Chapter 4
Financial Statements of New Brunswick Power Holding Corporation

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4.1 The financial statements of the New Brunswick Power Holding Corporation (NB Power) are complex. Consistent with other organizations that follow the accounting standards set by the Accounting Standards Board of the Canadian Institute of Chartered Accountants (CICA), the financial statement complexity increased in the year ended 31 March 2008 with the introduction of Other Comprehensive Income (OCI). Financial statement complexity also increased with NB Power's recognition of regulatory deferrals. In order for Members of the Legislative Assembly to properly hold NB Power accountable for its results, it is important to try to understand the information contained in the Corporation's financial statements, and to ask questions about anything that is unclear or confusing.

4.2 In this analysis, we will specifically look at the following components of NB Power's financial statements:

- financial instruments;
- regulatory deferrals; and
- transition to International Financial Reporting Standards (IFRS).

Financial instruments

4.3 Note 4(n) to NB Power's financial statements for the year ended 31 March 2008 describes the Corporation's accounting policy for financial instruments. Note 26 describes the financial instruments held by NB Power, and Note 5 describes the impact on the financial statements of the new accounting policy NB Power put in place for financial instruments. The end result is that the value of some balance sheet items changed. Some of that change affected Net Earnings, and some of the change was recorded as Other Comprehensive Income. Elsewhere in this Report we have provided a brief explanation of Other Comprehensive Income.

4.4 While NB Power provides a lot of information about its financial instruments, it is not easy to tie the information together to get a clear picture. For example in Note 5 it is not clear that the 1 April 2007 figure of $8 million is a total and it is arrived at by adding the four numbers above it together – and in doing so the $53 million for Derivative Liabilities has to be treated as a negative.

4.5 In the same note, the information about the 31 March 2008 impacts is also difficult to understand.

4.6 Below is how some of the information is presented in Note 5 ($ millions):

For 1 April 2007:	
Increase (decrease)	
Derivative assets	$12
Nuclear decommissioning and used fuel management funds	28
Future special payments in lieu of taxes – other comprehensive income (asset)	5
Derivative liabilities	53
Accumulated other comprehensive income (deficit)	(8)
31 March 2008:	
Balance Sheet – increase (decrease)	
Nuclear decommissioning and used fuel management funds	$32
Long-term receivable	93
Derivative assets	62
Derivative liabilities	30
Future special payments in lieu of taxes – other comprehensive income (liability)	22
Other comprehensive Income – increase (decrease)	
Other comprehensive income	50
Accumulated other comprehensive income (deficit)	42

4.7 Trying to make sense of the numbers reported above is not easy. A presentation similar to the following would have been clearer:

	31 March ($ millions)		
	Balance Sheet		**OCI**
	2007	**2008**	**2008**
Changes recorded in other comprehensive income			
Increase in nuclear decommissioning and used fuel management funds	$28	$32	$4
Increase in derivative assets	12	62	50
Increase in future special payments in lieu of taxes – other comprehensive income asset	5		(5)
(Increase) in derivative liabilities	(53)	(30)	23
(Increase) in future special payments in lieu of taxes – other comprehensive income liability		(22)	(22)
Accumulated other comprehensive income (deficit)	**($8)**	**$42**	
Other comprehensive income			**$50**
Changes recorded in net earnings			
Increase in long-term receivable	**0**	**$93**	

4.8 While such a presentation is still complicated, it is easier to tell which numbers are added together, which are treated as negatives and whether the change affected net earnings or other comprehensive income.

4.9 Note 26 to NB Power's financial statements, which provides details about the Corporation's financial instruments, is also confusing. While it starts out with a table that can be tied into the balance sheet through the "Total" column, it is not easy to tie the numbers in the body of the table to the information contained in the rest of the note. For example, the table shows the fair value of Heavy Fuel Oil derivatives at $21 million, while the detail says the fair value asset for 2008 was $51 million. It is also not easy to tell where the changes in fair value of each of the financial instruments listed in Note 26 are recorded; in Net Earnings or in Other Comprehensive Income.

4.10 Like other organizations providing financial instrument information, NB Power is trying to establish a level of disclosure that is appropriate and useful to the reader of their financial statements. We feel there is still room for improvement.

Regulatory deferrals

History of Regulatory Accounting at NB Power

4.11 In previous years, NB Power recorded regulatory assets and liabilities. This method of accounting has resulted in confusion to the readers of NB Power's financial statements and in significant accounting adjustments. The 31 March 2008 financial statements of New Brunswick Power Holding Corporation indicate that regulatory assets and liabilities are going to become significant items on the Corporation's balance sheet in the future.

4.12 Note 3 to the financial statements entitled Basis of Regulation says:

> *…regulatory assets or liabilities may arise as a result of the rate-setting process. Regulatory assets represent future revenues associated with certain costs incurred in current or prior periods that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of revenue increases associated with amounts that are expected to be refunded to customers.*

4.13 In 1995, NB Power recognized the problems caused by the recognition of some regulatory balance sheet items and started to eliminate them. In the Management's Discussion and Analysis section of the company's annual report for the year ended 31 March 1995 there is an explanation of its accounting policy changes that resulted in:

> *…the elimination of equalization and stabilization accounting practices originally designed to smooth the impact of hydro and nuclear generation fluctuations and export sales fluctuations.*

4.14 The annual report goes on to say:

> *These accounting approaches have proven to be confusing to readers of the Corporation's financial statements. They are also uncommon among utilities today and would not be acceptable for a non-regulated company.*

4.15 It is our opinion that regulatory accounting is still confusing to the readers of an organization's general purpose financial statements. And it is still true that accounting approaches resulting in the recording of regulatory assets or liabilities would not be acceptable for a non-regulated company. The recognition of regulatory assets and liabilities is common for utilities today that meet the accounting definition of being rate regulated. However, in order for regulatory accounting to properly reflect the substance of the transactions of an organization, the regulatory process must be credible. The New Brunswick Energy and Utilities Board, in its 26 June 2008 *Report to the Minister of Energy Concerning the Decision by the New Brunswick Power Distribution and Customer Service Corporation to Increase its Rates by 3% on April 1, 2008,* said that:

> *The current regulatory structure does not match the actual operations of the NB Power Group of Companies resulting in significant impediments to effective and credible setting of electricity rates.*

4.16 In our opinion this seriously calls into question whether the regulatory structure the government has put in place around the NB Power Group of Companies is sufficiently robust to support the recognition of regulatory assets and liabilities. If it is not, we believe there is a risk that the recognition of regulatory assets and liabilities could result in future significant accounting adjustments, as has been the case in the past.

4.17 NB Power's recording of regulatory assets and liabilities under the government's previous regulatory regime resulted in net income smoothing or "levelizing," interspersed with accounting adjustments such as the one in 1995 to remove deferrals of over $200 million. As indicated by Grant Thornton in its 30 September 1999 review of the Province's financial situation, this accounting approach also contributed to the amount that the nuclear facility was written down in 1999. For example Grant Thornton said:

> *In the past, N.B. Power prepared its financial statements in accordance with accounting principles appropriate for a rate-regulated entity. These principles permitted the capitalization of many costs that would not have been capitalized under the accounting principles generally accepted in the private non-regulated sector. N.B. Power management has specifically identified $152 million of these costs and has indicated there are more that have not been specifically identified. As a result, the capital assets of N.B. Power include significant amounts that would, under its current application of accounting principles, have been expensed.*

4.18 And they concluded that:

Given the inclusion in the carrying value of N.B. Power's capital assets of significant amounts that would have been expensed under the current accounting practice…we recommend the Government of New Brunswick accept the 1998 write-down of $450 million.

4.19 It should be noted that, in 1998, our Office qualified our opinion on the Province's financial statements because we did not agree with the way this $450 million was accounted for.

31 March 2008 Regulatory Deferrals

4.20 The impact of recording regulatory deferrals on NB Power's 31 March 2008 financial statements is described in Note 17 to the financial statements, which says that this accounting resulted in a decrease in earnings for the year of $73 million. This presumably means that if NB Power followed accounting policies used by non-regulated businesses, the Net Earnings for the year would have been significantly different. Note 17 would lead the reader to believe that without regulatory accounting the corporation's net income would have been $162 million, not $89 million. Unfortunately Note 17 does not record all of the impact of regulatory accounting and so it is not possible to tell from the financial statements what the impact on Net Earnings of regulatory accounting is.

4.21 Some details provided in the financial statements related to regulatory accounting include:

1. According to a parenthetical comment in note 7, miscellaneous revenue includes $29 million in revenue caused by the "One-time recovery of costs previously written off." According to the 22 February 2008 decision of the Energy and Utilities Board (EUB) NB Power was proposing to recognize $47 million in revenue but the EUB decided on $29 million. This represents a small part of the total settlement with the Venezuelan company PDVSA.

2. NB Power now has a regulatory deferral liability established for $75 million also related to the PDVSA settlement. Note 3 gives an explanation that is not very helpful; it says "…the projected benefits of the settlement, which will be realized over the projected 23 year remaining life of Coleson Cove Generating Station, will be accumulated in this deferral. Such accumulated

projected benefits will be passed through to customers on a levelized basis over 17 years…"

3. Note 3 says that "Since allowance for funds used during construction includes a cost-of-equity component as well as an interest component, it exceeds the amount that would be capitalized in similar circumstances in the absence of rate regulation." There is no indication of how much the excess is.

4. Note 3 also says that "Disco also has a regulatory asset related to the refurbishment of the Point Lepreau Generating Station. This regulatory deferral was created as a result of legislation enacted related to the refurbishment of the Point Lepreau Generating Station. The purpose of this deferral is to record the normal period costs (net of any revenues), and the costs of replacement power, that are charged to Disco by Nuclearco and Genco respectively during the period of refurbishment. The amounts are to be recovered from customers by Disco over the operating life of the refurbished Point Lepreau Generating Station, and are to be reflected in the charges, rates and tolls charged to customers by Disco." Note 17 indicates that the impact on earnings of this deferral was $2 million.

4.22 From this list of explanations, we believe that the concern that regulatory accounting is confusing to the readers of the financial statements is valid.

Point Lepreau Outage Deferral

4.23 The fourth item in the list above is worth particular scrutiny since it is causing items, such as purchased fuel, that a non-regulated company would record as expenses to be capitalized and expensed over a long period of time – the useful life of the new station. The $2 million deferral related to the Point Lepreau outage is significant because the outage started on the evening of 28 March 2008, so $2 million represents the cost of about three days of outage. This indicates that the deferred costs that will be recorded over a full year will be very large.

4.24 The deferral of the costs related to the outage of Point Lepreau is legislated through Section 143.1 of the *Electricity Act*. The accounting is imposed on NB Power and on the regulator - the New Brunswick Energy and Utilities Board (EUB) – by the government rather than as part of a normal, independent rate setting process.

4.25 Based on the information contained in NB Power's 31 March 2008 financial statements, we can estimate that, without regulatory accounting, the Corporation would have had a significantly larger surplus in 2008, and would be facing large deficits in the years ended 31 March 2009 and 2010. This would then be followed by the need to create modest annual surpluses in future years to pay for the large deficits.

4.26 It should also be understood that NB Power's results for a given year are reflected in the Surplus or Deficit for the year of the Province. The Province's results for the year ended 31 March 2008 included NB Power's Net Earnings of $89 million. So any large losses incurred by NB Power in the future would also affect the Province's results. However, this is simply a combining of the results of all organizations under the control of the Province; it does not imply that taxpayers have subsidized ratepayers in years where NB Power has losses, or that ratepayers have subsidized taxpayers in years of NB Power profits. The degree of subsidization between the two groups is determined by the rate setting process, not by the Province's accounting.

International Financial Reporting Standards

4.27 Note 5 (c) to NB Power's financial statements entitled International financial reporting standards says:

> *On February 13, 2008, the Accounting Standards Board confirmed that the use of international financial reporting standards will be required by January 1, 2011, with appropriate comparative data from the prior year. Accordingly, the NB Power Group will adopt the new standards for its fiscal year beginning April 1, 2011. While international financial reporting standards uses a conceptual framework similar to Canadian generally accepted accounting practices, there are significant differences in accounting policy that must be addressed. The Group is currently evaluating the impact of the adoption of this new Section on its combined financial statements.*

4.28 The adoption of international financial reporting standards by NB Power could have a significant impact on NB Power's accounting. While the note refers to "…the adoption of this new Section…" it is in fact the adoption of a whole new set of accounting standards, some of which are consistent with current Canadian accounting standards and some of which are different.

4.29 While NB Power has met the technical accounting requirements required for disclosure about the impact of adopting IFRS accounting standards, Note 5 (c) does not provide the reader of NB Power's financial statements with any assessment of how significant the impact of moving to IFRS will be on NB Power's financial statements. Such an assessment need not be quantitative; it could be a discussion of areas that are significant and that will have to be carefully considered under IFRS, such as the recording of regulatory assets and liabilities.