



**SaskEnergy**

SASKENERGY ANNUAL REPORT  
**BREAKING GROUND**

2008

CONSOLIDATED FINANCIAL STATEMENTS

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The accompanying financial statements are the responsibility of the management of SaskEnergy. They have been prepared in accordance with Canadian generally accepted accounting principles, using management's best estimates and judgments where applicable.

Management is responsible for the reliability and integrity of the consolidated financial statements, the notes to the financial statements and all other financial information contained in this annual report. Management is also responsible for maintaining a system of internal controls, policies and procedures designed to provide reasonable assurance that assets are safeguarded and that accounting systems provide timely, accurate and reliable financial statements. The internal control system includes an internal audit function and an established code of conduct.

The Corporation's Board of Directors (the Board), is responsible for ensuring that management fulfills its responsibilities for financial reporting and control. The Board is assisted in exercising its responsibility through its Audit and Finance Committee (the Committee). The Committee is composed of directors who are not employees of the Corporation. The Committee reviews the annual report and meets regularly with management, internal audit and the external auditors to discuss internal controls, accounting, auditing and financial matters. The Committee recommends the appointment of the external auditors. The Committee reports its findings to the Board for its consideration in approving the consolidated financial statements and subsidiary financial statements.

The consolidated financial statements have been audited by Deloitte & Touche LLP, Chartered Accountants as appointed by the Lieutenant Governor in Council and approved by the Crown Investments Corporation of Saskatchewan. The Auditors' Report expresses their opinion on the fairness of the financial statements prepared by management.

*[Original signed by D. Kelln]*

Doug Kelln  
President and Chief Executive Officer

*[Original signed by G. Mrazek]*

Greg Mrazek  
Vice-President, Finance and Chief Financial Officer

February 17, 2009

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### AUDITORS' REPORT

To the Members of the Legislative Assembly  
Province of Saskatchewan

We have audited the consolidated statement of financial position of SaskEnergy Incorporated as at December 31, 2008 and the consolidated statements of income and retained earnings, comprehensive income, accumulated other comprehensive loss and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original signed by Deloitte & Touche LLP]*

Chartered Accountants

Regina, Saskatchewan  
February 17, 2009

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### SASKENERGY INCORPORATED

Consolidated Statement of Financial Position  
As at December 31  
(millions of dollars)

	2008	2007
<b>ASSETS</b>		
Current assets		
Cash	\$ 4	\$ 2
Accounts receivable (Note 5)	163	131
Natural gas in storage held for resale (Note 6)	199	149
Inventories of supplies (Note 7)	17	13
Debt retirement funds (Note 8)	—	3
Fair value of derivative instruments	46	26
	429	324
Property, plant and equipment (Note 9)	1,008	978
Natural gas in storage held for resale and operations (Note 6)	35	36
Debt retirement funds (Note 8)	48	40
Investments and other assets (Note 10)	41	33
	\$ 1,561	\$ 1,411
<b>LIABILITIES AND PROVINCE'S EQUITY</b>		
Current liabilities		
Short-term debt (Note 11)	\$ 164	\$ 88
Accounts payable (Note 12)	136	136
Dividends payable	6	7
Current portion of long-term debt (Note 11)	39	75
Fair value of derivative instruments	61	18
	406	324
Asset retirement obligations (Note 13)	8	8
Long-term debt (Note 11)	714	633
	1,128	965
Province of Saskatchewan's equity		
Retained earnings	364	379
Accumulated other comprehensive loss (Note 14)	(3)	(5)
	361	374
Equity advances (Note 15)	72	72
	433	446
	\$ 1,561	\$ 1,411

Commitments and contingencies (Note 16)

(See accompanying notes)

On behalf of the Board:

*[Original signed by N. Krenosky]*

Director

*[Original signed by R. Pletch]*

Director

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### SASKENERGY INCORPORATED

Consolidated Statement of Income and Retained Earnings  
Years ended December 31  
(millions of dollars)

	2008	2007
<b>REVENUE</b>		
Commodity sales	\$ 441	\$ 400
Gas marketing sales	576	485
Delivery	182	167
Transportation and storage	77	82
Revenue collected for municipalities (Note 18)	25	24
Other (Note 19)	16	13
	1,317	1,171
<b>EXPENSES</b>		
Commodity cost of gas sold	479	373
Gas marketing cost of gas sold	539	450
Operating and maintenance	139	132
Interest (Note 20)	41	43
Amortization (Note 9)	56	54
Payment to municipalities (Note 18)	25	24
Saskatchewan taxes (Note 21)	8	7
	1,287	1,083
Net income	30	88
Retained earnings, beginning of year	379	344
Change in accounting policy (Note 3)	(2)	–
Dividends	(43)	(53)
Retained earnings, end of year	\$ 364	\$ 379

(See accompanying notes)

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### SASKENERGY INCORPORATED

Consolidated Statement of Comprehensive Income  
Years ended December 31  
(millions of dollars)

	2008	2007
<b>Net Income</b>	\$ 30	\$ 88
<b>OTHER COMPREHENSIVE INCOME</b>		
Gains and losses on derivative instruments designated as hedges for accounting purposes in prior years transferred to net income in the current year	–	1
Unrealized gains (losses) on translating financial statements of self-sustaining foreign operations	2	(3)
<b>Comprehensive income</b>	\$ 32	\$ 86

### SASKENERGY INCORPORATED

Consolidated Statement of Accumulated Other Comprehensive Loss  
Years ended December 31  
(millions of dollars)

	2008	2007
<b>Accumulated other comprehensive loss, beginning of year</b>	\$ (5)	\$ (2)
Transitional amounts for gains and losses on derivative instruments designated as hedges for accounting purposes in prior years	–	(1)
Other comprehensive income (loss)	2	(2)
<b>Accumulated other comprehensive loss, end of year</b>	\$ (3)	\$ (5)

(See accompanying notes)

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### SASKENERGY INCORPORATED

#### Consolidated Statement of Cash Flows

Years ended December 31

(millions of dollars)

	2008	2007
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 30	\$ 88
Add (deduct) items not requiring an outlay of cash		
Amortization	56	54
Change in fair value derivative instruments	23	(21)
Debt retirement funds	(2)	(2)
Equity earnings	(2)	(2)
Asset retirement obligations	–	2
Other	1	2
	106	121
Net change in non-cash working capital related to operations (Note 22)	(86)	(19)
Decrease in natural gas in storage – non-current	1	–
Cash provided by operating activities	21	102
<b>INVESTING ACTIVITIES</b>		
Additions to property, plant and equipment	(124)	(94)
Additions to investments and other assets	(5)	(4)
Capital contributions received (Note 9)	37	23
Acquisition	–	(6)
Increase in natural gas storage – non-current	–	(4)
Cash used in investing activities	(92)	(85)
<b>FINANCING ACTIVITIES</b>		
Decrease in bank indebtedness	–	(2)
Increase in short-term debt	75	19
Proceeds from long-term debt	120	75
Repayments of long-term debt (net)	(75)	(43)
Debt retirement fund installments	(6)	(5)
Debt retirement fund redemptions	3	–
Increase in deferred charges	–	(1)
Dividends paid	(44)	(58)
Cash provided by (used in) financing activities	73	(15)
Increase in cash during the year	2	2
Cash position, beginning of year	2	–
Cash position, end of year	\$ 4	\$ 2

(See accompanying notes)

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

#### 1. Status of the Corporation

SaskEnergy Incorporated (SaskEnergy or the Corporation) is a Saskatchewan provincial Crown corporation operating under authority of *The SaskEnergy Act*.

By virtue of *The Crown Corporations Act, 1993*, SaskEnergy has been designated as a subsidiary of Crown Investments Corporation of Saskatchewan (CIC), a provincial Crown corporation. Accordingly, the financial results of SaskEnergy are included in the consolidated financial statements of CIC.

As a provincial Crown corporation, SaskEnergy and its wholly owned subsidiaries are not subject to Federal or Provincial income taxes in Canada.

The Corporation owns and operates natural gas-related businesses located both within and outside Saskatchewan.

#### 2. Summary of Significant Accounting Policies

The consolidated financial statements include the accounts of SaskEnergy and its direct and indirect wholly owned subsidiaries, Bayhurst Gas Limited, Bayhurst Energy Services Corporation (and its ten wholly owned subsidiaries), Many Islands Pipe Lines (Canada) Limited, Saskatchewan First Call Corporation, SaskEnergy International Incorporated, SaskEnergy Chilean Holdings I Ltd., SaskEnergy Chilean Holdings II Ltd., SaskEnergy Mexican Holdings Ltd., SaskEnergy Nova Scotia Holdings Ltd., Swan Valley Gas Corporation, and TransGas Limited. The accounts also include the Corporation's 100 per cent ownership interest in SaskEnergy Chilean Holdings Limitada, a Chilean limited partnership, the Corporation's 50.1 per cent proportionate share of Heritage Gas Limited, accounted for as a joint venture, and the 50 per cent proportionate share of the Kisbey Gas Gathering and Processing Facility, an unincorporated joint venture.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management periodically evaluates the estimates and assumptions used based on past experience and other factors considered reasonable under the circumstances. The inherent uncertainty involved in making such estimates and assumptions may impact the actual results reported in future periods. Due to market volatility, changes in future conditions in the near term could result in a material change. Significant areas requiring the use of estimates and assumptions are described in the following summary of significant accounting policies. The impact of rate regulation on the application of GAAP is described in note 25. The following accounting policies are considered to be significant:

##### a. Natural gas in storage

Natural gas in storage is stated at the lower of cost and net realizable value and is accounted for on a weighted average cost basis.

##### b. Inventories of supplies

Inventories of supplies consist primarily of pipe and general stock for construction and maintenance and are recorded at the lower of average cost or net realizable value. Replacement cost is used as management's best estimate of the net realizable value.

##### c. Property, plant and equipment

Property, plant and equipment is stated at cost and includes all direct costs plus overhead charges and an allowance for interest costs related to financing construction of the related assets.

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 2. Summary of Significant Accounting Policies (continued)

The costs of renewals and betterments which extend the economic useful life of assets are capitalized.

Retirement or sale of a major item or class of property, plant and equipment is accounted for by relieving the asset accounts of the associated cost and accumulated amortization. The difference between the proceeds and the net book value of the assets disposed is included in income for the current period.

Other asset retirements are recorded by reducing the account by the cost of the asset and charging this amount, net of proceeds received, to accumulated amortization.

Amortization expense is calculated on a straight-line basis over the estimated service life of the asset. The amortization rates are as follows: (per cent)

Transmission and storage	2.5	to	2.6
Distribution	2.5	to	3.5
Gathering, treatment and compression	2.5	to	3.5
Computer hardware	20.0	to	33.3
Computer software	10.0	to	20.0
Vehicles, equipment and other	2.5	to	16.4

Customer capital contributions relate to construction of new service connections. These contributions from customers are amortized on a straight-line basis over the estimated service life of the related asset.

#### d. Investments

The Corporation accounts for its investments in Gas Sur S.A. and IGASAMEX USA Ltd. using the equity method.

#### e. Asset retirement obligations

Where a legal obligation exists, the Corporation recognizes the fair value of its asset retirement obligations relating to the future decommissioning of certain natural gas facilities as a liability in the period in which the obligation is incurred provided a reasonable estimate of fair value can be determined. The liability is increased annually for the passage of time through accretion expense. The associated asset retirement cost is added to the carrying amount of the related asset and amortized over the estimated useful life of the related asset.

Due to the long-term nature of the assumptions made in the cost estimates, there could be a material adjustment to income in future reporting periods. Therefore, revisions will be made periodically to reflect more accurate estimates.

#### f. Financial instruments

SaskEnergy classifies its financial instruments into one of the following categories: 1) held-for-trading, 2) held-to-maturity, 3) loans and receivables, 4) available-for-sale, and 5) other liabilities.

All financial instruments are measured at fair value upon initial recognition. The fair value of a financial instrument is the amount at which the financial instrument could be exchanged in an arm's length transaction between knowledgeable and willing parties under no compulsion to act.

Financial assets and liabilities classified as held-for-trading are subsequently measured at fair value with changes in fair value recognized in net income. Financial assets classified as available-for-sale are subsequently measured at fair value with changes in fair value recognized in other comprehensive income until the financial asset is sold or other than temporarily impaired at which time the cumulative gain or loss is recognized in net income. Financial assets classified as

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 2. Summary of Significant Accounting Policies (continued)

held-to-maturity and loans and receivables as well as financial liabilities classified as other liabilities are subsequently amortized using the effective interest method. All derivatives are recognized as an asset or liability on the trade date.

Transaction costs related to held-for-trading financial assets and liabilities are expensed as incurred. For all other financial instruments, transaction costs are included in the initial carrying amount.

Cash is classified as held-for-trading. Accounts receivable are classified as loans and receivables. Carrying value approximates fair value due to the short-term nature of these instruments. The debt retirement funds are classified as held-for-trading assets and recorded at fair value. The change in the fair value of the debt retirement funds is recognized in interest expense.

Bank indebtedness is classified as held-for-trading. Short-term debt, accounts payable, and dividends payable are classified as other liabilities. Carrying value approximates fair value due to the short-term nature of these instruments. Long-term debt is classified as other liabilities and recorded at amortized cost. The related debt premium, discount and issue costs are included in the carrying value of the long-term debt and are recognized in interest expense using the effective interest rate method.

The Corporation uses hedge accounting for interest rate swaps used to hedge long-term debt. The effective portion of changes in the fair value is recognized in other comprehensive income while any ineffective portion of changes in the fair value is recognized immediately in interest expense. Gains and losses deferred in accumulated other comprehensive loss are reclassified in interest expense in the same period as the hedged item is

settled. The Corporation uses hedge accounting for foreign currency forward contracts used to hedge capital expenditures denominated in a foreign currency. Gains or losses are recognized in other comprehensive income and reclassified to amortization expense over the life of the related capital asset. Interest rate swaps and foreign currency forward contracts may be designated as cash flow hedges.

Derivative financial instruments not designated as a hedge are classified as held-for-trading and are recorded at fair value in the statement of financial position in current assets or current liabilities as applicable. The change in the fair value of these derivatives is recorded in net income and classified within the revenue or expense category to which they relate. The revenue and expense categories impacted are described in note 17.

Embedded derivatives are recorded at fair value on the statement of financial position.

The Corporation's foreign investments are self-sustaining, and the financial statements are translated from the functional currency into Canadian dollars using the current rate method. Translation adjustments resulting from changes in the exchange rate between the functional currency and the Canadian dollar are reflected in accumulated other comprehensive loss in the Province of Saskatchewan's equity.

#### g. Revenue recognition

Delivery and commodity revenue is recognized when natural gas is delivered to customers. An estimate of natural gas delivered, but not billed, is included in revenue.

Revenue from natural gas marketing is recorded upon completion of the delivery of natural gas to the customer. The Corporation acts as a principal in these natural gas marketing transactions, taking title to the natural gas purchased for resale, and

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 2. Summary of Significant Accounting Policies (continued)

assuming the risks and rewards of ownership. Changes in the fair value of outstanding gas marketing sales contracts are recorded as gains or losses in the period of change.

Revenue is recognized when transportation, transportation-related services and storage are provided to customers and the ultimate collection is reasonably assured. An estimate of transportation, storage and related services rendered, but not billed, is included in revenue.

Royalty revenue, included in other revenue, is recognized when natural gas is sold from wells subject to royalty agreements and the ultimate collection is reasonably assured.

Natural gas and liquid sales, included in other revenue, is recognized when natural gas and natural gas liquids are delivered to customers and ultimate collection is reasonably assured.

#### h. Cost of gas sold

The cost of gas sold includes the cost of purchasing natural gas in the open market, derivative financial instrument settlements, fair value adjustments on outstanding derivative financial and non-financial instruments, transportation, direct operating costs related to supply acquisition, and natural gas inventory carrying costs.

#### i. Gas marketing

The Corporation may enter into contracts that require either the physical delivery (sale) or receipt (purchase) of natural gas in a future period. The gain or loss on these transactions is the difference between the sales revenue recognized in the period and the average cost of natural gas required to fulfill those sales.

Changes in the fair value of the contracts due to a change in market prices up to the date of settlement are recorded as gains or losses in gas marketing sales or gas marketing cost of gas sold in the period of change.

#### j. Employees' future benefits

##### i. Pension plans

The Corporation provides pension plans for all eligible employees, including a defined contribution pension plan and a defined benefit pension plan.

Under both multi-employer plans the Corporation's obligations are limited to making regular payments to the plans for current services. When made, these contributions are charged to expenses.

##### ii. Retiring allowance plan

The cost of future retirement allowance benefits earned by employees under this plan is actuarially determined using the projected benefit method and management's best estimates.

#### k. Future accounting policy changes

The Canadian Institute of Chartered Accountants (CICA) has issued new accounting recommendations for goodwill and intangible assets, Section 3064 – Goodwill and Intangible Assets, which is effective for fiscal years beginning on or after October 1, 2008. This section establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. At December 31, 2008, the impact of this section has not yet been determined but is not expected to have a material impact on the Corporation's financial statements for the year ended December 31, 2009.

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 2. Summary of Significant Accounting Policies (continued)

The CICA has issued several new Handbook Sections: Section 1582 – Business Combinations, Section 1601 – Consolidated Financial Statements and Section 1602 – Non-Controlling Interests for fiscal years beginning on or after January 1, 2011. These sections replace existing Handbook Sections 1581 and 1600 and establish standards for the accounting of business combinations, preparation of consolidated financial statements and accounting for a non-controlling interest in a subsidiary. The Corporation is evaluating the potential impacts of these accounting recommendations and does not anticipate a significant impact on the Corporation's financial statements.

The CICA has announced that publicly accountable Canadian entities will be required to prepare financial information in accordance with International Financial Reporting Standards (IFRS) effective January 1, 2011. Although IFRS are a principle-based set of standards, similar to current GAAP, there are areas where the accounting treatment differs from Canadian GAAP. The Corporation is evaluating the potential impacts of IFRS on the Corporation's financial statements.

### 3. Changes in Accounting Policies

Effective January 1, 2008, SaskEnergy adopted the CICA Handbook Section 1535 – Capital Disclosures in accordance with the transition provisions of the section. This section requires disclosure of information related to the objectives, policies and processes for managing capital, and particularly whether the Corporation has complied with externally imposed capital requirements. As this standard only addresses disclosure requirements, there is no impact on the Corporation's operating results. The new required disclosure is provided in Note 4.

Effective January 1, 2008, SaskEnergy adopted the CICA Handbook Section 3862 – Financial Instruments – Disclosures and Section 3863 – Financial Instruments – Presentation in accordance with the transition provisions of the sections. These sections replace the existing CICA Handbook Section 3861 – Financial Instruments – Presentation and Disclosure. The new disclosure standards increase the disclosures related to financial instruments, and the nature, extent and management of the Corporation's risks arising from financial instruments. As these standards only address disclosure and presentation requirements, there is no impact on the Corporation's operating results. The new required disclosure is provided in Note 17.

Effective January 1, 2008, SaskEnergy adopted the CICA Handbook Section 3031 – Inventories in accordance with the transition provisions. The new recommendations establish standards for the determination of the cost of inventories and the subsequent recognition as expense, including any write-down to net realizable value and reversals of previous write-downs to recognize subsequent increases to net realizable value. Also, guidance is provided related to reclassification of inventory items as property, plant and equipment. The standard requires retrospective application with no restatement of prior year results.

Upon the adoption of the new standard, SaskEnergy began using the weighted average cost method for valuing all natural gas inventories. The impact of applying this change in accounting policy effective January 1, 2008 was as follows:

	<b>January 1, 2008</b>
	<b>(millions)</b>
Natural gas in storage held for resale	<b>\$ (5)</b>
Total assets	<b>\$ (5)</b>
Accounts payable	<b>\$ (3)</b>
Retained earnings	<b>(2)</b>
Total liabilities and equity	<b>\$ (5)</b>

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 4. Capital Disclosure

The Corporation's objective when managing its capital is to maintain financial stability through the effective management of liquidity and capital structure. Ensuring financial stability is critical to providing safe reliable service to Saskatchewan residents, businesses and industries.

SaskEnergy finances its capital requirements through internally generated funds and injections of capital from the Province of Saskatchewan, typically in the form of debt. Under *The SaskEnergy Act*, the Corporation may borrow up to \$1.3 billion of debt upon approval of the Lieutenant Governor in Council. As at December 31, 2008, SaskEnergy had \$898 million of debt outstanding, authority to borrow an additional \$249 million of temporary loans, and a \$35 million uncommitted line of credit with Toronto-Dominion Bank.

The Corporation borrows all of its capital, with the exception of occasional overnight loans from the Toronto-Dominion Bank, from the Province of Saskatchewan. Given the Province of Saskatchewan's strong credit rating, the Corporation was able to acquire all of its funding requirements during 2008. SaskEnergy's borrowing requirement constitutes a minor portion of the Government of Saskatchewan's total expenditures.

The Corporation monitors capital on the basis of the debt ratio. The current long-term per cent debt ratio target is 65 per cent, which is consistent with the prior year and comparable to publicly traded natural gas pipeline and distribution utilities. SaskEnergy adjusts its dividend payments to CIC to maintain its debt ratio at industry comparable levels. The purpose of this strategy is to ensure that SaskEnergy's debt is considered self supporting and does not adversely affect the Province's access to capital markets. The Corporation's objectives, policies and processes for managing its capital are consistent with the prior year.

The per cent debt ratio is calculated as net debt divided by end of year capitalization as follows:

	<u>2008</u>	<u>2007</u>
	(millions)	
Gross long-term debt	\$ 753	\$ 708
Short-term debt	164	88
Debt retirement funds	(48)	(43)
Cash	<u>(4)</u>	<u>(2)</u>
Total net debt	865	751
Equity advances	72	72
Retained earnings	<u>364</u>	<u>379</u>
Total capital	<u>\$ 1,301</u>	<u>\$ 1,202</u>
Debt ratio	<u>66.5%</u>	<u>62.5%</u>

SaskEnergy complied with all externally imposed requirements on its capital for the year ended December 31, 2008.

### 5. Accounts Receivable

	<u>2008</u>	<u>2007</u>
	(millions)	
Unbilled revenue	\$ 44	\$ 79
Trade accounts	114	47
Other receivables	<u>5</u>	<u>5</u>
	<u>\$ 163</u>	<u>\$ 131</u>

### 6. Natural Gas in Storage Held for Resale and Operations

During the year, \$959 million of natural gas in storage held for resale (2007 – \$805 million) was recognized as cost of gas sold.

### 7. Inventories of Supplies

During the year, \$2 million of inventories of supplies (2007 – \$2 million) were expensed. There was no write-down of inventory of supplies and no reversal of any prior period write-down during 2008.

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 8. Debt Retirement Funds

Under conditions attached to certain advances from the Province of Saskatchewan's General Revenue Fund, SaskEnergy is required (on an annual basis) to invest an amount equal to one per cent of the related outstanding debt. This investment is referred to as a debt retirement fund. These debt retirement funds are administered by Saskatchewan's Ministry of Finance. The investments held in these debt retirement funds are primarily Federal and Provincial Government debt instruments. The yield on these investments was 5.8 per cent for 2008 (2007 – 3.8 per cent). Debt retirement funds are held-for-trading assets and are recorded at fair value on the statement of financial position.

Amounts required to be invested in the debt retirement fund in each of the next five years are as follows: (millions)

2009	2010	2011	2012	2013
\$ 7	\$ 7	\$ 6	\$ 6	\$ 6

### 9. Property, Plant and Equipment

	2008			2007		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Distribution	\$ 753	\$ 246	\$ 507	\$ 709	\$ 228	\$ 481
Transmission and storage	703	245	458	678	226	452
Gathering, treatment and compression	172	77	95	168	71	97
Vehicles, equipment and other	104	49	55	105	48	57
Computers	82	56	26	75	53	22
Franchise acquisition costs	2	1	1	2	–	2
Construction in progress	49	–	49	17	–	17
	<u>\$ 1,865</u>	<u>\$ 674</u>	<u>1,191</u>	<u>\$ 1,754</u>	<u>\$ 626</u>	<u>1,128</u>
Less: Unamortized customer capital contributions			<u>183</u>			<u>150</u>
			<u>\$ 1,008</u>			<u>\$ 978</u>

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 9. Property, Plant and Equipment (continued)

#### a. Customer capital contributions

Customer capital contributions are required to be paid by customers to SaskEnergy to aid in construction of certain customer-specific facilities in accordance with established business policies.

	<u>2008</u>	<u>2007</u>
	(millions)	
Customer capital contributions, beginning of year	\$ 150	\$ 131
Contributions received	37	23
Amortization of contributions	<u>(4)</u>	<u>(4)</u>
Customer capital contributions, end of year	<u>\$ 183</u>	<u>\$ 150</u>

#### b. Amortization

	<u>2008</u>	<u>2007</u>
	(millions)	
Amortization of property, plant and equipment	\$ 60	\$ 58
Amortization of customer capital contributions	<u>(4)</u>	<u>(4)</u>
	<u>\$ 56</u>	<u>\$ 54</u>

The estimated service lives are based on depreciation studies with annual reviews for reasonableness. During 2007, a depreciation study was conducted by an independent third party. As a result of this study, the amortization rates of certain distribution and other assets changed. The impact of this change was applied on a prospective basis commencing January 1, 2008. The estimated impact was a \$1 million decrease to the amortization expense for the year ended December 31, 2008.

The composite rate of amortization (excluding the effect of customer capital contributions amortization) was 3.3 per cent during 2008 (2007 – 3.4 per cent).

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 10. Investments and Other Assets

Investments and other assets are as follows:

	2008		2007	
	Amount (millions)	Ownership (per cent)	Amount (millions)	Ownership (per cent)
Equity investments				
Gas Sur S.A.				
Initial investment	\$ 14	30.0	\$ 14	30.0
Accumulated equity earnings	4		3	
Foreign currency translation adjustment	(3)		(2)	
	<u>15</u>		<u>15</u>	
IGASAMEX USA Ltd.				
Initial investment	11	40.1	11	40.1
Accumulated equity earnings	3		2	
Foreign currency translation adjustment	(1)		(3)	
	<u>13</u>		<u>10</u>	
	<u>28</u>		<u>25</u>	
Other receivables	<u>13</u>		<u>8</u>	
	<u>\$ 41</u>		<u>\$ 33</u>	

Equity investments:

a. Gas Sur S.A.

The Corporation's 30.0 per cent share of Gas Sur S.A.'s 2008 net income was \$1 million (2007 – \$1 million) which was included in other revenue. The Corporation's foreign currency translation adjustment for 2008 resulted in a \$1 million reduction in the balance of the investment in Gas Sur S.A. (2007 – \$1 million reduction). The initial cost of the investment exceeded the Corporation's underlying share of the net book value of Gas Sur S.A. by approximately \$5 million (2007 – \$5 million).

b. IGASAMEX USA Ltd.

The Corporation's 40.1 per cent share of IGASAMEX USA Ltd.'s 2008 net income was \$1 million (2007 – \$1 million) which was included in other revenue. The Corporation's foreign currency translation adjustment for 2008 resulted in a \$2 million increase in the balance of the investment in IGASAMEX USA Ltd. (2007 – \$2 million reduction). The initial cost of the investment exceeded the Corporation's underlying share of the net book value of IGASAMEX USA Ltd. by approximately \$5 million (2007 – \$5 million).

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 11. Long-Term and Short-Term Debt

Years to Maturity	2008		2007	
	Principal Outstanding (millions)	Average Fixed Interest Rate (per cent)	Principal Outstanding (millions)	Average Fixed Interest Rate (per cent)
Province of Saskatchewan				
1–5	\$ 169	6.7	\$ 244	7.1
6–10	259	4.7	214	4.7
11–15	34	6.7	34	6.7
16–35	285	6.5	210	6.9
	747		702	
Unamortized premium/discount and issue costs	(1)		(1)	
Less due within one year	(39)		(75)	
Due to Province of Saskatchewan	707		626	
Other long-term debt	7	9.5	7	9.7
	\$ 714		\$ 633	

The effective interest rate on long-term debt was 5.9 per cent (2007 – 6.3 per cent).

#### a. Maturity dates

Maturity dates are equivalent to interest rate repricing dates.

#### b. Principal repayments

Principal repayments due in each of the next five years are as follows: (millions)

2009	2010	2011	2012	2013
\$ 39	\$ 80	\$ –	\$ 50	\$ –

#### c. Short-term debt

During 2008, the Corporation borrowed funds on a short-term basis from the Province of Saskatchewan's General Revenue Fund at an average interest rate of 2.5 per cent (2007 – 4.3 per cent).

Short-term debt at December 31, 2008 consists of \$164 million (2007 – \$88 million) that was due to the Province of Saskatchewan's General Revenue Fund with an interest rate of 1.4 per cent (2007 – 3.9 per cent).

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 12. Accounts Payable

	<u>2008</u>	<u>2007</u>
	(millions)	
Supplier payables	\$ 77	\$ 77
Interest payable	9	12
Other payables	<u>50</u>	<u>47</u>
	<u>\$ 136</u>	<u>\$ 136</u>

### 13. Asset Retirement Obligations

The Corporation has estimated the future costs of decommissioning certain natural gas facilities. The timing of future decommissioning and settlement dates of these obligations are conditional upon the Corporation's intended use for these facilities. For purposes of estimating the fair value of these obligations, as at December 31, a settlement period ranging from 2009 to 2016 has been assumed.

As at December 31, the estimated future cash flows required to settle these obligations were \$10 million (2007 – \$9 million), which were discounted to \$8 million (2007 – \$8 million) applying credit adjusted risk free rates ranging from 3.2 to 6.4 per cent.

	<u>2008</u>	<u>2007</u>
	(millions)	
Asset retirement obligations, beginning of year	\$ 8	\$ 6
Liabilities incurred	<u>-</u>	<u>2</u>
Asset retirement obligations, end of year	<u>\$ 8</u>	<u>\$ 8</u>

### 14. Accumulated Other Comprehensive Loss

The balance in accumulated other comprehensive loss consists of the following:

	<u>2008</u>	<u>2007</u>
	(millions)	
Unrealized losses on translating financial statements of self-sustaining foreign operations	<u>\$ (3)</u>	<u>\$ (5)</u>

### 15. Equity Advances

The Corporation does not have share capital. However, the Corporation has received advances from CIC to form its equity capitalization. The advances reflect an equity investment in the Corporation by CIC.

### 16. Commitments and Contingencies

#### a. Guarantees

SaskEnergy has granted a guarantee related to certain obligations established under the Gas Sur S.A. Shareholders' Agreement. The guarantee is expressly limited to \$5 million (United States dollars).

#### b. Letters of credit

i. The Corporation, through its subsidiary SaskEnergy Mexican Holdings Ltd., has posted a \$4 million (United States dollars) letter of credit in favour of Scotiabank Inverlat S.A., a Mexican bank. The letter of credit is used as collateral for the Corporation's share of a line of credit issued to IGASAMEX USA Ltd. Scotiabank Inverlat S.A. may draw upon this letter of credit if IGASAMEX USA Ltd. defaults under the terms of its loan agreement with Scotiabank Inverlat S.A.

ii. The Corporation has posted a \$10 million letter of credit with NGX Financial Inc. (NGX) as security for natural gas purchase and sales transactions conducted by SaskEnergy on the NGX natural gas exchange in Alberta. NGX may draw on the letter of credit if SaskEnergy fails to make timely payment for, or delivery of, natural gas as per the related contract.

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 16. Commitments and Contingencies (continued)

#### c. Leases

Future payments under operating leases are as follows: (millions)

2009	2010	2011	2012	2013	Thereafter	Total
\$ 4	\$ 4	\$ 3	\$ -	\$ -	\$ -	\$ 11

### 17. Financial Instruments and Risk Management

#### a. Financial instruments

The fair value of the Corporation's financial instruments is listed below:

	2008		2007	
	Carrying Amount	Fair Amount	Carrying Amount	Fair Amount
	(millions)			
Other liabilities				
Long-term debt	\$ 753	\$ 853	\$ 708	\$ 798
Held-for-trading				
Debt retirement funds	48	48	43	43

The fair value of the above instruments was based on the following:

- i. Long-term debt – The present value of future cash flows discounted at the market rate of interest for the equivalent Province of Saskatchewan debt instruments.
- ii. Debt retirement funds – The market value of the investments held in the debt retirement fund as determined by Saskatchewan's Ministry of Finance.

The fair value of other financial instruments, including cash, accounts receivable, bank indebtedness, short-term debt, accounts payable and dividends payable approximate their carrying values due to the short-term nature of the instruments.

#### b. Natural gas derivative instruments

The fair value of natural gas derivative instruments held-for-trading, with the exception of natural gas price options, is calculated daily and is based on

quoted market prices. The fair value of natural gas price options is determined using the Garman-Kohlhagen model which requires the use of various assumptions, including quoted market prices, interest rates and volatility estimates for forward natural gas prices, which are each based on external market sources. For physical natural gas contracts notional values are an approximation of future net cash flows based on contract price multiplied by contract quantity. For other derivative instruments, the notional value is the difference between the contract price and the market price. SaskEnergy has sufficient borrowing capacity to fund these contractual obligations. Where contract prices are referenced to an index price that has not yet been fixed, the market price at December 31, 2008 has been used to estimate the contract price. At December 31, 2008, all derivative assets and liabilities held-for-trading are recorded on the statement of financial position at fair value.

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 17. Financial Instruments and Risk Management (continued)

As at December 31, 2008, natural gas derivative instruments held-for-trading had the following fair values, notional values and maturities:

	2009	2010	2011	2012	2013	Total
	(millions)					
Physical natural gas contracts						
Fair value	\$ 10	\$ 1	\$ –	\$ –	\$ –	\$ 11
Notional value	(228)	10	4	1	–	(213)
Natural gas price swaps						
Fair value	(17)	1	–	–	–	(16)
Notional value	(17)	1	–	–	–	(16)
Natural gas price options						
Fair value	(10)	–	–	–	–	(10)
Notional value	(8)	–	–	–	–	(8)
Total						
Fair value	\$ (17)	\$ 2	\$ –	\$ –	\$ –	\$ (15)
Notional value	\$(253)	\$ 11	\$ 4	\$ 1	\$ –	\$(237)

Fair value – increase (decrease)

Notional value – estimated net cash inflow (outflow)

#### c. Changes in fair value

The fair value of derivative instruments is presented on the consolidated statement of financial position as follows:

	2008	2007
	(millions)	
Fair value of derivative instrument assets	\$ 46	\$ 26
Fair value of derivative instrument liabilities	(61)	(18)
	<u>\$ (15)</u>	<u>\$ 8</u>

The change in fair value of financial and derivative instruments is recorded in net income within the relevant revenue or expense category.

For the year ended December 31 the increase (decrease) in net income of these unrealized gains and losses was as follows:

	2008	2007
	(millions)	
Derivative instruments		
Gas marketing sales	\$ 31	\$ 8
Commodity cost of gas sold	(47)	18
Gas marketing cost of gas sold	(9)	(6)
	<u>(25)</u>	<u>20</u>
Financial instruments		
Gas marketing cost of gas sold	1	–
Interest expense	(1)	–
(Decrease) increase in net income	<u>\$ (25)</u>	<u>\$ 20</u>

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 17. Financial Instruments and Risk Management (continued)

#### d. Risk management

The Corporation uses various derivative financial instruments to manage the risks associated with its operating exposures to fluctuations in foreign currency exchange rates, interest rates and the price of natural gas. A Corporate Derivatives Policy and specific risk management strategies establish the guidelines within which such derivative financial instruments may be used. The objectives, policies and processes for managing risk were consistent with the prior year.

#### i. Natural gas price risk

The Corporation may manage the risk associated with the purchase and sale price of natural gas. The purchase or sale price of natural gas may be fixed within the contract, or referenced to a floating index price. When the price is referenced to a floating index price, natural gas derivative instruments may be used to fix the settlement amount. The types of natural gas derivative instruments SaskEnergy may use for price risk management include natural gas price swaps, options, swaptions and futures contracts.

Based on the Corporation's December 31, 2008 closing positions, an increase of \$1.00 per Gigajoule in natural gas prices would have increased net income, through an increase in the fair value of natural gas contracts, by \$7 million. Conversely, a decrease of \$1.00 per Gigajoule would have decreased net income, through a decrease in the fair value of natural gas contracts, by \$7 million.

#### ii. Foreign currency exchange and interest rate risk

The Corporation may use derivative financial instruments to manage the interest rate risk on anticipated borrowing requirements and the foreign currency exchange rate on foreign currency denominated transactions. For the purpose of managing interest rate risk, the Corporation may use forward rate agreements, options and interest rate swaps to achieve an annual average interest rate target. During the year ended December 31, 2008 the Corporation did not enter into or settle any such instruments.

For the purpose of managing the exchange rate risk on transactions denominated in foreign currency, SaskEnergy may use currency forwards and currency options. During the year ended December 31, 2008 the impact of these instruments on net income was \$nil (2007 – \$nil).

At year end, the Corporation had \$164 million of short-term debt which is refinanced quarterly. In addition, \$39 million of long-term debt will mature in 2009 at which time it will be refinanced. Based on the short-term debt balance as at December 31, 2008 and the long-term debt maturing in 2009, a one per cent change in interest rates would increase or decrease the annual interest expense by approximately \$2 million.

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 17. Financial Instruments and Risk Management (continued)

#### iii. Liquidity risk

Liquidity risk is the risk that the Corporation is unable to meet its financial obligations as they become due. For financial obligations, the Corporation has credit facilities available to refinance maturities in excess of anticipated operating cash flows. The following summarizes the contractual maturities of the Corporation's financial obligations as at December 31, 2008:

	<b>6 months or less</b>	<b>7 – 12 months</b>	<b>1 – 2 years (millions)</b>	<b>3 – 5 years</b>	<b>More than 5 years</b>
Short-term debt	\$ 164	\$ –	\$ –	\$ –	\$ –
Accounts payable	136	–	–	–	–
Dividends payable	6	–	–	–	–
Derivative instruments	183	71	–	–	–
Long-term debt	33	50	120	153	944
Debt retirement fund installments	4	4	7	18	63
	<u>\$ 526</u>	<u>\$ 125</u>	<u>\$ 127</u>	<u>\$ 171</u>	<u>\$ 1,007</u>

The long-term debt obligations include principal and interest payments.

#### iv. Credit risk

The Corporation is exposed to credit risk through cash, accounts receivable, debt retirement funds and derivative instrument assets. Credit risk related to cash and debt retirement funds is minimized by dealing with institutions that have strong credit ratings and holding highly-rated financial securities.

The Corporation extends credit to its customers in the normal course of business and is at risk of loss in the event of non-performance by counterparties on certain of the financial instruments described above. To reduce its credit risk, SaskEnergy has established policies and procedures to monitor and limit the amount of credit extended to its customers and counterparties and may require letters of credit and other forms of security. At December 31, 2008 the maximum credit exposure to a single counterparty was \$14 million (2007 – \$8 million).

Derivative credit risk arises from the possibility that a counterparty to a contract fails to perform according to the terms and conditions of that contract. Derivative credit risk is minimized by dealing with creditworthy counterparties in accordance with established credit approval policies.

The carrying amount of financial and derivative assets represents the maximum credit exposure as follows:

	<b>2008</b>	<b>2007</b>
	<b>(millions)</b>	
Cash	\$ 4	\$ 2
Accounts receivable	163	131
Debt retirement funds	48	43
Fair value of derivative instrument assets	46	26
Maximum credit exposure	<u>\$ 261</u>	<u>\$ 202</u>

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 17. Financial Instruments and Risk Management (continued)

The following reflects an aging summary of the Corporation's accounts receivable:

	2008	2007
	(millions)	
Current	\$ 158	\$ 127
30 – 59 days	3	4
60 – 89 days	1	1
Greater than 90 days	2	–
	<u>164</u>	<u>132</u>
Allowance for doubtful accounts	(1)	(1)
	<u>\$ 163</u>	<u>\$ 131</u>

Provisions for credit losses are maintained and regularly reviewed by the Corporation. Credit losses are estimated based on an aging of customer accounts. Amounts are written off once reasonable collection efforts have been exhausted. Details of the allowance are as follows:

	2008	2007
	(millions)	
Allowance for doubtful accounts, beginning of year	\$ 1	\$ 2
Provision	1	1
Recoveries	2	2
Write-offs	(3)	(4)
Allowance for doubtful accounts, end of year	<u>\$ 1</u>	<u>\$ 1</u>

### 18. Revenue Collected For and Paid to Municipalities

#### a. Natural gas distribution

In accordance with the provisions of *The SaskEnergy Act*, SaskEnergy is required to remit to 109 urban municipalities an amount calculated as either five per cent or three per cent of natural gas sales to customers within the

respective municipality. These municipal payments are charged to customers and reported as revenue collected for municipalities. These amounts are remitted to the respective municipalities and reported as payments to municipalities on the statement of income. In 2008, revenue collected for and paid to municipalities was \$23 million (2007 – \$21 million).

#### b. Natural gas transmission

In accordance with the provisions of *The SaskEnergy Act*, TransGas Limited (TransGas) is required to collect, from specific customers, an amount based on the value of natural gas transported on their behalf. TransGas in turn pays the revenue collected to those municipalities. The revenue collected is classified as revenue collected for municipalities, and the amount paid is classified as payments to municipalities on the statement of income. In 2008, revenue collected for and paid to municipalities was \$2 million (2007 – \$3 million).

### 19. Other Revenue

	2008	2007
	(millions)	
Royalty revenue	\$ 6	\$ 5
Natural gas and liquid sales	8	6
Income from investments accounted for by the equity method	2	2
	<u>\$ 16</u>	<u>\$ 13</u>

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 20. Interest Expense

	<u>2008</u>	<u>2007</u>
	(millions)	
Interest expense on long-term debt	\$ 41	\$ 44
Interest expense on short-term debt	4	2
Amortization of debt premium/ discount and issue costs	1	1
Debt retirement funds earnings	(3)	(2)
Debt retirement funds fair value adjustment	1	-
Interest capitalized	(1)	-
Interest allocation to commodity cost of gas sold	(2)	(2)
	<u>\$ 41</u>	<u>\$ 43</u>

Interest paid during 2008 on long-term debt was \$44 million (2007 – \$44 million).

### 21. Saskatchewan Taxes

	<u>2008</u>	<u>2007</u>
	(millions)	
Corporate capital tax	\$ 6	\$ 5
Property taxes and other	2	2
	<u>\$ 8</u>	<u>\$ 7</u>

The above amounts do not include Saskatchewan Provincial Sales Tax payments.

### 22. Net Change in Non-Cash Working Capital

	<u>2008</u>	<u>2007</u>
	(millions)	
Accounts receivable	\$ (32)	\$ 8
Natural gas in storage held for resale	(50)	(25)
Inventories of supplies	(4)	(6)
Accounts payable	-	4
	<u>\$ (86)</u>	<u>\$ (19)</u>

### 23. Related Party Transactions

Included in these financial statements are transactions with various Saskatchewan Crown corporations, departments, agencies, boards and commissions related to the Corporation by virtue of common control by the Government of Saskatchewan and non-Crown corporations and enterprises subject to joint control and significant influence by the Government of Saskatchewan (collectively referred to as related parties).

Routine operating transactions with these related parties are settled at exchange amounts which approximate prevailing market prices under normal trade terms. Transactions during the year, and amounts outstanding at year end, are as follows:

	<u>2008</u>	<u>2007</u>
	(millions)	
Revenue	\$ 48	\$ 49
Operating expenses	32	29
Customer capital contributions	35	14
Accounts receivable	3	2
Accounts payable	1	1

In addition, the Corporation pays Saskatchewan Provincial Sales Tax to the Province of Saskatchewan on all of its taxable purchases. Taxes paid are recorded as part of the cost of those purchases.

### 24. Employee Future Benefits

#### a. Pension plans

Employees of the Corporation are members of either a defined contribution or a defined benefit pension plan. During the year, the Corporation contributed \$4 million (2007 – \$4 million) on behalf of employees for current services.

#### b. Retiring allowance plan

The amounts related to the unfunded defined benefit retiring allowance plan for executive,

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 24. Employee Future Benefits (continued)

management employees and members of the Communications, Energy and Paperworkers Union (CEP), Local 649 are as follows:

	<u>2008</u>	<u>2007</u>
	(millions)	
Accrued benefit liability	\$ 14	\$ 16
Benefits paid during the year	<u>1</u>	<u>1</u>
Net expense	<u>(1)</u>	<u>3</u>

The Corporation measures its accrued benefit liability as at December 31 of each year with an annual actuarial valuation. The significant actuarial assumptions adopted in measuring the Corporation's accrued benefit liability at December 31 are:

	<u>2008</u>	<u>2007</u>
Discount rate (per cent)	7.1	5.0
Inflation rate (per cent)	2.5	2.5
Average remaining employee service life (years)	8.3	9.0

For employees who are members of the CEP, the length of service earned for the purpose of the retiring allowance plan is equal to their service up to and including December 31, 2004 less service time converted to other employee benefits. Remaining entitlements, if any, under the retiring allowance plan will be paid out to CEP members upon their retirement in accordance with the terms of the plan.

For management employees, the length of service earned for the purpose of the retiring allowance plan is equal to their service up to and including December 31, 2005. Entitlements under the retiring allowance plan will be paid out to management employees upon their retirement in accordance with the terms of the plan.

### 25. Rate Regulation

Rate regulation did not cause the Corporation to account for transactions or events differently than it would have in the absence of rate regulation, except where specifically noted. The impact of rate regulation on the Corporation was as follows:

#### a. SaskEnergy Incorporated

By virtue of legislation, SaskEnergy has the exclusive authority to sell and distribute natural gas within Saskatchewan. In accordance with an Order in Council, the rates charged to customers for both the sale of the commodity and the distribution of natural gas are subject to review by the Saskatchewan Rate Review Panel (SRRP). The Provincial Cabinet has the authority to establish SaskEnergy's commodity and delivery rates and accordingly takes into consideration recommendations from the SRRP.

Based on the foregoing rate-setting process, revenue recognition policies for commodity and delivery revenue are as described in note 2g. SaskEnergy's delivery revenue was \$171 million for 2008 (2007 – \$158 million) and commodity revenue was \$432 million for 2008 (2007 – \$395 million).

Cost of gas sold is accounted for in accordance with the policy described in note 2h.

For those commodity sales subject to the rate-setting process described above, commodity rates charged to customers are based on the principle that SaskEnergy neither realizes a gain nor incurs a loss on sales of natural gas. Accordingly, SaskEnergy maintains a record of the differences between commodity revenue and cost of natural gas sold and accumulates these differences in a notional account referred to as the Gas Cost Variance Account (GCVA). The rate-setting process contemplates the balances reflected in the GCVA being recovered from or refunded to customers through future rate decisions of the Provincial Cabinet.

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 25. Rate Regulation (continued)

In accordance with the foregoing rate-setting process, commodity revenue is reflected in these financial statements based on the rates approved by the Provincial Cabinet applying the accounting policies described in note 2g. The amounts accumulated in the GCVA are not reflected in these financial statements.

The Provincial Cabinet requires that the amounts in the GCVA be audited annually by the Provincial Auditor.

#### b. TransGas Limited (TransGas)

By virtue of legislation, TransGas has the exclusive authority to transport natural gas within Saskatchewan. Accordingly, the Provincial Cabinet has the authority to set transportation rates charged to shippers. Transportation rates are not subject to review by the SRRP.

Based on the foregoing rate-setting process, revenue recognition policies for transportation revenue are as described in note 2g. TransGas transportation revenue was \$60 million for 2008 (2007 – \$66 million).

#### c. Many Islands Pipe Lines (Canada) Limited (MIPL)

The business activities of MIPL are regulated by the National Energy Board.

Revenue recognition policies for MIPL transportation revenue are as described in note 2g. MIPL transportation revenue was \$1 million for 2008 (2007 – \$1 million).

#### d. Swan Valley Gas Corporation (SVGC)

The business activities of SVGC are regulated by the Manitoba Public Utilities Board. SVGC's delivery revenue was \$1 million for 2008 (2007 – \$1 million) and commodity revenue was \$1 million for 2008 (2007 – \$1 million).

#### e. Heritage Gas Limited (Heritage Gas)

The business activities of Heritage Gas are regulated by the Nova Scotia Utility and Review Board (NSUARB). The following is a description of the effects of regulation on Heritage Gas as they relate to the Corporation's 50.1 per cent interest:

##### i. Return on rate base

Heritage Gas is allowed to earn a return on its rate base intended to provide its shareholders with a fair return on investment and to cover the cost of interest expense on debt. The rate base is the aggregate of Heritage Gas' investment in property, plant and equipment, revenue deficiency account and deferred charges, less accumulated amortization, plus working capital excluding the interest free loan from the Province of Nova Scotia. The return is based on Heritage Gas' regulated capital structure as approved by the NSUARB.

##### ii. Regulatory process – delivery tariff

Heritage Gas' delivery tariffs are determined through a General Tariff Application (GTA) process which establishes the revenue requirement and the rates to be charged to various customer classes as approved by the NSUARB. The most recent completed GTA process occurred in 2006 which established the Company's revenue requirement and rates to be charged to various customer classes for the period January 1, 2007 – December 31, 2011.

##### iii. Revenue deficiency account (RDA)

Heritage Gas has approval from the NSUARB to use an RDA until it is fully recovered. The RDA changes based on the difference between the actual revenue billed and the weather normalized revenue required to earn the rates of return approved by the NSUARB.

## CONSOLIDATED FINANCIAL STATEMENTS

SASKENERGY 2008 ANNUAL REPORT

### 25. Rate Regulation (continued)

During Heritage Gas' customer development stage, it is expected that the actual revenue billed will be less than the revenue required to earn the approved rates of return and therefore an RDA asset will accumulate.

As the distribution network matures, the actual revenue billed is expected to exceed the revenue required to earn the approved rates of return, and the RDA will be drawn down.

The RDA, included in investments and other assets, as at December 31, 2008 was \$13 million (2007 – \$9 million). The effect of the RDA accumulation was to increase revenue in 2008 by \$4 million (2007 – \$3 million). In the absence of rate-regulated accounting, GAAP would not have permitted the RDA to be recorded.

#### iv. Allowance for funds used during construction (AFUDC)

Heritage Gas capitalizes an imputed carrying cost on assets under construction. The calculation method and rate of AFUDC have been approved by the NSUARB.

#### v. Operating expenses

The NSUARB has approved the capitalization of operating and maintenance expenses to 2011. If Heritage Gas was not subject to rate regulation, certain of these amounts would not be capitalized.

#### vi. Income taxes

Heritage Gas follows the taxes payable method of accounting for income taxes. Provision is only made for those income taxes currently payable and no future tax is recorded on timing differences between accounting and taxable income.

### 26. Joint Ventures

The following amounts have been included in these consolidated financial statements with respect to the Corporation's 50.1 per cent proportionate share of Heritage Gas, accounted for as a joint venture, and its 50 per cent proportionate share of the Kisbey Gas Gathering and Processing Facility, an unincorporated joint venture:

#### a. Consolidated statement of financial position

	<u>2008</u>	<u>2007</u>
	(millions)	
Current assets	\$ 4	\$ 4
Property, plant and equipment	51	43
Regulatory receivable	13	8
Current liabilities	<u>(4)</u>	<u>(6)</u>
Investment in joint ventures	<u>\$ 64</u>	<u>\$ 49</u>

#### b. Consolidated statement of income

	<u>2008</u>	<u>2007</u>
	(millions)	
Revenue	\$ 18	\$ 10
Expenses	<u>(12)</u>	<u>(6)</u>
Income from joint ventures	<u>\$ 6</u>	<u>\$ 4</u>

#### c. Consolidated statement of cash flows

	<u>2008</u>	<u>2007</u>
	(millions)	
Cash (used in) provided by operating activities	\$ (1)	\$ 1
Cash used in investing activities	<u>(9)</u>	<u>(11)</u>
Decrease in cash	<u>\$ (10)</u>	<u>\$ (10)</u>

### 27. Comparative Figures

Certain of the prior year's figures have been reclassified to conform with the current year's presentation.