Evidence in Chief re. unsettled aspect of Issue 1L from 2011 ESM Settlement Agreement: Provision for Uncollectible Amounts

Question 1: What is the relevant accounting standard and requirement for the manner in which an entity must account for doubtful accounts and bad debt losses?

Response: The relevant accounting standard is CICA Section 3020, which addresses required accounting treatment of accounts and notes receivable (including allowance for doubtful accounts and bad debt losses). Copies of the relevant provisions are attached.

The required accounting treatment recognizes that in establishing future receivable amounts from customers for goods or services delivered to them, that there are always some customers who cannot pay their debts.

Where it is expected that an entity will not recover all of its receivables from customers the required accounting treatment is to estimate the level or amount of existing receivables not likely to be recovered. The amount of unrecoverable accounts receivable estimated is considered bad debt expense and is charged as a debit through the income statement along with credits establishing an allowance for doubtful accounts which act as an offset or reduction to the receivables balance included in an entities balance sheet.

Sub sections 05 & 06 recognize that actual bad debt losses may be more or less than any estimate and the difficulty in determining such losses applicable to any one period and allows for a variety of methods for estimating an allowance for doubtful accounts and consequently the amount of bad debt expense.

Regardless of the method of estimation used, reviews are to be performed from time to time to determine whether the estimated allowance is materially more or less than the amount that would be required based on a review of actual accounts outstanding at the balance sheet date.

Question 2: What is the relevant accounting standard and requirement for the manner in which an entity must accommodate changes in estimates that have been made?

Response: The relevant accounting standard is CICA Section 1506, which addresses required accounting treatment of accounting changes.

This section specifies the required treatment of changes in accounting policies and changes in accounting estimates. Copies of the relevant provisions are attached.

Subsection 05(b) provides the definition of changes in accounting estimates which indicates that they result from new information or new developments and, accordingly, are not corrections of errors.

Subsections 32 & 33 indicate that as a result of inherent business uncertainties, the use of reasonable estimates is an essential element of financial statement preparation as many items in financial statements cannot be measured precisely.

Subsection 35 confirms that estimates may need revision where changes in information, particulars or experience occur and upon which the estimate is based. Additionally, the section indicates that by its nature, the revision of an estimate does not relate to prior periods and is not the correction of an error.

Question 3: How does Enbridge account for uncollectible accounts on its balance sheet?

Response: Enbridge attempts to collect all of its accounts receivable. The Company continues collection efforts over an average period of twenty-seven months. When an account has not been paid in full by the end of the twenty-seven month collection period, the unpaid balance of the account is written off.

Accounts receivable are an asset reported on the Company's balance sheet and represent the total dollar value of amounts billed to customers that have not yet been collected by the Company.

As noted in the applicable accounting standard, it is understood that not all of the Company's accounts receivable will be ultimately paid by customers.

Since the value of the unpaid accounts receivable are reported as an asset of the Company on its balance sheet an offsetting balance sheet account, the Allowance for Doubtful Accounts is used to reflect the value of a portion of the accounts receivable that will never be collected from customers. The effect of this contra account is to reduce the net book value of the Company.

Question 4: How is the total value of the Allowance for Doubtful Accounts adjusted over time?

Response: Each month, the Company evaluates the Allowance for Doubtful Accounts, taking into consideration the dollar value of sales in the month, forecast economic indicators, collection performance, changes in collection practices and any other information available that could impact upon the collectability of its accounts receivable.

i. At the end of any month, if it is determined that the Company has over-estimated bad debt expense, then the Allowance for Doubtful Accounts is decreased (debit the balance sheet account "Allowance for Doubtful Accounts", and credit the income statement account "Bad Debt Expense", or Provision for Uncollectibles). These entries serve to increase income in the month that they are booked.

ii. At the end of any month, if it is determined that the Company has under-estimated bad debt expense, then the Allowance for Doubtful Accounts is increased (credit the balance sheet account "Allowance for Doubtful Accounts" and debit income statement account "Bad Debt Expense", or Provision for Uncollectibles). These entries serve to reduce income in the month that they are booked.

Each month as accounts are written-off at the end of their twenty-seven month collection period, Enbridge debits the balance sheet account "Allowance for Doubtful Accounts" and credits a corresponding amount to the "Accounts Receivable" balance sheet account. These entries serve to reduce both the value of the Company's Accounts Receivable and the Allowance for Doubtful Accounts.

Question 5: How has Enbridge's approach to Allowance for Doubtful Accounts changed over time?

Response: The Company has employed this accounting treatment with respect to its Accounts Receivable and Allowance for Doubtful Accounts in a consistent manner for at least the last twenty years. There have been no changes in approach during the IR term.

Each year, including 2010 and 2011, the Company's Bad Debt Expense and Allowance for Doubtful Accounts are reviewed as part of Enbridge's external audit. The Company has received a clean audit opinion each year.

The Company believes that an average collection / write-off period of twenty-seven months is appropriate based on significant experience with the process and because amounts to continue to be collected throughout this period of time which has served to reduce the cost of bad debt recovered from customers as part of the Company's cost of service.

Question 6: What was Enbridge's Provision for Uncollectibles for 2011, and how does that compare with 2010?

Response: As set out in prefiled evidence Exhibit B, Tab 4, Schedule 2, Page 1, the Company's 2011 Provision for Uncollectibles was $21.5 million compared to $11.5 million for 2010. This change was driven by new information that the Company became aware of in 2011 that required the Company to increase its Allowance for Doubtful Accounts and 2011 Bad Debt Expense in order to remain compliant with accounting standards.

Question 7: In response to CME Interrogatory #4, the Company indicated that the change in Enbridge's Provision for Uncollectibles in 2011 resulted from two deficiencies in Accounts Receivable reporting. Please explain each of these two items.

Response: The "deficiencies" noted relate to information which was not previously available to management in the normal course of their duties in managing its customer accounts. This new information, which became available in late 2011, allowed management to refine its estimate of the allowance for doubtful accounts and bad debt expense.

The first refinement in reporting allowed the Company to better identify details of individual customer accounts. Prior to the implementation of the Company's new CIS, all customer accounts were aggregated in a single Accounts Receivable General Ledger Account for financial reporting purposes. The implementation of the new CIS included an Accounts Receivable Subledger which provides details of individual customer accounts. This allows for the reconciliation of all customer accounts to the General Ledger Account balance. This capability did not exist prior to the implementation of the new CIS. During the conversion of its legacy system to the new CIS, the Company became aware that the detail in its customer accounts did not agree to the balance in the General Ledger Account.

The balance in the Accounts Receivable Subledger (which was considered to be the best available information) was used in the estimate of bad debt expense for 2010. The resulting difference of $4.1 million between the General Ledger Account and the Accounts Receivable Subledger served to reduce the Company's bad debt expense in 2010. Through 2011, Enbridge was able to conduct detailed analysis of the individual accounts (2 million customers) within the Accounts Receivable Subledger. This analysis indicated that some amounts were incorrectly stated or included within the Accounts Receivable Subledger. The net impact is a $7 million increase in bad debt expense from 2010 to 2011, on a comparative basis. This is also discussed in response to Exhibit I-D23-14.1 in the EB-2011-0354 proceeding (Enbridge's 2013 rates case).

The second refinement in reporting allowed the Company to better understand the composition of its arrears balances. The arrears balances are an important factor used to forecast the amount of receivables that will not be recovered and will have to be written-off in future accounting periods. The arrears reporting that was implemented as part of the new CIS caused reported arrears balances to be understated, because the finalized accounts with debit balances were partly offset by the finalized accounts with credit balances in the aggregated report. In 2011, this reporting was refined to provide detailed information about finalized accounts with credit and debit balances. This revealed that the reported arrears balances were understated. Once the Company became aware that the reported arrears balances were understated, it became evident that the Allowance for Doubtful Accounts was insufficient. This required the Company to recognize an increase in 2011 bad debt expense (i.e. Provision for Uncollectibles). As explained in response to Board Staff Interrogatory #5 in this proceeding, the net impact of this item (when combined with other offsets) is a $3 million increase in bad debt expense from 2010 to 2011, on a comparative basis.