
DATE: April 4, 2022

TO: Year-end Support File

FROM: Kevin Blelloch, CPA, CA
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RE: SaskEnergy Place Building Purchase Treatment

BACKGROUND:

Purchase Option & Appeal

SaskEnergy has occupied its head office building at 1777 Victoria Avenue Regina, Saskatchewan known as SaskEnergy Place (SEP) pursuant to the Lease Agreement between the Corporation and ADAG (the building owner) effective July 25, 2000. The Lease Agreement included a purchase option and right of first refusal agreement, which granted SaskEnergy certain options to purchase the property for \$18.9 million. By Option Exercise Notice dated August 25, 2011, SaskEnergy exercised an unconditional option to purchase SEP. ADAG refused to acknowledge the exercised option to purchase therefore the sale of property could not be completed.

The dispute processed through the province of Saskatchewan's court system with the last ruling by the Saskatchewan Court of Queen's Bench being in favor of SaskEnergy. ADAG submitted an application to appeal the decision to the Supreme Court of Canada, which is the final step available in the appeal process. On January 20, 2022, the Supreme Court of Canada decision dismissed ADAG's appeal.

The Supreme Court decision stated title for the head office land and building assets were to transfer to SaskEnergy. Effective February 11, 2022, title to the SaskEnergy Place building (including Land and Minerals) was transferred to SaskEnergy.

SaskEnergy Lease Payments

SaskEnergy continued to lease SEP from ADAG throughout the litigation process, which included the lease cost of the building (as well as the monthly operating expenses). The lease was initially treated as an operating lease, per criteria set forth in IAS 17, *Leases* and costs were recorded as rent expense in SaskEnergy O&M expenses. Upon adoption of IFRS

16, *Leases*, the lease was recorded as a “capital lease” with a right-of-use asset and corresponding lease liability recorded in the statement of financial position and expenses flowing through depreciation and finance expense. By the end of 2019 lease payments to ADAG totaled over \$19.2 million and exceeded the \$18.9 million option to purchase.

Effective January 2020, SaskEnergy was directed to make the monthly lease payments to the Court of Appeal (“the court”) instead of directly to ADAG. This continued until May 2021, with payments into the court totaling \$3.6 million. SaskEnergy continued to treat payments to the court as lease payments and continued to record depreciation and finance expense costs throughout this timeframe.

Starting in May 2021, SaskEnergy continued to record monthly lease transactions. However, having built up a significant balance with the Court of Appeal, the Corporation stopped remitting the lease payments. The result of continuing to record the monthly lease transactions was a \$1.9 million liability in SaskEnergy’s statement of financial position at the end of January 2022.

Separate from the lease, SaskEnergy continued to pay SEP building operating costs directly to ADAG from the time the Corporation exercised its option to purchase SEP through to transfer of title to SaskEnergy.

SaskEnergy Purchase Settlement Costs

As SaskEnergy took title to the SEP building, certain costs were identified owing to ADAG in the Statement of Adjustments. As well certain costs relating to the building were identified which ADAG had not yet paid. To remove liens that vendors had placed on the SEP building (occurring prior to SaskEnergy taking title of the building) SaskEnergy intends to pay a one-time amounts to settle these outstanding amounts. SaskEnergy Plans to reduce these from the amounts owing to ADAG in the Statement of Adjustments. The net amount SaskEnergy has or plans to settle includes:

- 1) Settlement of ADAGS line of credit that is associated with the building (\$2.5 million using funds returned from Court)
- 2) Settlement with ADAG per Statement of Adjustments (est. \$0.3 million); this may be settled by paying directly the outstanding Vendor invoices. (est. \$0.3 million)

ANALYSIS & TREATMENT

From the beginning of the litigation process through to the Supreme Court of Canada dismissing ADAG’s appeal, SaskEnergy assessed the criteria in IAS 37, *Provisions, contingent liabilities, and contingent assets*.

Management concluded that throughout the litigation timeframe, it was not virtually certain that the Corporation would receive a successful decision pertaining to exercising its option to purchase SEP. Therefore, no contingent asset was recognized in the financial statements or disclosed in its financial statement notes throughout the litigation period. As a result, SaskEnergy continued to treat the SEP arrangement with ADAG as a lease.

When the Corporation's option to purchase SEP was validated by way of the Supreme Court of Canada ruling, title and ownership of SEP was transferred to SaskEnergy on February 11, 2022. At this time, SaskEnergy was not required to remit the \$18.9 million cash payment for the purchase price of the SEP building, instead the Corporation's lease payments to ADAG throughout litigation covered the cash purchase price of SEP. As a result of the lease treatment SaskEnergy has recorded a combination of lease expense, depreciation, and finance expense.

Upon title transfer, SaskEnergy should recognize SEP as a property, plant and equipment asset as set forth in IAS 16 Par 6 and building and land assets. The cost of SEP shall be the \$18.9 million purchase price agreed to as outlined in IAS 16, Par 16a.

The recovery of prior expenses does not appear to meet the qualification of a restatement or opening retained earnings adjustment as outlined in IAS 8 Accounting Policies, changes in account estimates, and errors. The transaction is a result of an event that occurred in the current year (Supreme Court of Canada ruling which resulted in the exercising of the option to purchase). SEP was not the asset of SaskEnergy prior to this ruling (other than through the lease agreement), thus could not have been set up previously as property, plant, or equipment.

SaskEnergy will set up the SEP asset at the \$18.9 million (\$3 million Land, \$15.9 million Building) per the cost outlined in the original option to purchase agreement. The offset to the \$18.9 million (the recovery of prior year expenses) will be treated as a gain in the current year.

SaskEnergy was returned \$3.6 million of amounts previously paid to the court. These amounts are also a recovery of prior expenses and treated as a gain in the current year. Additionally, the derecognition of the \$1.9 million liability built up between May 2021 and January 2022 will also result in a gain. As February 11, 2022 was the date title transferred, and the date SaskEnergy assumed ownership of the building, all previous transactions were under the assumption that the building was still leased.

The purchase settlement costs included in the Statement of Adjustments that SaskEnergy will be paying will be presented as a loss in the current year. There is no ongoing benefit to warrant capitalization from these payments they are required to remove the liens and satisfy other outstanding liabilities. These costs are not a part of on-going and continued operations.

SaskEnergy plans to present the net amount of the above transactions as the net-gain of the SEP ruling (See attached schedule below), when discussing and communicating the building transaction. From the perspective of a user of the financial statements, these are one-time, non-recurring items that are part of the same transaction and therefore, should be presented as such.

	<u>(Gain) Loss Summary</u>	
1)	Removal of ROU Asset & Lease Liability	\$ 0.06
2)	Purchase Price of Building	\$ (18,900,000.00)
3)	Return of Amounts Paid to Court	\$ (3,592,656.91)
3a)	Settlement of Line of Credit	\$ 2,477,211.30
3b)	Settlement to ADAG from Schedule of Adjustments	\$290,000.00
4)	Reversal Accrued Lease Payment (Accrued Not paid)	\$ (1,888,166.16)
5)	Settlement of Lien & Suppliers	\$ -
6)	Recovery of Withholding Tax / GST	\$ -
		\$ (21,613,611.71)

CONCLUSION

With the successful ruling from the Supreme Court of Canada, SaskEnergy was able to finally exercise the option to purchase of SaskEnergy Place with title transferring in February 2022. As the result of receiving credit for previous lease payments, SaskEnergy will be recording gains to recognize the building purchase as well as recovery of additional returned lease payments. This gain will be offset by recording losses relating to additional expenses SaskEnergy will be incurring related to taking ownership of the building. The net gain in SaskEnergy's 2021-22 consolidated statement of comprehensive income is expected to be \$21.6 million.

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APPENDIX A:
IFRS APPLICABLE SUPPORT

IFRS Conceptual Framework extracts:

Definition of an asset:

- 4.3 *An asset is a present economic resource controlled by the entity as a result of past events.*
- 4.4 *An economic resource is a right that has the potential to produce economic benefits.*
- 4.12 *In many cases, the set of rights arising from legal ownership of a physical object is accounted for as a single asset. Conceptually, the economic resource is the set of rights, not the physical object. Nevertheless, describing the set of rights as the physical object will often provide a faithful representation of those rights in the most concise and understandable way.*

Definition of a liability:

- 4.26 *A liability is a present obligation of the entity to transfer an economic resource as a result of past events.*
- 4.27 *For a liability to exist, three criteria must all be satisfied:*
- (a) the entity has an obligation (see paragraphs 4.28–4.35);*
 - (b) the obligation is to transfer an economic resource (see paragraphs 4.36–4.41); and*
 - (c) the obligation is a present obligation that exists as a result of past events (see paragraphs 4.42–4.47).*
- 4.31 *Many obligations are established by contract, legislation or similar means and are legally enforceable by the party (or parties) to whom they are owed. Obligations can also arise, however, from an entity's customary practices, published policies or specific statements if the entity has no practical ability to act in a manner inconsistent with those practices, policies or statements. The obligation that arises in such situations is sometimes referred to as a 'constructive obligation'.*

Extract from Property Plant and Equipment IAS 16:

6 Property, plant and equipment are tangible items that:

- a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and*
- b) are expected to be used during more than one period.*

15 *An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.*

Elements of cost

- 16 *The cost of an item of property, plant and equipment comprises:*
- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.*
 - (b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.*
 - (c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence*

of having used the item during a particular period for purposes other than to produce inventories during that period.

Extract from IAS 37, Provisions, contingent liabilities, and contingent assets.

- 31 *An entity shall not recognise a contingent asset.*
- 32 *Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the entity. An example is a claim that an entity is pursuing through legal processes, where the outcome is uncertain.*
- 33 *Contingent assets are not recognised in financial statements since this may result in the recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.*
- 34 *A contingent asset is disclosed, as required by paragraph 89, where an inflow of economic benefits is probable.*
- 35 *Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset (see paragraph 89).*