

1 Q. With regard to Hydro's budget and control processes:

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3 a) What process is followed to develop the capital and operating
4 budgets?

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6 b) Does Hydro calculate variances or expected variances from its capital
7 and operating budgets? If so, how frequently is it done?

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9 c) If variances are calculated, who are they reported to?

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11 d) Who is responsible for dealing with the variances?

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13 e) What action is taken when variances are identified?

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16 A. a) The process followed to develop the capital and operating budgets is
17 outlined on Pages 3 to 6.

18

19 b) Variances related to Capital are calculated on a monthly basis.
20 Variances related to Operating are reported on a monthly basis by
21 means of a comparison to the latest operating forecast which is
22 prepared as required and also on a mandatory basis twice a year,
23 once during the preparation of the annual budget and again in
24 October.

25

26 c) Capital variances are reported monthly to the Project Managers.
27 Operating variances are reported monthly to the Directors and Vice-
28 Presidents and CEO.

1 d) The Project Managers are responsible for Capital variances. The
2 Business Unit Managers, Asset Managers, Directors and V/P's are all
3 responsible for dealing with Operating variances.

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5 e) When Capital variances are identified, appropriate action is taken and
6 if necessary a Change Order issued and a reforecast prepared for
7 review and approval by the appropriate levels of management.

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9 When Operating variances are identified, appropriate action is taken
10 and if necessary a reforecast is requested from the applicable
11 Business Unit Manager who is required to submit a reforecast of
12 operating expenditure with appropriate approvals if the annual
13 expense is going to be greater than or less than the previous forecast.

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15 **Capital Budgeting Process:**

16 The Capital budgeting process within Hydro is a very intensive and essential
17 process that involves the input of supervisory personnel with budgetary
18 responsibility all the way through each level of Management until it is
19 eventually approved by Hydro's Board of Directors before being forwarded to
20 the Public Utilities Board for approval. This process spans approximately
21 nine months, from start to finish and involves the review and evaluation of
22 every capital budget proposal that is prepared, to determine if it should move
23 forward for approval to the next level of supervision.

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25 The first step is for supervisory personnel to review their requirements with
26 the regional managers and plant managers to identify potential projects that
27 meet the criteria for "Capital" expenditure. Examples of these requirements
28 would be:

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- 1 a) Purchases of new equipment that have a useful service life that is
- 2 expected to extend over several years.
- 3 b) Replacement of units of property (e.g. A diesel engine, vehicle,
- 4 transformer, etc.).
- 5 c) Major upgrading of transmission or distribution systems.
- 6 d) Construction of generating plants.
- 7 e) Payments for feasibility studies and environmental assessments.

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9 Once these requirements are identified, the various directors undertake a

10 review of the individual proposals (usually in March) of the dollar estimates.

11 Projects are assessed based on the following criteria:

- 12
- 13 i. To protect human life;
- 14 ii. To prevent imminent interruption of service to customers;
- 15 iii. To protect Hydro's assets against loss or damage;
- 16 iv. To maintain power system reliability and availability;
- 17 v. To comply with pertinent regulations, standards, etc. and environmental
- 18 standards;
- 19 vi. To meet projected customer load demand; and,
- 20 vii. To reduce costs and improve efficiency.

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23 These capital plans are prepared to cover the budget year in question as well

24 as estimates for four subsequent years. After the directors finish their

25 review, and revisions made, the proposals are further reviewed by the Vice-

26 President of each Division, then, in May, the Management Committee does

27 its review and reassesses each proposal according to the criteria listed

28 above.

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1 The Management Committee refers to the four subsequent year estimates as
2 an indicator of future dollars to be spent and considers this information in
3 assessing the current capital budget year dollars under review. After
4 Management Committee has reviewed the capital budget it is then forwarded
5 to the Hydro Board of Directors for their review and approval. This normally
6 takes place in September or early October. After Board approval is received,
7 the capital budget is then forwarded to the Public Utilities Board for public
8 review and approval.

9
10 **Operating Budget Process**

11 The basic budget reporting unit is called a Business Unit. In total, there are
12 approximately 150 Business Units, which need to be budgeted. A budget is
13 prepared on each of these units on an account-by-account basis.

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15 The operating budget process normally begins in March of each year when a
16 detailed set of budget instructions is forwarded to all Directors and Managers
17 by the Controllers Department. Each area has approximately 4 weeks to
18 prepare their budgets.

19
20 **Operating Costs** – The process of budgeting for operating costs uses the
21 JD Edwards system. On-line access to the system is available to all areas
22 and as a result much of the budget process is being de-centralized by having
23 staff in the areas prepare their budgets and then input the information on-line
24 to the JD Edwards system. Budget department staff assists in the process by
25 giving direction and guidance.

26

1 Once all the data has been input, reports are prepared for review at different
2 levels of responsibility up to and including the Management Committee,
3 which normally takes place in June of each year.

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5 **Load, Fuel and Power Purchase Forecasts** - The short-term load forecast
6 is received from Systems Planning department in May. Using existing rates,
7 the preliminary revenue figure is obtained. The hydraulic/thermal split and
8 related fuel information is received from the Operations department in early
9 June. All information on fuel, load, and revenue is input to the Rate
10 Stabilization Plan (RSP). The final output is the finalized fuel budget (net of
11 recoveries through the RSP) and the finalized load forecast.

12

13 Power purchase estimates are provided to the Budgeting department in June
14 by the Operations Planning department. These estimates are based on the
15 latest load forecast for Labrador, the contract for recall of power from
16 CF(L)Co, and current non-utility generators (NUGS) contracts.

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18 **Depreciation Budget** - Based on the latest capital budget and the most
19 recent information regarding work in process and estimates of in-service
20 dates, the Plant Ledger department will prepare the Depreciation expense
21 budget by mid-June.

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23 **Revenue / Interest Budget** - The load forecast generated above is then
24 computed at the existing approved PUB rates to determine the revenue
25 budget. Based on the operating costs and fuel budgets, a monthly cash flow
26 forecast is prepared which is provided to the Treasury Department for input
27 to an interest model. Information regarding existing debt and future

1 borrowing requirements are also inputs to the model. The output of the
2 model is an interest expense budget and an estimate of the debt guarantee
3 fee.

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5 **Review & Approval** - All elements of the operating budget are now
6 combined. At this point, a final budgeted net income statement and
7 budgeted balance sheet is prepared for review by the Management
8 Committee in September of each year.

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10 During the Management Committee review, further clarification may be
11 required on various items. Explanations are provided by the Budget
12 Department. Any revisions to the budget as a result of the Management
13 Committee review are then made.

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15 The operating and capital budgets are combined at this point, and are
16 presented to the Board of Directors for review and approval in October of
17 each year. Once the Board has approved the budget, a copy is sent to the
18 Minister of Energy.