OLFERT: I think there's a couple of -- of elements to that discussion. I think in terms of a competitor's perspective on what might be fair, and advantage to be taken from existing asset infrastructure, it's a legitimate challenge from the competitor. I think that is necessarily a different perspective than what should happen from a -- a rate setting perspective.

THE CHAIRPERSON: I wasn't arguing for it. I was just sort of seeking your discussion point on it. I'm quite familiar with this other case, and in that case the original argument was that the ancillary operation would have to have separate employees, separate building, basically separate Board, and the entire purpose was to provide a -- a competitive nature to that particular ancillary.

So, anyway, thank you for your comments. And I think that brings us to a close for today. Thank you to everyone for your patience. And thank you, Mr.

Olfert. You made a very good witness and we appreciate your comments and your contributions.

And, Ms. Everard, if you could remind us of what we're going to be doing tomorrow.

MS. CANDACE EVERARD: Sure. Tomorrow we'll be hearing from two (2) representatives of KPMG, Mr. Kowalchuk and Mr. Parkinson. So we'll start at 9:00. I expect Ms. Kalinowsky will have some direct exam, and then we'll flow through the same order of cross that we followed today with Mr. Olfert, and if there's time at the end of the day I'll resume my cross of the MPI panel.

And then after tomorrow, we sit again on Monday, the 18th.

THE CHAIRPERSON: Very good. We stand adjourned.

(PANEL STANDS DOWN)

--- Upon adjourning at 4:38 p.m.

Certified correct,

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Cheryl Lavigne, Ms.