Q. Re: IFRS: Please identify, explain, rank and justify the benefits and detriments associated with sinking fund, ASL (and average life group if different than ASL), and ELG depreciation as each relate to compliance with IFRS. Further, provide a complete copy of each IAS of the IFRS referenced in the response (i.e., IAS 16, etc.).

A. The International Financial Reporting Standards are subject to very strict copyright protection. The copyright protection includes the following wording:

> *"All rights reserved. No part of this publication may be translated, reprinted or reproduced or utilized in any form either in whole or in part or by any electronic , mechanical or other means, now known or hereafter invented, including photocopying and recording, or in any information storage and retrieval system, without prior permission in writing from the IFRS Foundation."*

As such, a complete copy of the International Accounting Standards (IAS) referred to in this response cannot be provided, as requested. Copies of the International Accounting Standards are available for purchase directly through the IFRS Foundation Publications Department which can be accessed at www.ifrs.org.

In order to be responsive to this request for information, an overview of the relevant paragraphs of IAS is provided followed by an application of IAS 16 to the ELG and ASL procedures and the sinking fund method. IAS 16 deals with depreciation through paragraphs 43 through 62. A few notable directions are as follows:

> *"Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately". [para 43]*

"A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge" [para 45]

"The depreciable amount of an asset shall be allocated on a systematic basis over its useful life" [para 50]

A comprehensive description is provided of specific items to consider in para 56.

"The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of the entity may involve the disposal of assets after a specified time or after the consumption of a specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgment based on the experience of the entity with similar assets" [para 57]

"The depreciation method used shall reflect the pattern in which the assets future economic benefits are expected to be consumed by the entity. [para 60]

"A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a consistent charge over the useful life if the asset's residual value does not change. The diminishing balance method results in a decreasing charge over the useful life. The units-of-production method results in a charge based on the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits" [para 62]

The definition of the term "economic life" is provided in the IFRS Glossary of Terms as

"Either (a) the period over which an asset is expected to be economically useable by one or more users; or (b) the number of production or similar units expected to be obtained from the asset by one or more users".

Gannett Fleming (and in particular, Mr. Kennedy) have held a number of meetings and discussions with the Big Four accounting firms related to the impact of the implementation of IFRS on the historic and future depreciation practices of regulated Canadian utilities. The understanding gained from these discussions is highlighted below:

- Regulated utilities that are subjected to periodic reviews of the regulator are generally following the appropriate provisions for the determination of useful life as outlined in IAS 16, paragraphs 56 and 57. However, if the regulator makes changes to the useful life estimates that cannot be shown to be in compliance with the provisions of paragraphs 56 and 57, then the life estimates as determined by the regulator are not appropriate for financial disclosure purposes.
- The depreciation expense as charged annually to the income statement cannot include any provision for costs of removal. All disclosure related to costs of removal must be in accordance with IAS 37.
- The utilities must review the account structure to ensure compliance with paragraphs 43 and 45 in IAS 16. The accounting firms have generally recognized that the regulated utilities are unique to some degree in that the componentization of utility assets into various groups has been subject to regulatory scrutiny for many years in order to ensure that assets are grouped in a homogeneous manner and to recognize the similar forces of retirement that exist pertaining to the grouped assets.
- The more precise nature of the depreciation calculations inherent in the Equal Life Group Procedure, where the calculation specifically considers the

grouping of assets by expected life within each group and then provides for a separate and specific depreciation calculation for each expected life group, can result in the use of fewer accounts. It has been noted that the need for precise componentization is reduced when the ELG procedure is used.

- In contrast to the above, in circumstances where the ASL (or average life group) procedure is used, there may be a need for increased componentization. However, the use of ASL is an appropriate method and will comply with both the provisions of paragraphs 43 and 60 of IAS 16. External accounting firms have specifically noted the paragraph 60 language in which the pattern in which economic benefits are derived is an important consideration, that is met though the use of the Iowa (or other generally accepted) survivor curves.
- The use of the Equal Life Group procedure will likely greatly reduce the amount of gains or losses that will need to be recognized at the time of disposal given the more precise nature of the calculations. A number of Canadian utilities have received approval from their external auditors to use a test at the end of the year to determine whether or not they would have any gains or losses to report, if the ELG procedure is used. However, if the ASL procedure is used, it is expected that gains or losses resulting from retirement will be required to be booked to the income statement for financial reporting purposes.
- The provisions of paragraph 62 of IAS 16, which specifically outline the acceptable methods of depreciation, do not allow for any type of back end loaded depreciation methods such as the sinking fund or reverse of the sum of the year’s digit methods.

In summary, the IFRS standards, as confirmed by Mr. Kennedy in a number of discussions with external accounting firms, will allow for grouping of assets, providing that the componentization requirements of paragraph 43 and 45 of IAS 16 are met. Generally the precise nature of the ELG procedure will allow for less componentization than would be required if the ASL procedure is used. The firms have also indicated that the recognition of gains or losses at time of retirement is likely much smaller if the ELG procedure is used. However, the audit firms have also recognized that the ASL procedure will, if the componentization review is expanded, result in a reasonable calculation of depreciation expense, but also recognize that the ASL method will likely result in increased amounts of gains or losses to book to the income statement. Lastly, it is noted that the Sinking Fund method does not comply with IAS 16 and cannot be used for financial statement disclosure purposes.