Board of Commissioners of Public Utilities
2002 Annual Financial Review of
Newfoundland and Labrador Hydro

Grant Thornton

Contents

Introduction

This report to the Board of Commissioners of Public Utilities ("the Board") presents our observations, findings and recommendations with respect to our 2002 Annual Review of Newfoundland and Labrador Hydro ("the Company")("Hydro").

Scope and Limitations

Our analysis was carried out in accordance with the following Terms of Reference:

1. Examine Hydro's accounting system and code of accounts to ensure that it can provide information sufficient to meet the reporting requirements of the Board.

2. Review calculation of the return on rate base, return on equity, capital structure and interest coverage ratio.

3. Conduct an examination of operations and administration expenses, fuels, power purchased, depreciation, and interest to assess their reasonableness and prudence in relation to sales of power and energy. The examination of the foregoing will include, but is not limited to, the following:

    a) salaries and benefits,
    b) system equipment maintenance,
    c) insurance (including director's liability),
    d) transportation,
    e) building rental and maintenance,
    f) professional services,
    g) miscellaneous,
    h) capitalized expenses,
    i) intercompany charges,
    j) office expenses and membership fees,
    k) equipment rentals
    l) fuels,
    m) power purchased,
    n) depreciation,
    o) interest.

4. Review Hydro's non-regulated activity and assess the reasonableness of adjustments in the calculation of regulated earnings.

5. Review Hydro's rates of depreciation and assess their compliance with the 1998 Peat Marwick Depreciation Policy Study. Assess reasonableness of depreciation expense.

6. Conduct an examination of the changes to the Rate Stabilization Plan to assess compliance with Board directives.

7. Conduct an examination of the changes to deferred charges and assess their reasonableness and prudence in relation to sales of power and energy.

8. Review Minutes of Board of Director's and Management Committee meetings.

9. Review Hydro's initiatives and efforts with respect to productivity improvements, rationalization of operations and expenditure reductions. Obtain update on current activities and inquire as to any future initiatives currently being evaluated.

10. Review a sample of Contribution in Aid of Construction (CIAC) calculations for accuracy and compliance with approved policy.

The nature and extent of the procedures which we performed in our review varied for each of the items in the Terms of Reference. In general, our procedures were comprised of:

- enquiry and analytical procedures with respect to financial information included in the Company's records;
- examining, on a test basis where appropriate, documentation supporting amounts included in Company's records; and,
- assessing the Company's compliance with Board directives.

The procedures undertaken in the course of our financial review do not constitute an audit of Hydro's financial information and consequently, we do not express an opinion on the financial information as provided by Hydro.

The financial statements of the Company for the year ended December 31, 2002 have been audited by Ernst and Young LLP, Chartered Accountants, who have expressed their opinion on the fairness of the statements in their report dated February 14, 2003. In the course of completing our procedures we have, in certain circumstances, referred to the audited financial statements and the historical financial information contained therein.

Accounting System and Code of Accounts

Scope: ***Examine Hydro's accounting system and code of accounts to ensure that it can provide information sufficient to meet the reporting requirements of the Board.***

Section 58 of the *Public Utilities Act* states that the Board may prescribe the form of all books, accounts, papers and records to be kept by Hydro and that Hydro shall comply with all such directions of the Board.

The objective of our review of Hydro's accounting system and code of accounts was to ensure that it can provide information sufficient to meet the reporting requirements of the Board. We have observed that the Company has in place a well-structured, comprehensive system of accounts and organization / reporting structure. Hydro was able to meet all our requests for information and reports on a timely basis during our Annual Review. Our review also indicated that there were very few changes to the chart of accounts and these changes were not of a significant nature.

In P.U. 7 (2002-2003), the Board approved Hydro's code of accounts pursuant to Section 58 of the *Act*. This Decision also included a requirement for Hydro to file its written policies and procedures for the accounting of all intra and inter-corporate transactions, identifying what is to be included in regulated versus non-regulated activities.

Hydro filed these written policies and procedures with the Board by December 31, 2002. With respect to the accounting and reporting of non-regulated activities, Hydro uses separate business units within the JD Edwards accounting system to capture this information.

Return on Rate Base and Equity, Interest Coverage and Capital Structure

Scope: ***Review the calculation of the return on rate base, return on equity, capital structure and interest coverage ratio.***

Return on Rate Base

The Company's calculation of the return on rate base is included on Return 12 of the annual report to the Board. The return on average rate base for 2002 was 7.25% (2001- 7.79%). Our procedures with respect to verifying the reported return on rate base included agreeing the data in the calculation to supporting documentation and recalculating the rate of return to ensure it is in accordance with the methodology and approach that was approved in P.U. 7 (2002-2003).

Details with respect to Hydro's calculation of the average rate base and return on rate base are as follows:

(000)'s	2002	2001	2000
Plant investment	$ 1,755,561	$ 1,719,700	$ 1,678,600
Less: Accumulated depreciation	(433,572)	(407,100)	(380,500)
CIAC's	(87,569)	(88,600)	(89,000)
	1,234,420	1,224,000	1,209,100
Balance previous year	1,224,000	1,209,100	-
Average	1,229,210	1,216,550	604,550
Cash working capital allowance	3,579	3,265	2,947
Fuel inventory	17,715	17,230	20,005
Supplies inventoy	19,966	20,720	21,251
Average deferred charges	85,503	86,300	87,300
Average rate base	$ 1,355,973	$ 1,344,065	$ 736,053
Regulated net income (Schedule 1)	$ 9,742	$ 11,918	$ 5,850
Hydro net interest expense	88,547	92,800	96,900
Return on Rate Base	$ 98,289	$ 104,718	$ 102,750
Regulated rate of return on rate base	**7.25%**	**7.79%**	**13.96%**

The above calculation of the average rate base and the calculation provided by the Company on Return 12 differs by approximately $200,000. This is a result of an error in the calculation of the average deferred charges. This component includes the deferred foreign exchange losses and the deferred 2001 regulatory hearing costs. This discrepancy is not significant and does not impact the determination of the rate of return on rate base for 2002. Hydro is aware of this misstatement.

The regulated net income component of the return on rate base excludes the profit contribution from the Iron Ore Company of Canada (IOCC) and the street lighting costs for the Town of Bay D'Espoir. Regulated net income for 2001 and 2000 has also been adjusted to reflect this change. This is a result of the approach that was proposed by Hydro and accepted by the Board at the last rate hearing which indicated that the profits relating to the IOCC and the street lighting costs were to be classified as non-regulated on a go forward basis.

The reported return of 7.25% for 2002 as noted above, compares to the 7.081% ordered by the Board for rate setting purposes in P.U. 21 (2002-2003). The additional return of 0.169% is primarily attributable to the increase in regulated earnings of $1.783 million ($9.742 - $7.959 million) relative to the test year forecast.

As a result of completing our procedures we can conclude, with the exception of the discrepancy related to the average deferred charges component, that the calculation of average rate base and the rate of return on average rate base included in the Company's annual report to the Board is in accordance with established practice and P.U. 7 (2002-2003).

Return on Equity

The Company's calculation of regulated average equity and return on regulated average equity for the year ended December 31, 2002 is included on Return 13 of the annual report to the Board.

Similar to the approach used to verify the rate base, our procedures in this area focused on verification of the data incorporated in the calculations and on the methodology used by the Company. Specifically, the procedures which we performed included the following:

- agreed all carry-forward data to supporting documentation, including audited financial statements and internal accounting records where applicable;
- agreed component data (dividends; regulated earnings; etc.) to supporting documentation;
- checked the clerical accuracy of the continuity of regulated common equity; and,
- recalculated the rate of return on common equity for 2002 and ensured it was in accordance with the methodology adopted in P.U. 7 (2002-2003).

The return on regulated average equity for 2002 has been calculated at 4.03% as follows:

(000)'s		**2002**	**2001**	**2000**
Shareholder's equity				
	2002	$ 213,789		
	2001	$ 269,770	$ 269,770	
	2000		$ 267,614	$ 267,614
	1999			$ 289,700
Average equity		$ 241,780	$ 268,692	$ 278,657
Regulated earnings (Schedule 1)		$ 9,742	$ 11,918	$ 5,850
Return on equity		**4.03%**	**4.44%**	**2.10%**

In P.U 7 (2002-2003), the Board accepted Hydro's request for a 3% return on equity for the 2002 test year. The Board did acknowledge that this level of return is below normal market returns, however Hydro's position in the Application was to lessen the rate impact on consumers. The Board also noted that consideration of a more normal return will be subject to a future request by the Company. In the amended application currently before the Board, the Company has requested a return on equity of 9.75%.

As previously noted in the "return on rate base" section of this report, the calculation of regulated equity also excludes the profit contribution from the IOCC which was approximately $1.4 million in 2002. This has also been adjusted for 2001 and 2002.

The 2002, 2001 and 2000 calculation of "regulated equity" has also been adjusted as follows:

- In 2002, Hydro adopted new recommendations from the Canadian Institute of Chartered Accountants with respect to foreign exchange gains and losses. Unrealized gains and losses associated with the First Mortgage Bonds that are not recoverable from Hydro-Quebec under the Power Contract, are included in net income in the current year. Previously, these gains and losses were deferred and amortized on a straight line basis over the remaining life of the debt. This change has been applied retroactively. The impact relating to 2002 is an increase in Hydro's equity in net income of Churchill Falls of $1.2 million. The impact on 2001 is an increase in Hydro's investment of $0.6 million. The impact on 2000 is a reduction in Hydro's investment of $5.7 million.

- Also in 2002, Hydro started to accumulate the non-regulated costs to be added back to determine regulated equity, similar to the approach used by Newfoundland Power in its calculation of regulated common equity. In its adoption of this approach in calculating regulated equity, Hydro adjusted the regulated equity in 2001 for the non-regulated costs incurred in 2001.

The shareholder's equity of Hydro has been adjusted to eliminate the portion of the equity of Hydro, which is attributable to non-regulated operations. These adjustments to Hydro's equity are as follows:

(000's)	2002	2001	2000
Equity per non-consolidated financial statements	$ 493,550	$ 563,574	$ 562,899
Less: Contibuted capital			
- Lower Churchill Development	(15,400)	(15,400)	(15,400)
- Muskrat Falls Project	(2,165)	(2,165)	(2,165)
Share capital issued to finance investment in CF(L)Co.	(22,500)	(22,500)	(22,500)
Net retained earnings attributable to IOCC	(2,614)	(1,257)	
Non-regulated expenses	544	134	
Net retained earnings attributable to CF(L)Co. (income recorded minus dividends flowed through to government)	(236,654)	(226,327)	(222,783)
Net retained earnings attributable to the sale of recall power to Hydro Quebec (income recorded minus allocation of dividends)	(972)	(26,289)	(32,437)
"Regulated Equity"	$ 213,789	$ 269,770	$ 267,614

The calculation in the above table agrees to the calculation of regulated equity prepared by the Company in Return 13 of the annual report filed with the Board.

The adjustment to regulated equity relating to the net retained earnings attributable to the sale of recall power to Hydro Quebec is based on Hydro's revised calculation of profit from the sale of recall power and incorporates an allocation of dividends between the regulated versus non-regulated earnings.

Based upon our review, we did not note any discrepancies in the calculation of regulated average equity and rate of return on regulated average equity.

Interest Coverage

Interest coverage for 2002 has been calculated at 1.37 times as follows:

(000's)	2002	2001	2000
Total interest	**$ 90,812**	$ 94,121	$ 96,034
Less: CF(L)Co	**(2,264)**	(2,523)	(1,841)
Hydro net interest	**88,548**	91,598	94,193
Add: Interest earned and IDC			
Power bills	**27**	1	16
RSP	**7,168**	4,361	3,217
Sinking funds	**7,243**	6,382	5,323
IDC	**7,679**	5,151	3,694
Gross interest	**$ 110,665**	$ 107,493	$ 106,443
Net income (per Schedule 3)	**$ 40,815**	$ 40,431	$ 17,296
Gross interest	**110,665**	107,493	106,443
Adjusted income	**$ 151,480**	$ 147,924	$ 123,739
Interest Coverage	**1.37**	**1.38**	**1.16**

Gross interest costs have been increasing since 2001. During that year, Hydro issued two new bonds in August and December for a total of $250 million. In 2002, the Company issued two more bonds in April and September that also totaled $250 million. These recent issuances are a primary source for the increased Canadian bond interest costs in 2002. However, the overall net interest expense has decreased due to increased interest revenue from sinking funds and the Rate Stabilization Plan. The amount of interest capitalized during construction is also increasing. It is important to note that in 2002, the company changed its interest coverage calculation by no longer adjusting for the guarantee fee. The calculations for 2001 and 2000 have been revised to reflect this change.

The Company's interest coverage is comparable to 2001. It has increased over the past two years due to an increase in income in 2001 and 2002 as compared to 2000.

Capital Structure

The capital structure of Hydro based on its regulated operations is as follows:

(000)'s	2002	%	2001	%	2000	%
Debt	$ 1,323,250	84.7%	$ 1,177,740	80.0%	$ 1,186,423	80.3%
Employee benefits	24,932	1.6%	24,059	1.6%	22,851	1.5%
Equity	213,789	13.7%	269,770	18.3%	267,608	18.1%
	$ 1,561,971		$ 1,471,569		$ 1,476,882	

In comparison to 2001 and 2000 ratios, Hydro's debt to equity ratio for 2002 continues to deteriorate. This deterioration can be attributed primarily to the significant dividends declared and paid in 2002.

During 2002 Hydro declared and paid dividends totaling approximately $128.0 million to the Provincial Government which included a $6.8 million dividend based on a partial flow through of CF(L)Co revenue and a $55.4 million dividend from the sale of recall power to Hydro Quebec. The remaining $65.7 million was based on regulated operations. The dividend policy approved by the Board of Directors of Hydro on May 12, 2000 provides for the payment of dividends annually up to 75% of net operating income before net recall revenue for that year plus 100% of net recall revenues received provided such payment shall only be made after due consideration has been given by the Board of the impact the payment will have on the debt to equity ratio.

The payment of dividends of $65.7 million from regulated operations was in excess of 75% of net operating income for 2002, which totaled $9.7 million. The minutes of the Board of Directors meeting in which the dividends were approved document the fact that consideration was given to the Company's dividend policy including the impact the payment will have on Hydro's debt to equity ratio.

Other Costs

Scope: ***Conduct an examination of operations and administration expenses, fuels, power purchased, and interest to assess their reasonableness and prudence in relation to sales of power and energy.***

The table below provides a breakdown of other costs for the years 2000 to 2002 together with the forecast for 2002. This schedule shows that the total other costs have increased relative to 2001 by $2,646,000 ($104,626,000- $101,980,000). This 2.6% increase in 2002 is primarily attributable to a $2.8 million increase in salaries during the year. The Company's salaries increased in 2002 because there were two union increases of 2.5% effective in April and October during the year. In addition, there were two corresponding increases for non-union staff during the year. Furthermore, there was approximately $1.1 million in severance payments made to 46 staff that were in redundant positions.

Other costs for the years 2000 to 2002 are as follows:

	2002	2002 Forecast	2001	2000
Salaries	**$ 64,559**	**$ 61,926**	$ 61,729	$ 61,267
System equip. maint.	**17,179**	**16,763**	17,445	18,976
Insurance	**1,198**	**977**	949	1,037
Transportation	**2,464**	**2,223**	2,332	2,892
Office supplies	**1,856**	**1,864**	1,872	2,081
Bldg. rentals and maint.	**900**	**626**	704	998
Professional services	**5,318**	**4,943**	5,530	3,815
Travel	**2,337**	**2,484**	2,778	2,835
Equipment rentals	**1,372**	**1,558**	1,369	1,400
Miscellaneous	**4,674**	**4,398**	5,371	5,179
Loss on disposal	**2,769**	**890**	1,839	2,186
Productivity allowance		**(2,000)**		
Sub-total	**104,626**	**96,652**	101,918	102,666
Non regulated customer	**(2,914)**	**(2,914)**	(2,753)	
Hydro capitalized	**(8,623)**	**(6,131)**	(9,567)	(7,852)
C.F.(L) Co.	**(2,006)**	**(1,910)**	(1,766)	(1,774)
Sub-total	**(13,543)**	**(10,955)**	(14,086)	(9,626)
Total	**$ 91,083**	**$ 85,697**	$ 87,832	$ 93,040

The above table also highlights a significant increase in 2002's actual costs over the budgeted 2002 test year costs of $7,974,000 ($104,626,000 - $96,652,000) or 8.2%. This increase in 2002 actual costs is largely a result of three main variances: 1) increase in salaries of $2.633 million; 2) productivity allowance of $2 million; and 3) increase in loss on disposal of $1.879 million. The productivity allowance of $2 million was a requirement in Board Order P.U. 7 (2002-2003). The Board gave Hydro the discretion to allocate the allowance among the individual expenditure categories, however, in order to expedite finalization of the 2002 revenue requirement, Hydro presented the $2 million as a separate item in the 2002 test year budget.

On a net basis, other costs show a similar trend with an increase in 2002 relative to 2001 of $436,000 ($91.083 million- $90.647 million) and an increase over the budgeted test year of $5.386 million. The increase on a net basis in 2002 over 2001 is attributable to higher transfers to capital in 2001 as compared to 2002, in addition to the increased salaries.

The variances in other categories of operating costs are not as significant as those noted above when comparing 2002 to 2001 and budget. The Company's insurance expense increased during the year which is consistent across all industries. The Company's losses on disposal also increased by approximately $930,000 in 2002. This was primarily due to the write-off of diesel plants destroyed in the fire at Rencontre East and the disposal of several assets from the Holyrood plant. All of these items are discussed later in the report.

Schedule 2C of our report provides an analysis of the "other costs" on a kWh's sold basis for the years 1998 to 2002. The schedule reveals an overall increase in the total "other costs" and in the amount of kWh's sold for 2002, however the overall cost per kWh, as well as the individual costs per kWh are comparable to 2001.

Salaries and fringe benefits

Gross payroll costs for 2002 were $64,559,000, which was higher than 2001 levels by $2,830,000 or 4.6%. These costs for 2002 were also $2,633,000 (4.2%) higher than the budgeted amount of $61,926,000 included in the 2002 test year. The reason for the increase in comparison to the test year is primarily two-fold: 1) an increase in overtime of $1 million primarily for capital projects; and 2) approximately $1.1 million increase in salaries for severance costs associated with the elimination of 46 full-time positions.

The salaries and fringe benefits costs incurred from 2000 to 2002 are summarized below by category:

(000)'s	2002	2002 Forecast	2001	2000
Salaries	**$ 44,362**	**$ 43,315**	$ 41,498	$ 41,062
Directors fees	**23**	**62**	35	21
Hourly wages	**5,961**	**5,293**	6,367	6,482
Overtime	**3,910**	**2,616**	3,987	3,998
Employee future benefits	**2,445**	**2,433**	2,411	2,243
Fringe benefits	**6,630**	**6,426**	6,192	6,205
Group insurance	**1,123**	**1,680**	1,129	1,129
Labrador travel benefit	**105**	**101**	110	127
	$ 64,559	**$ 61,926**	$ 61,729	$ 61,267

The overall increase in 2002 compared to 2001 is primarily attributable to increases in salaries which occurred as the result of the signing of a new collective agreement with both the Operations and Office Workers Union. This agreement resulted in two salary increases of 2.5% effective April 1 and October 1, 2002. In addition to this agreement, there were two salary increases of 2.5% for the non-union staff effective January 1 and July 1, 2002. Also, as previously indicated, the salaries figure for 2002 includes approximately $1.1 million paid to 46 employees in redundant positions.

The breakdown of salaries only, by division, is as follows:

(000)'s	2002	2002 Forecast	2001	2000
Finance	**$ 3,913**	**$4,754**	$3,332	$3,901
Human resources and legal	**3,528**	**2,997**	3,161	3,165
TRO	**19,130**	**18,948**	18,132	17,410
Production	**16,488**	**15,352**	15,654	15,344
Internal Audit	**243**	**255**	252	206
Management	**1,070**	**1,009**	971	1,143
Unregulated	**(10)**		(4)	(107)
	$ 44,362	**$43,315**	$41,498	$41,062

Fringe benefits have increased by approximately $438,000 in comparison to 2001. This increase corresponds to the increase in overall salaries. Fringe benefits were approximately 12.96% of salaries and hourly wages in 2001 and they are approximately 13.15% in 2002 which appears reasonable.

The most significant decline in salaries and benefits in comparison to 2001 is in the area of hourly wages where there has been a decrease of approximately $406,000. This decrease is largely due to declines in the temporary wage expense in the Finance, TRO and Production departments.

- The Finance hourly wages have decreased because a temporary employee in Corporate Affairs resigned and was replaced by a permanent employee. In addition, fewer temporary meter readers were required due to an introduction of the Diesel Service Representative (DSR) program.

- The decrease in TRO hourly wages was primarily due to several temporary lineworkers that were filling vacant lineworker positions in 2001 were classified as permanent employees in 2002.

- The decline in temporary wages in the Production department is a result of a conscious effort to reduce temporary wages in Information Services and Technology. Furthermore, there was less hiring of co-op students and temporary engineers in System Planning and Generation Engineering and there were less temporary staff at Holyrood.

Employee future benefits consist of two components: 1) the current service portion, and 2) an interest portion. The cost of the interest portion can vary depending on the average balance of the pension benefit obligation or liability. The expense for 2002 is consistent with the 2001 expense and it appears reasonable.

During 2000, Hydro developed a system to report full-time equivalent employees by category. A detailed comparison of the number of full-time equivalent (FTE) employees by category for 2002 and 2001 is as follows:

	2002	2001
Management	8	8
Internal Audit	5	5
Production	350	358
Finance	97	100
Transmission & Rural Operations	448	456
Human Resources & Legal	106	108
Total	1014	1035

When reviewing this table, it is important to recognize that the FTE numbers contain the staffing for permanent full-time positions as well as other temporary employees such as apprentices, part-time and term employees. This is consistent with the approach used by Newfoundland Power in reporting FTE's.

The number of FTE's in 2002 compared to 2001 indicates a decrease of 21 FTE's. This is primarily a result of the positions that were made redundant during 2001 and 2002.

As part of our review we also completed an analysis of the average salary per FTE, including and excluding executive compensation. The salary costs include each category of salary and fringe benefits as detailed previously in the report with the exclusion of directors' fees, overtime and future employee benefits. The results of our analysis for 2002 and 2001 are included in the table below:

	2002	2001
Salary costs	$ 58,181	$ 55,296
Less: special redundancy pay	(1,109)	
	57,072	55,296
Less: executive compensation	(971)	(860)
	$ 56,101	$ 54,436
FTE's (including executive members)	1,014	1,035
FTE's (excluding executive members)	1,009	1,030
Average salary per FTE	**$ 56,284**	**$ 53,426**
% increase	**5.35%**	
Average salary per FTE (excluding executive members)	**$ 55,600**	**$ 52,850**
% increase	**5.20%**	

The above analysis indicates that while the number of FTE's are decreasing, the average salary per FTE continues to increase. This is primarily related to salary increases based on collective agreements for unionized and non-unionized employees, annual increases for managerial and executive salaries, as well as increases resulting from employees advancing to the next step progression within their salary scales.

The gross payroll costs for 2000 to 2002 were allocated to operations and capital as follows:

(000)'s	**2002**	**2002 Forecast**	2001	2000
Payroll charged to operating	**$ 56,443**	**$ 57,703**	$ 52,752	$ 54,048
Payroll charged to capital	**8,116**	**5,723**	8,977	7,219
	$ 64,559	**$ 63,426**	$ 61,729	$ 61,267

The payroll costs charged to capital decreased in 2002 in comparison to 2001, however they increased by $2.4 million in comparison to the test year forecast. The amount of capitalized salaries has decreased in comparison to 2001 due to the nature of the capital program which involved a lower utilization of internal forces. Capitalized salaries are made up of more than fifteen separate projects, however eight of these projects represent approximately 78% of total salary costs. Some of these projects are continuations of the larger projects capitalized in 2001 such as the Labrador River project (non-regulated project), the construction of the Nain Diesel Plant, and the Granite Canal Development. Several of the larger projects in 2002 included upgrading work on TL242 and TL236, and service extension and upgrading to the Central, Labrador and Northern Regions.

The increase in comparison to the test year forecast can be attributed primarily to overtime incurred on three projects: Nain Diesel Plant; Granite Canal; and upgrading work on TL242.

Upgrading and service extensions include the erection of new poles, upgrading existing transmission lines and providing services to new customers. The Granite Canal development relates to the new generation project started in 2000.

Executive salaries for the years 2000 to 2002 are as follows:

	Base Salary	Incentive Base Pay & Special bonus	Fringe Benefits	Total
2002				
Total executive group	$ 820,755	$ 99,550	$ 50,408	$ 970,713
Average per executive (5)	**$ 164,151**	**$ 19,910**	**$ 10,082**	**$ 194,143**
2001				
Total executive group	$ 817,737	$ -	$ 44,867	$ 860,354
Less: retirement	(47,740)		(2,250)	(49,990)
Add: Annualize replacement	11,455			11,455
	$ 781,452		$ 42,617	$ 821,819
Average per executive (5)	**$ 156,290**	**$ -**	**$ 8,523**	**$ 164,363**
2000				
Total executive group	$ 793,415	$ -	$ 45,163	$ 838,578
Average per executive (5)	**$ 158,683**	**$ -**	**$ 9,033**	**$ 167,716**
% Average increase 2002 vs 2001	**5.0%**	**100.0%**	**18.3%**	**18.2%**

Hydro provided several reasons for the large increase in executive compensation in 2002. Firstly, a study was conducted in 2001 to review executive compensation which led to the introduction of a performance-based system as part of the Company's compensation structure. The first payments using this system were for the 2001 fiscal year and these payments were included in the total salary and benefits figures for 2002. Secondly, there were two 2.5% increases in base salary for executives to coincide with the union and non-union wage increases during the year. Thirdly, the Vice-President of production retired in 2001, leaving the position vacant for a period before it was filled. Finally, the Board of Directors approved a "special bonus" of $17,000 each for three of the Vice-Presidents in 2002 to compensate them for their work relating to the 2001 General Rate Hearing.

As noted in our 2001 report, the Compensation Committee recommended a salary increase for the President and Vice-Presidents consistent with the increase provided for non-union staff. They also approved a step progression for the VP of Transmission and Rural Operations after an evaluation was prepared by a consulting group on the current responsibilities of each vice president. The recommendations of the consulting group resulted in significant change for the position of Vice President of Transmission and Rural Operations and approved the job rate for this position to be equivalent to that of the positions of Vice Presidents of Finance and of Human Resources.

As noted above, the Company introduced a performance-based incentive system as a pilot project for the executive and senior management. The Board of Directors decision to introduce this pilot project was two-fold: 1) to narrow the gap between the salaries paid at Hydro and those paid by comparable organizations; and 2) to move the corporation to a performance-based culture. The system was designed to include major areas for potential performance and responsibility, along with benchmarks to determine acceptable performance and targets for calculating the incentive payout.

The major areas that were selected for the evaluation of corporate performance included financial performance, improvement in system reliability, safety and strategic planning. The specific performance measure within each of these areas would be defined prior to the commencement of the year. For example, for 2001, the measure established for financial performance was a threshold target of 1.10 for interest coverage. The weighting of the incentive payments to be assigned to the total of these areas is 100% for the President and CEO, 60% for Vice-Presidents and 40% for Directors. In addition, to these four areas, divisional and departmental targets have been established and assigned to each vice-president and director. The payout for achievement of targeted performance was 6% of salary with a threshold level of 3% and an opportunity target of 9%. All payments related to the performance-based incentive system for 2001 were paid in 2002.

Based on the performance achieved in 2001 in relation to the established targets, a total of $119,500 was paid out to the seventeen individuals who participated in the project in 2002. Hydro decided that this program would continue in the pilot stage until more experience was obtained with respect to the determination of appropriate target performance areas and appropriate outcomes. However it was recommended that this pilot project be extended to five senior managers in the Company in 2002.

The continuation of this pilot project will require further monitoring during future annual reviews.

System equipment maintenance

In 2002, system equipment maintenance costs decreased slightly from 2001 levels by approximately $266,000 or 1.5%. The decrease is largely a result of a reduction in maintenance material costs of $345,000. Theses cost savings were partially offset by slight increases in the remaining sub-categories of system equipment maintenance for a total of $79,000. Even though cost levels for 2002 decreased compared to 2001, when compared to the forecast for the 2002 test year, system equipment maintenance costs increased by $416,000 or 2.5%.

The 2002 amounts were higher than the test year figures in the areas of freight expense and lubricants, gases and chemicals. The freight expense was higher because there was more movement of freight than originally anticipated. However, it was fairly consistent with the actual expense amounts for 2001 and 2000. The lubricants, gases and chemicals expense was higher than anticipated because of increased production during the year at the Holyrood Plant. This increased production resulted in more chemicals and lubricants being used.

The costs for 2000 to 2002 for the system equipment maintenance portion of this expense only (excluding tools and equipment, freight and lubricants, gases and chemicals) are broken down by department as follows:

(000)'s	**2002**	**2002 Forecast**	2001	2000
Transmission and rural operations	**$ 7,042**	**$ 6,522**	$ 5,946	$ 8,666
Production	**7,773**	**8,063**	9,230	8,439
Human Resources & Legal	**800**	**865**	814	536
Finance	**120**	**127**	138	137
Other	**63**	**37**	22	2
	$ 15,798	**$ 15,614**	$ 16,150	$ 17,780

The increase for the transmission and rural operations division for 2002 as compared to 2001 is primarily due to certain non-recurring extra maintenance requirements in the Central and Northern regions of the Province during 2002. The extra maintenance requirements in these regions included inspections and replacement of wood poles, reconditioning transformer oil at the Bay D'Espoir site, repairs to the air blast circuit breakers in Sunnyside, repairs to diesel plant units due to a leak in the exhaust manifold, radiator and generator failure and an overhaul on a diesel unit. In addition to maintenance requirements, an increase in 2002 over 2001 for the Northern region is a result of timing of credits (or core charges) relating to an overhaul done on a generating unit in L'Anse au Loup in 2000 that were recorded in 2001.

The overall decrease of $1,457,000 experienced in the production division in 2002 is largely related to the extra maintenance costs that were incurred at the thermal plant in Holyrood during 2001.

The Holyrood thermal plant costs are as follows:

(000)'s	2002	2001	2000
Unit # 1 overhaul	$1,109	$1,199	$1,433
Unit # 2 overhaul	1,404	1,048	1,148
Unit # 3 overhaul	963	3,175	1,170
Annual routine maintenance	2,331	2,132	2,769
	$5,807	$7,554	$4,530

Maintenance costs at Holyrood are subject to a high degree of variability. Based on information provided by the Company the main contributing factor to the overall decrease in thermal plant costs in 2002 from 2001 is due to the fact that there were no major overhauls in 2002. Unit # 1 had a minor overhaul in 2002, 2001 and 2000, however the overhaul for Unit #1 in 2000 also included costs relating to work performed on the valves. Unit # 2 had a minor overhaul in 2002, 2001 and 2000, however the overhaul for 2002 also included costs relating to work performed on the valves, which explains the slight increase over 2001 and 2000. Unit # 3 had a minor overhaul done in 2002 which was consistent with 2000. However, in 2001, there was a major overhaul done on Unit #3 which resulted in a significant increase in cost for this Unit. This was the first major overhaul performed on Unit #3 since 1994.

The annual routine maintenance includes the maintenance on Holyrood buildings and sites, common equipment, water treatment plant equipment and administration equipment. In 2002, the routine maintenance costs have increased by approximately $181,000 from 2001. Costs relating to structures and equipment are incurred on a project-by-project basis, and costs incurred for regular routine maintenance can vary greatly depending on the type of maintenance projects that are completed, and due to the age of the plant and the surrounding grounds, some years are much more costly than others.

Insurance (including director's liability)

In 2002, insurance costs increased by $249,000 or 26.2% over 2001 and increased by $221,000 in comparison to the 2002 test year forecast.

The All-risk (property) and Boiler and Machinery increased by approximately $114,000 and, the company's vehicle policy premium increased by approximately $104,000. These large increases in insurance premiums are reflective of overall changes in the insurance market and they have been prevalent across all industries.

Miscellaneous changes to other premiums paid in the year net to an increase of $31,000 over 2001, which is consistent with the trend discussed above.

Transportation

Transportation expense is comprised of aircraft rentals, vehicle expenses (fuel, rental and allowances) and mobile equipment fuel. This expense category increased overall by approximately $132,000 (5.7%) in 2002 as compared to 2001 and $241,000 in comparison to the test year forecast. This variance from both 2001 and forecast is due to higher aircraft costs and fuel of $169,000 which have been offset by small decreases in the other transportation expense categories.

The increase in aircraft costs and fuel is primarily attributed to an increase of approximately 20% in the rates for casual helicopters. In addition, there was an increased usage of helicopters in Labrador for emergency response requirements and in the Central area on TL206 for lightning arrestors.

Based on information provided by Hydro, in 2001 the Company had 390 vehicles and 395 mobile equipment units, and in 2002 the Company had 395 vehicles and 386 mobile equipment units.

Office expenses, including membership fees

Office expenses in 2002 (including heat and light, telephone, supplies, postage, advertising, cleaning, office equipment maintenance, books and subscriptions and membership fees) decreased slightly by $16,000 or 0.85% from 2001 and $8,000 in comparison to the test year forecast. The decrease was due to small reductions in telephone and fax and postage expenses which was partially offset by an increase in membership fees and dues of $42,000.

The increase in fees and dues was primarily attributable to increased participation in the Canadian Electrical Association's special interest activities and focus groups by the company's generation engineering staff.

Building rental and maintenance

Building rental and maintenance increased in 2002 over 2001 and in comparison to the 2002 test year forecast. The increase of $196,000 or 27.9% and $274,000 or 43.8% respectively is mainly attributed to an increase of approximately $184,000 in the "safety equipment and supplies" category. This category included safety clothing in 2002. Until the spring of 2001, safety clothing was grouped in a category called "employee expenses" within the miscellaneous grouping.

As a result of this change in grouping plus the purchase of flame retardant protective clothing that was not originally anticipated during the budget preparation, the "safety equipment and supplies" category exceeded the 2002 forecast.

Professional services

In 2002, professional services costs decreased from 2001 levels by approximately $212,000 or 3.8%. However, these costs exceeded the budget for the 2002 test year by $375,000.

The changes in professional services costs in 2002 as compared to 2001 are as follows:

• Higher professional service fees	$ 1,430,000
• Lower regulatory related costs	(1,664,000)
• Higher software and maintenance costs	22,000
	$ (212,000)

For 2002, regulatory related expenses totaled approximately $806,000, a decrease of 67.4% compared to 2001. This significant decrease is primarily related to costs for the 2001 rate hearing. While this hearing did extend into 2002, the majority of the costs had been accrued in 2001. Hydro had anticipated regulatory related costs of approximately $1,203,000 for the 2002 test year, however all of these costs did not materialize as budgeted due in part to the deferral approved in P.U. 16 (2002-2003).

In P.U. 16 (2002-2003), the Board approved a deferral of a portion of the costs relating to the 2001 hearing. The Order indicated that external regulatory costs in excess of $1 million were permitted to be deferred and amortized over a sixteen month period commencing September 2002. The total external costs for the Hearing totaled $1,805,000, the amortization of $202,000 relating to the four month period ending December 31 2002 is included in the depreciation expense on Schedule 1, and the remaining $603,000 is included in deferred charges.

Based on this information, regulatory related costs included in professional services would be expected to be in excess of $1 million in 2002, however the Company recorded a provision of $1 million in 2001 related to regulatory hearing costs which resulted in some of the costs being accrued in the prior year.

Despite the fact that the regulatory related costs were significantly lower in 2002, the professional service fees in 2002 were significantly higher. The total professional service costs were approximately $3,315,000 which was a 76.3% increase over the total professional service fees in 2001 and $754,000 or 29.4% over the test year. These fees were substantially increased in 2002 due to the Business Process Improvement study. This initiative alone accounted for approximately $1,010,000 in consulting fees.

The software acquisition and maintenance costs increased by approximately $22,000 in 2002. This was not a significant change from the prior year. The total costs in 2002 were approximately $1,202,000.

In recent years, the professional services expense account has been exhibiting significant upward trends. In order to obtain a better understanding of the nature of the items included in this department, we conducted a more detailed review. We vouched some invoices grouped in professional service fees and assessed the nature of the services provided. The significant consulting/professional services that have been contracted out by individual departments during 2002 are as follows:

Department		Professional Services	Cost
Management	•	Business Process Improvement	$1,009,700
	•	Audit Services	45,260
Human resources & legal	•	Employee Assistance Program	38,365
	•	Compensation consulting services	36,300
	•	Various medical assessments & Occupational Health Programs	21,500
Finance	•	UCIS billing enhancement	49,100
TRO	•	Phase 1 environmental assessments	54,600
	•	Enviromental Management system audits	44,200
	•	Registration of Environmental Management	26,150
Production	•	Monthly consulting services for unit 1, 2, and 3 at Holyrood Plant	268,900
	•	Information Tech Infrastructure Library	259,400
	•	Mentoring/Coaching IS&T	187,200
	•	EXP Advisory Service	138,100
	•	Engineering Study on w ater treatment	120,020
	•	EMS/Scada Study	89,250
	•	Hydrology review	51,000
			$2,439,045

With respect to the variances in this expense category, we have obtained explanations and performed additional analysis where appropriate. However, considering the significant variances in this category, we will continue to monitor it closely.

Travel and conferences

In 2002 the travel and conference expense category decreased from 2001 levels by approximately $441,000 or 15.9% and decreased $147,000 or 5.9% in comparison to the test year forecast.

When comparing sub-categories from 2001 to 2002, travel costs decreased from $2.6 million to $2.2 million and conference costs decreased from $179,000 to $124,000. The travel costs declined significantly in 2002 because of large decreases in the travel expenses for the TRO and the Production departments. The travel costs for the TRO department decreased by approximately $229,000 due to additional travelling requirements in 2001 for the Reliability Centered Maintenance (RCM) Approach, TL214 assessments and increased corrective maintenance work, and relocation expense for six line workers. In addition, the travel costs for the Production department declined by approximately $110,000. These decreases are also due to extra travelling costs that occurred in 2001. During 2001, information system & telecommunication staff visited offices throughout the Province to install and upgrade equipment and instruct local area staff. There were also some moving costs in 2001 when several employees were relocated to different parts of the province.

Conference costs also decreased in 2002. The decreased spending on conferences of approximately $54,000 was primarily attributable to reductions in conference spending for the TRO and the Human Resources and Legal departments.

Based on our review of a sample of travel costs, there were no instances of spousal travel noted in the regulatory travel costs, which is in compliance with P.U. 7 (2002-2003)

Equipment rentals

In 2002, equipment rental expense increased slightly by approximately $3,000 or 0.2%, as compared to 2001, however the costs were $186,000 lower than the test year forecast. A decrease in equipment rentals of $133,000 was the result of a discontinued satellite service to the Bay D'Espoir area as well as a delay in the installation of a leased service for video conferences. In the 2002 forecast for computer cost, Hydro had allocated $57,000 for the proposed replacement of the AS400 to coincide with the anticipated migration of the JD Edwards financial suite to One World from World Vision. It had been expected that JD Edwards would no longer support World Vision, however when they agreed to continue support, replacement of the AS400 was no longer required resulting in a $57,000 cost savings. The remaining differences result in a net variance increase of $4,000.

The increase between 2002 and 2001 is not significant and as such no further analysis was undertaken. The equipment rental costs have been consistent for the past three years totaling $1,372,000, $1,369,000 and $1,400,000 in 2002, 2001 and 2000 respectively.

Miscellaneous

In 2002, miscellaneous expense decreased by approximately $697,000 or 13.0% from 2001, but increased in comparison to the 2002 test year forecast by $276,000. The major variances in this expense category are as follows:

2002 compared to 2001 (actuals):		
Decrease in inventory write-offs	$	(787,000)
Increase in bad debt expense		651,000
Decrease in staff training		(394,000)
Decrease in sundry costs		(192,000)
Net increase in other categories		25,000
	$	(697,000)
2002 actuals compared to test year forecast:		
Increase in bad debt expense	$	737,000
Decrease in inventory write-offs		(306,000)
Decrease in staff training		(183,000)
Increase in business and payroll tax		157,000
Net decrease in other categories		(129,000)
	$	276,000

As noted in our 2001 report, there was a large initiative in 2001 to identify excess and obsolete inventory items and to remove them from inventory. As a result, there was a write-off of approximately $1 million in 2001 for inventory losses. For 2002, the anticipated write-offs did not totally materialize resulting in a substantial decrease in this category.

The increase in bad debt expense is due to a significant write-off of accounts related to isolated customers in Labrador.

The decrease in staff training in 2002 is related to several factors. In the Human Resources division there was a Diesel Plant Operations Training program that was an initiative for 2000 and 2001. It had much lower costs than anticipated in 2002, however an increase in these training costs are expected for 2003 for new diesel system representatives and retraining of others. Also during 2002, there were reduced training costs in the Central Region ($75,000), the IS & T department ($61,000) and the Financial Planning and Customer Services department ($28,000).

The decrease in the sundry costs is due to the elimination of the “Wabush Profit” component from that category. This elimination was due to a ruling from the 2002 Rate Hearing. In 2001, the Wabush Profit component was $189,000 and it was included in sundry costs.

For the 2002 test year, payroll tax was budgeted at a fixed percentage of 2% of salaries. Since salaries and fringe benefits exceeded budget by more than $2.6 million the result was an increase in payroll tax of approximately $119,000. The remaining increase of $38,000 is attributed to an increase in sales budgeted for retail customers. Hydro's municipal tax is based on 2.5% of revenue generated in areas it sells its energy directly to rural customers of Newfoundland and the coastal and western regions of Labrador.

With respect to the variances noted above, we have obtained explanations and performed additional analysis where appropriate.

Capitalized expenses

Capitalized expenses for 2002 were $8.623 million as compared to the forecast of $6.131 million, $9.566 million for 2001 and $7.852 million in 2000.

The breakdown of capitalized expenses for the three years is as follows:

	2002	**2002 Forecast**	2001	2000
Salaries	**$ 8,116,250**	**$ 5,722,500**	$ 8,977,207	$ 7,218,993
Fleet expense	**485,570**	**300,000**	473,546	502,400
Travel direct work orders	**21,341**	**108,640**	115,693	131,110
	$ 8,623,161	**$ 6,131,140**	$ 9,566,446	$ 7,852,503

The decrease in capitalized salaries in 2002 compared to 2001 is due to the nature of the capital program which involved a lower utilization of internal sources. In 2002, fifteen individual projects make up 89.6% of the $8.116 million capitalized, and more than half of this amount can be attributed to eight main projects: the Labrador River Project, the construction of a new diesel plant in Nain, the Granite Canal Development, upgrading work on TL242, upgrading work on TL236, and service extension and upgrading in the Central, Labrador and Northern regions. Three of these projects have been carried over from prior year(s). The increase in capitalized salaries relative to forecast can be attributed to additional overtime on certain projects including construction of the new Diesel Plant in Nain, the Granite Canal Development, upgrading work on TL242, plus sleet and lightening storms.

The methodology employed by Hydro with respect to capitalizing expenses is outlined below. This methodology changed slightly in 2002 relating to travel direct work orders. This change is the main reason for the decrease in this sub-category for 2002 compared to 2001 and forecast.

Capitalized salaries include the salaries and benefits of the Company's employees whose time is charged directly to capital projects, as well as, departmental and non-departmental overhead. The benefits component is determined by applying a pre-determined percentage to the gross salaries, which are capitalized directly. The departmental overhead component is allocated to the capital projects as a percentage of direct salaries and benefits depending on the employees' responsibilities. Finally, the non-departmental overhead component includes costs of departments which are not directly related to the capital program but which are considered necessary to support the various capital projects throughout the year. The non-departmental overhead charge is determined by applying a pre-determined percentage to the total cost of capital projects as per the work orders.

Fleet expense and travel direct work orders encompass fleet costs and costs associated with smaller work orders related to the Company's distribution system. These costs were primarily capitalized using standard rates developed by the Company; however during 2002 Hydro began charging these expenses directly to the capital job.

All categories of capitalized expenditures other than capitalized direct salaries are allocated to work orders using percentages or standard rates developed by the Company. These allocations are intended to ensure that capital projects are adequately charged with the cost of support functions such as accounting and finance, engineering, and other such expenses which cannot be directly charged to specific capital projects.

For 2002, the percentages used to capitalize fringe benefits and overhead costs were as follows:

Benefits (% of direct salaries)	
Island	33.0%
Labrador	43.0%
Departmental overhead	
Non-field (% of direct salaries and benefits of engineers and office staff)	37.6%
Field (% of salaries and benefits of crews)	19.8%
Non-departmental overhead (% of work order total costs)	6.0%

Intercompany charges

Intercompany charges to CF(L)Co. for 2002 have increased from 2001 by approximately $240,000 or 13.6%, and increased from the 2002 test year of $1,910,241 by approximately $95,700. The breakdown of intercompany charges by department is as follows:

	2002	2001	2000
Production	$ 589,199	$ 629,714	$ 231,806
Finance	462,315	406,755	430,496
Transmission and Rural Operations	67,387	73,358	172,834
Internal Audit	33,961	36,211	10,670
Management	179,917	29,421	40,694
Human Resources and Legal	673,171	590,413	887,979
	$ 2,005,950	$ 1,765,872	$ 1,774,479

These charges are for the provision of services in accordance with a Services Agreement between Hydro and CF(L)Co. Hydro's methodology for determining intercompany charges utilizes specific work orders in most situations to capture the actual costs of providing services to CF(L)Co. According to the report prepared by Hydro relating to its methodology for determining intercompany charges, costs recoveries such as salary and overhead charges are determined as follows using the JD Edwards integrated suite of applications and a Lotus Notes Time Reporting application:

a) Departments track salaries, overtime, temporary wages and employee expenses through time reporting.
b) Departments use the percentage calculated from the time reporting to allocate other costs such as membership dues and conferences.
c) Interest and depreciation costs for Hydro Place are based on the equivalent complement percentage. This percentage is used to allocate the costs of providing administrative services such as telephone, maintenance materials, janitorial, etc.
d) "Information Systems and Telecommunication" costs are allocated based on the ratio of personal computers assigned to CF(L)Co. to the total number of personal computers corporate-wide. This percentage is applied to computer costs and software acquisition and maintenance cost accounts.
e) All specific costs are recorded directly into the CF(L)Co. accounting system.

As previously noted, the recovery of costs for services provided to CF(L)Co has increased overall by $240,000 from 2001. This increase is made up of several significant variances within the account groupings for this category as indicated in the table above. The most notable variations are in the management department and the human resources and legal department. The human resources and legal department had increased charges of $83,000 and the management department had increased charges of $150,000 in 2002.

The increase in the human resources and legal department is primarily attributable to charges for severance and redundancy payments for terminated employees who regularly provided services to CF(L)Co. However the variance between 2002 and 2001 was not as large as expected as Hydro employees who normally provided services to CF(L)Co focused much of their attention on one of Hydro's initiative's, the Business Process Improvement (BPI). On the other hand, the increases in management charges were actually due to the Company's involvement in the Business Process Improvement initiative. Hydro felt CF(L)Co could benefit from the BPI initiative since the service for both companies would be improved, therefore Hydro calculated a portion of the effort of its management employees on BPI as billable to CF(L)Co. Overall, the increase in intercompany charges for 2002 appears reasonable.

Fuels

In 2002, the fuel expense increased overall by approximately $23,041,000 or 45.9% in comparison to 2001, however it decreased from the test year by $15,368,000 or 17.3%.

This increase in comparison to the prior year is primarily the result of the increase in No.6 Fuel costs. This cost (net of RSP recoveries) increased by $23.4 million or 55.3%. This increase is due to the following reasons:

- The price of No.6 Fuel per barrel included in Hydro's Cost of Service increased in September 2002 from $12.50 per barrel to an average of $26.91 per barrel as a result of the Order arising from the 2001 General Rate Hearing.

- Hydro also consumed approximately 3,678,000 barrels of oil in 2002 versus 3,316,000 in 2001. This was the result of an increase in thermal generation in 2002 of 285 GWh in comparison to 2001.

In addition to the above noted items, there were other aspects of the fuel expense that caused the increase in this expense category. The fuel additives expense was higher in 2002 due to higher production at the Holyrood Plant and higher metal content in the fuel used. The indirect fuel costs were higher than anticipated because of more frequent shipments and additional testing for environmental and efficiency purposes. Also, there was one rental of a tug to facilitate docking a ship due to inclement weather conditions in December, 2002. These increases were offset by a decrease in diesel fuel relating to the rural systems.

The decrease in fuel expense relating to the 2002 test year forecast is primarily due to the implementation of the revised price of No. 6 Fuel per barrel as a result of P.U.7 (2002-2003). The price per barrel became effective September 2002 while the budget had assumed a January 2002 implementation.

Power purchased

The Company's purchased power expense increased by $281,000 in 2002 (excluding the Hydro Quebec Recall). This overall increase is not significant however there are fluctuations in the various components comprising this expense. The major variances in this expense category are as follows:

Decrease in secondary energy costs	$(369,000)
Increase in power purchased from NUG's	311,000
Increase relating to Wabush Terminal Station	150,000
Increase in L'Anse-au-Loup costs	164,000

The decrease in secondary energy costs is primarily the result of lower secondary energy being available from Abitibi Consolidated. Also, as noted in the 2001 report, there was a large increase last year that related to approximately $210,000 in accounting adjustments that resulted from an over-accrual and a payment allocated to an incorrect account.

This increase in the cost of power purchased from the two non-utility generators relates to an increase in the contract rate for both Star Lake and Algonquin Power in 2002. The amount of power purchased from the NUG's in 2002 is consistent with 2001.
The expense for capacity expansion at the Wabush Terminal Station increased by $150,000 due to an under-accrual for charges from the Iron Ore Company of Canada in 2001. There is an agreement in place between both companies that permits the IOCC to charge back 53% of the capacity expansion costs. However, as noted in our 2001 report, IOCC did not bill Hydro for Hydro's share of all of the 2001 capacity expansion costs and an accrual for these costs was not recorded by Hydro. As a result, some of the costs relating to 2001 are recorded in 2002, thus increasing the purchased power costs from the prior year.

The increase of $164,000 in purchases from L'anse au Loup is primarily the result of higher customer demand. This increase in demand required the Company to purchase more power from Hydro-Quebec.

The power purchased expense also includes an amount of $1.3 million paid to Abitibi Price in Stephenville for the right to interrupt a portion of their power supply should Hydro need the power to meet its own demand. A ten-year contract has been signed between Hydro and Abitibi to this effect. This contract was signed in 1994 and has a cancellation clause, which requires a three-year notice.

The Company's purchase power expense for 2002 also increased in comparison to the 2002 test year forecast by $781,000. This is primarily due to the increase in the purchase power costs from NUG's, the increase in capacity expansion costs for the Wabush Terminal Station and the increase in costs relating to L'Anse au Loup as described above. Also, the purchase power costs relating to the Hydro Quebec recall in the 2002 test year was forecast at $4.3 million in comparison to the actual amount of $4 million that was allocated to this non-regulated activity.

Interest

Interest expense for 2002 decreased overall compared to 2001 despite the increases in gross interest, the debt guarantee fee and amortization of foreign exchange losses. The decrease in interest expense of $3.1 million or 3.4% is primarily attributable to an increase in the amount of interest earned on the rate stabilization plan and sinking funds, as well as the amount of interest capitalized during construction.

The interest expense for 2002 is comparable to the interest expense of $88.3 million included in the 2002 test year.

The following is a summary of interest expense for 2002 to 2000:

(millions)	2002	2001	2000
Gross interest	$97.4	$96.7	$95.0
Debt guarantee fee	12.2	11.2	10.7
Amortization of debt discount and financing costs	1.2	1.1	1.1
Foreign exchange losses	2.2	1.0	1.0
	113.0	110.0	107.8
Less:			
Interest earned	(14.5)	(10.7)	(8.1)
Interest attributable to CF(L)Co share purchase	(2.3)	(2.5)	(1.8)
Interest capitalized during construction	(7.7)	(5.2)	(3.7)
	$88.5	$91.6	$94.2

Non-Regulated Activity

Scope: ***Review Hydro's non-regulated activity and assess the reasonableness of adjustments in the calculation of regulated earnings.***

As a result of P.U.7 (2002-2003), Hydro was ordered that for all regulatory reporting, separate financial statements for regulated and non-regulated activities were required to be filed with the Board, including a reconciliation with annual consolidated financial statements.

The Company has complied with this Order and has filed separate financial statements for both regulatory and non-regulatory operations in its 2002 Quarterly reports starting with the quarter ended September 30, 2002

The Company was also ordered to submit its written policies and procedures to account for all intra and inter-corporate transactions, identifying what is to be included in regulated and non-regulated activities as a normal reporting function. This report was submitted to the Board. It includes the definition of "non-regulated" operations and the Company's procedures with regards to reporting non-regulated operations. The report also describes each of the Company's current non-regulated operations and how the cost allocations and charges to these operations are determined. Based on our review, we conclude that Hydro has appropriately identified and defined its various non-regulated operations and has established appropriate procedures for recording and reporting on these activities.

Based on our review, the Company has set up separate business units for the various non-regulated operations within its financial reporting system.

Our review of non-regulated operations included the following specific procedures:

- assessed the Company's compliance with P.U. 7 (2002-2003);
- compared non-regulated expenses/operations for 2002 to prior years and investigated any unusual fluctuations;
- reviewed detailed listings of expenses for 2002 and investigated any unusual items;

The non-regulated operations (other than CF(L) Co.) includes activity for the following:

- Export sales relating to the Hydro Quebec recall power agreement. This operation includes revenue of approximately $34.1 million, purchase power costs of $4 million and operation and administrative costs of $1,617. The net profit relating to this activity in 2002 was approximately $30 million (2001 - $27.4 million). In 2001, Hydro had also made an adjustment for notional interest based on the timing of receipt of export sales and payment of related dividends. During 2002 Hydro commenced paying dividends on export sales on a monthly basis, effectively eliminating the lag in cash flow and hence the need for a notional interest adjustment in 2002.

The original contract was amended on February 19, 2001 to include the recall of power for the period March 9, 2001 to March 31, 2004. Under this amended contract Hydro can purchase power from Upper Churchill at the mil rate of $2.5425 per MWh and resell it to Hydro Quebec at $23.90/ MWh, up to a revenue cap of $97.53 million. The contract also stated that if the revenue cap was achieved before the end of the three-year contract then all power resold to Hydro Quebec above this cap would be at the same price that Hydro paid for this power (i.e. $2.5426/MWh).

- The supply of power to The Iron Ore Company of Canada. IOCC is a customer on the Labrador Interconnected system and consequently the portion of costs associated with this customer are derived from the Cost of Service. The rate charged to IOCC is based on a negotiated contract and does not require approval of the Board. The non-regulated activity represents the profit Hydro earns from IOCC. In 2002, the profit earned relating to this customer was $1.4 million (2001 - $1.3 million)

- The non-regulated expenses relating to the Lower Churchill Development Corporation Limited totaled $3,376 (2001 - $Nil). This represents salary costs and professional services. This Corporation is primarily inactive.

- The non-regulated costs relating to Gull Island Power Company totaled $809 (2001-$Nil) which represents an allocation of salary costs. This Corporation is primarily inactive.

- The Company is also providing services on behalf of the Federal Government relating to Natuashish. According to Hydro these costs are to be reimbursed by the Federal Government. The total non-regulated expenses relating to this activity in 2002 were $24,168 (2001 - $Nil).

- Other non-regulated costs that would include items resulting from Board Orders such as contributions and donations, advertising that would be for the purpose of corporate image, companion travel costs and maintenance costs associated with Muskrat Falls, totaled $381,530 for 2002 (2001 - $134,146).

Based upon our review and analysis, the amounts reported as non-regulated expenses appear reasonable and are in compliance with Board Orders, including P.U. 7 (2002-2003). We have included the a copy of the Company's Non-Regulated Statement of Earnings and Retained Earnings for the year ended December 31, 2002 as Schedule 3 to this report.

Depreciation

Scope: ***Review Hydro's rates of depreciation and assess their compliance with the 1998 KPMG Depreciation Policy Study. Assess reasonableness of depreciation expense.***

Our procedures with respect to depreciation were focused on reviewing the rates of depreciation used and assessing their compliance with the 1998 KPMG Depreciation Policy Study and also on assessing the overall reasonableness of depreciation expense. The changes in depreciation rates and policies flowing from the 1998 Depreciation Policy Study were approved by the Board to come into effect January 1, 2002 according to P.U. 7 (2002-2003).

During 2002 Hydro reported depreciation expense of $31.1 million compared to $31.2 million estimated for the 2002 test year and $32.2 million in 2001. The breakdown of depreciation expense for 2002 is as follows:

Location	Asset Class	Net Cost	Method	2002 Expense
Hydro	Hydraulic stations Terminal stations Transmission lines	$1,022.7 million	Sinking Fund	$11.3 million
Hydro	All other classes	213.9 million	Straight Line	19.8 million
		$1,236.6 million		$31.1 million

The majority of Hydro's high dollar value capital assets are depreciated using the sinking fund method. As noted above this method is applied to hydraulic stations, terminal stations and transmission lines which account for approximately 83% of the net cost of all capital assets. Depreciation on the remaining classes of assets is calculated using the straight line method.

Under the sinking fund method, depreciation is very low in the early years of an asset's life and increases with time such that it is very high in the final years. The underlying rationale in support of this methodology by Hydro is that the combined charge of depreciation plus interest on the long-term debt required to finance the asset should be equal over the short and long term to minimize fluctuations in operating income. The straight-line method results in equal amounts of depreciation being charged to each period/year over an asset's useful life.

In completing our procedures, we recalculated depreciation for both depreciation methods on a test basis and compared the estimated service lives used in the calculations to the 1998 KPMG Depreciation Policy Study. We also reviewed the interest rates used in calculating sinking fund depreciation for reasonableness.

As a result of completing our procedures, no significant discrepancies were noted and therefore, we report that depreciation expense for 2002 appears reasonable.

Based on our review of depreciation expense, we conclude that Hydro is in compliance with P.U. 7 (2002-2003), and the recommendations and results of the 1998 KPMG Depreciation Policy Study have been incorporated into the Company's depreciation calculations for 2002.

Rate Stabilization Plan

Scope: ***Conduct an examination of the changes to the Rate Stabilization Plan to assess compliance with Board orders.***

In its Decision on the 2001 General Rate Hearing, the Board ordered in P.U.7 (2002-2003) that the balance in the existing Rate Stabilization Plan (the "old" plan) as of August 31, 2002 be fixed and recovered from ratepayers over a five year period on a straight line basis. The balance in this plan would continue to have an interest component until the balance was eliminated.

In the same Decision, the Board ordered that a "new" rate stabilization plan would commence on September 1, 2002. Any balances that accumulate in this "new" plan will be recovered from ratepayers over a two year period on a straight line basis and recovery will commence on January 1, 2004 for industrial customers and July 1, 2004 for retail customers.

Our examination of the Rate Stabilization Plan (RSP) for 2002 included reviewing compliance with Board Orders and assessing the charges and credits in the both the "old" and "new" plans for reasonableness. We also assessed the reasonableness of the interest charged and credited to the Plans during the year.

As of August 31, 2002, the RSP had accumulated a balance of $105.8 million. In compliance with the Board Order this balance has been segregated and will be recovered over a five year period. The significant increase in this plan is primarily attributed to the rising cost of No. 6 fuel in comparison to the cost of service price of $12.50 per barrel. From the period September 1, 2002 to December 31, 2002, this plan balance accumulated interest charges of approximately $2.4 million (using a weighted average cost of capital of 7.157%) and approximately $4 million was recovered from ratepayers. P.U. 7 (2002-2003) also ordered the Company not to change the existing rates that were in place to recover this balance from the Industrial and Retail customers until January 1, 2003 and July 1, 2003, respectively.

The "new" plan that commenced September 1, 2002 included revisions to the various components as follows:

- The cost of service price of No.6 fuel was reset at an average price of $25.91 per barrel from the previous price of $12.50.
- The Holyrood average annual operating efficiency increased to 615 kWh per barrel from 605 kWh.
- The cost of service hydraulic production increased to 4,425.00 GWh from 4,205.32 GWh.
- The cost of service energy sales (load) increased to 5,873.9 GWh from 5,533.3 GWh.
- The cost of service barrels of fuel increased to 3,173,825 barrels from 3,043,686 barrels.

From the period September 1, 2002 to December 31, 2002 the "new" plan accumulated a balance of $20.5 million. Similar to the activity in the "old" plan up to August 31, 2002, the most significant component in the plan is the fuel cost variation. Even though the fuel price was reset to an average price of $25.91 per barrel, the price of fuel continued to escalate due to world events and the average price per barrel for this period was approximately $36 per barrel. Also, the Company experienced poor hydraulic conditions during this period which has also contributed approximately $7 million to the accumulated balance.

In accordance with P.U 7 (2002-2003), there were no recoveries from ratepayers for this "new" plan during the period September 1, 2002 to December 31, 2002. As previously indicated, the recovery of this balance will commence in 2004 and will be recovered over a two year period.

Schedule 4A of our report summarizes the changes in the "old" RSP for the period January 1 to August 31, 2002. Schedule 4B summarizes activity in the "new" RSP which covers the period September 1 to December 31, 2002.

In P.U. 7 (2002-2003), the Board included a requirement for a study of the Rate Stabilization Plan. At the request of the Board, we have completed a discussion paper which discusses issues raised with respect to the operation of the current Plan and identifies possible modifications which the Board may wish to consider.

Based upon our review, we report that the RSP is operating in accordance with Board Orders and the charges and credits made to the Plan in 2002 are reasonable.

Deferred Charges

Scope: ***Conduct an examination of the changes to deferred charges and assess their reasonableness and prudence in relation to sales of power and energy.***

The following table shows the transactions in the deferred charges account for 2000 to 2002:

(000)'s	Balance Dec./99	Net Add.	Amort.	Balance Dec./00	Net Add.	Amort.	Balance Dec./01	Net Add.	Amort.	Balance Dec./02
CF(L) Co.	1,478	-2	(383)	$ 1,093	26	(382)	$ 737		(387)	$ 350
Realized foreign exchange losses	96,278			$ 96,278			$ 96,278	(10,000)	(2,157)	$ 84,121
Rate hearing costs								805	(201)	$ 604
Discounts/premiums & issue costs on long term debt	12,695		(1,140)	$ 11,555	1,995	(1,137)	$ 12,413	(7,538)	(1,178)	$ 3,697
	$ 110,451	($ 2)	($ 1,523)	$ 108,926	$ 2,021	($ 1,519)	$ 109,428	($ 16,733)	($ 3,923)	$ 88,772

The changes in deferred charges for 2002 relate to:

- a reclassification of the accrued provision for the foreign exchange losses;
- the deferral of premiums and discount on the issue of bonds during the year; and
- the deferral of certain regulatory costs as approved by the Board.

From 1992 to 2001 Hydro had been accruing $1 million per year towards its foreign exchange losses in compliance with a Board recommendation from the 1992 Hearing. During the 2001 Hearing, Hydro proposed that the accumulated provision of $10 million be netted against the total realized foreign exchange losses of $96.278 million and amortization of these losses should begin in 2002 at a rate of $2.157 million per year. The Board accepted this proposed treatment in P.U.7 (2002-2003) and Hydro recorded the $10 million reclassification and amortization in 2002.

During 2002 Hydro issued additional bonds in existing Series AB and AC for an aggregate amount of $250 million. Series AB, with a coupon rate of 6.65% and maturity date of 29 years, was sold in August at a premium of $9.049 million. Series AC, with a coupon rate of 5.05% and maturity date of 4.6 years, was sold in April at a discount of $1.512 million. The net of this premium and discount results in a reduction in deferred charges of $7.538 million as noted in the table above.

In addition to these two reductions, there was a new addition to deferred charges in 2002. This amount was for $805,000 in regulatory hearing costs. In accordance with P.U. 16(2002-2003), the Company was permitted to defer regulatory costs in excess of $1 million which are to be amortized over a period of 16 months beginning in September, 2002 and running through December, 2003. The company has complied with this Board Order as indicated in the table above.

Cost Control/Productivity Initiatives

Scope: ***Review Hydro's initiatives and efforts with respect to productivity improvements, rationalization of operations and expenditure reductions. Obtain an update on current activities and inquire as to any future initiatives currently being evaluated.***

The Company has undertaken a number of initiatives to explore the possibility of future savings and increased productivity. In our 2001 report, we noted several initiatives that the Company was in the process of implementing. The Diesel Plant Operation Review initiative was fully implemented by December 31, 2001 consequently no further update has been provided. An update on the progress of the Reliability Centered Maintenance initiative is outlined below.

Reliability Centered Maintenance (RCM) Approach for Transmission and Rural Operations

This approach to maintenance places the emphasis on reliability, therefore not all of the systems would be treated the same with respect to the frequency of maintenance. It is believed that this approach would result in a more effective maintenance program and result in an efficient use of resources in the maintenance area.

Based on correspondence from Hydro officials, this initiative is proceeding on schedule with RCM programs to be in place by mid 2003 for distribution systems, diesel plants and terminal stations. It was also noted that RCM principles for gas turbines and transmission systems will be established by the end of 2003. In addition, the company indicated that the cost savings and/or productivity improvements are expected to be realized after full implementation.

Other Initiatives

In addition to the above, the Company continued and/or initiated work on several other cost control/productivity initiatives during 2002 including:

- review of an evaluated receipts system;
- review of freight, transportation and courier service;
- elimination of an automated expense management report system;
- negotiation of an air travel agreement; and
- continuation of a business process review.

Hydro has reported progress on the evaluation and implementation of each of these projects in 2002 with benefits expected in 2003 and future years.

With respect to the business process review, the Company continued in 2002 with the implementation of a business improvement process to ensure continuous improvement in work processes. As of the end of 2002, there were reviews done in accounts payable, corporate purchasing card and travel, consumables and inventory. In these areas changes in processes and work methods were identified for implementation in 2003.

Hydro has advised that in 2003 three other areas are being reviewed under the business improvement process. These include the acquisition of goods and services, work management and asset management.

As part of the annual review process, we will monitor the results of the above initiatives, obtain an update from the Company and inquire as to any future initiatives that are being considered and evaluated.

Contributions in Aid of Construction (CIAC's)

Scope: ***Review a sample of Contribution in Aid of Construction (CIAC) calculations for accuracy and compliance with approved policy.***

Our procedures in this area included the following:

- review the implementation of the undertakings of Hydro in respect of the revised CIAC policy as ordered in P.U. 4 (1997-98); and
- review a sample of CIAC calculations for accuracy and compliance with approved policy.

As part of our review, we have held discussions with Mr. Barry Brophy, Customer Communications and Support Supervisor (Acting) of Hydro, regarding the Company's CIAC policies and procedures and we have selected and reviewed documentation supporting a sample of five (5) CIAC calculations prepared during 2002.

Based on the results of our inquiry and review we have made certain observations which are noted below for your information:

- Effective January 2002, Hydro implemented a new computerized program for CIAC's. Hydro advised us that all CIAC quotes for the 2002 year have been generated using this system. The results of our procedures indicate that all quotes are now done via the computer system unless they relate to customers that are "over 350 kVA". These calculations can be very complex, and therefore, they are done manually. In addition, these calculations would be performed at Head Office.

- Hydro does not include sketches with the customer letters. However these sketches are maintained in the file for Hydro's review. This is consistent with prior years.

- In the past the company had a system that required the regional offices to complete quarterly spreadsheets reporting quoted CIAC's by the region to Barry Brophy. However, with the implementation of the computer system and the online network, this quarterly reporting is no longer required as all the quotes are maintained in the overall database.

Based on our review of five CIAC quotes in 2002, we noted that each of the files were very detailed, containing a written request from the customer, appropriate sketches of the area to calculate a correct quote, letters to interested parties outlining the details of the quote; and the necessary approval from supervisors. This was consistent with our findings in 2001.

Based on the results of our inquiry and review of documentation, we noted that the Board's requirements for the approval, review and calculation processes as specified in P.U.4 (1997-98), are being complied with. The overall process has improved substantially with the full implementation of the computerized system.

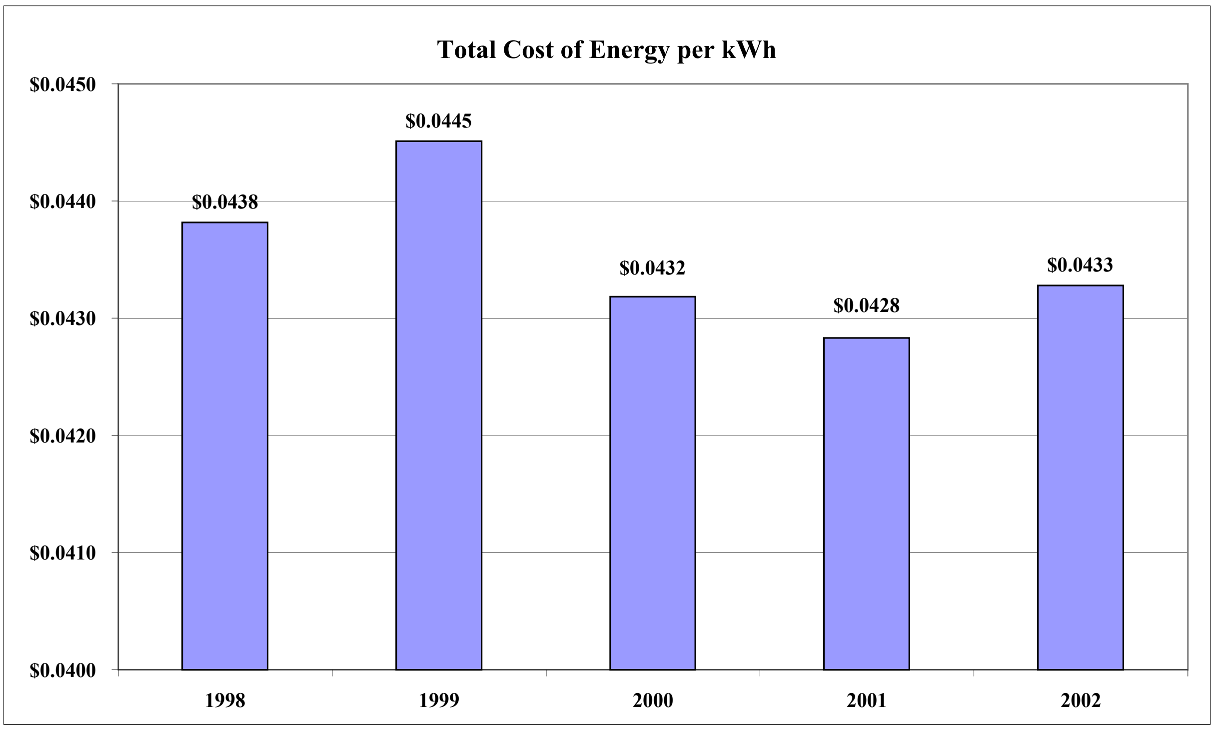
Newfoundland and Labrador Hydro **Schedule 1**
Revenue Requirement
2000 to 2002

(000)'s	Test Year 2002	Actuals 2002	Actuals 2001	Actuals 2000
Depreciation	$ 31,390	$ 31,302	$ 32,175	$ 35,469
Fuel	88,616	73,248	50,207	42,568
Power purchased	15,100	15,881	15,600	15,961
Other costs	-	-		
Salaries and fringe benefits	61,926	64,559	61,729	61,267
System equip. maint.	16,763	17,179	17,445	18,976
Insurance	977	1,198	949	1,037
Transportation	2,223	2,464	2,332	2,892
Office supplies	1,864	1,856	1,872	2,081
Bldg. rentals and maint.	626	900	704	998
Professional services	4,943	5,318	5,530	3,815
Travel	2,484	2,337	2,778	2,835
Equipment rentals	1,558	1,372	1,369	1,400
Miscellaneous	4,398	4,674	5,371	5,179
Productivity allowance	(2,000)			
Loss on disposal	890	2,769	1,839	2,186
Sub-total	96,652	104,626	101,918	102,666
Allocations				
Other	(2,914)	(2,914)	(2,753)	-
Hydro capitalized	(6,131)	(8,623)	(9,567)	(7,852)
C.F.(L) Co.	(1,910)	(2,006)	(1,766)	(1,670)
Sub-total	(10,955)	(13,543)	(14,086)	(9,522)
Total	85,697	91,083	87,832	93,144
Interest	88,298	88,547	92,788	96,868
Regulated earnings	7,959	9,742	11,918	5,850
Revenue requirement	317,060	309,803	290,520	289,860

Schedule 2A

Newfoundland and Labrador Hydro
Comparison of Total Cost of Energy to kWh Sold and Used
(000)'s

Year	kWh sold and used	Depreciation	Fuel	Purchased Power	Other Costs	Interest	Regulated Earnings		Total Cost of Energy		Cost per kWh
1998	6,254,000	$ 32,843	$ 26,880	$ 9,442	$ 80,827	$ 98,903	$ 25,132		$ 274,027		$ 0.0438
1999	6,257,000	$ 36,108	$ 35,110	$ 13,785	$ 85,152	$ 95,327	$ 13,033	1	$ 278,515	1	$ 0.0445
2000	6,712,000	$ 35,469	$ 42,568	$ 15,961	$ 93,144	$ 96,868	$ 5,850		$ 289,860		$ 0.0432
2001	6,783,000	$ 32,175	$ 50,207	$ 15,600	$ 87,832	$ 92,788	$ 11,918		$ 290,520		$ 0.0428
2002	7,158,000	$ 31,302	$ 73,248	$ 15,881	$ 91,083	$ 88,547	$ 9,742		$ 309,803		$ 0.0433



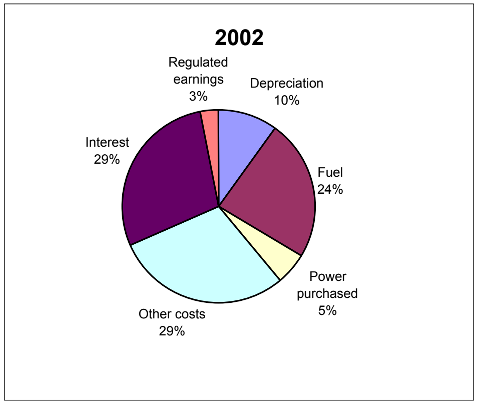
1 Both of these numbers have been restated for the writedown of the Roddickton chip plant

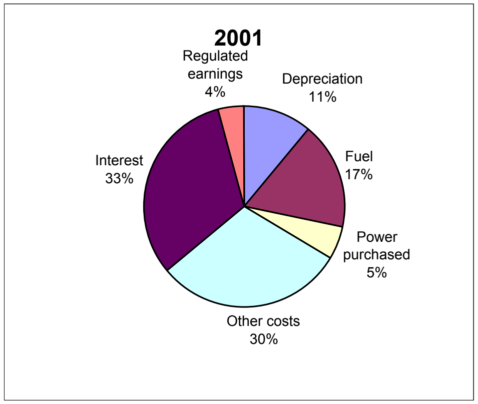
Newfoundland and Labrador Hydro
Comparison of Costs as a Percentage of kWh Sold and Used

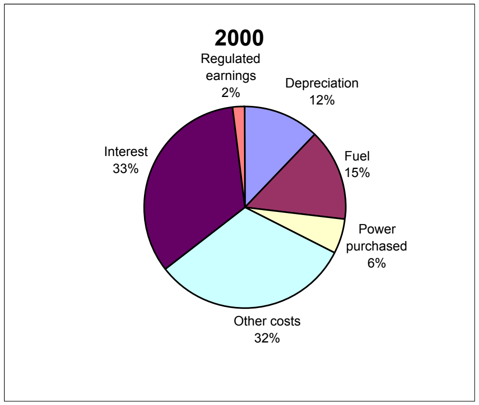
	1998			1999			2000			2001			2002		
kWh sold and used	6,254,000			6,257,000			6,712,000			6,783,000			7,158,000		
	Cost	Cost per kWh	% of Total	Cost	Cost per kWh	% of Total	Cost	Cost per kWh	% of Total	Cost	Cost per kWh	% of Total	Cost	Cost per kWh	% of Total
Depreciation	$ 32,843	0.0053	11.99%	$ 36,108	0.0058	12.96%	$ 35,469	0.0053	12.24%	$ 32,175	0.0047	11.07%	$ 31,302	0.0044	10.10%
Fuel	26,880	0.0043	9.81%	35,110	0.0056	12.61%	42,568	0.0063	14.69%	50,207	0.0074	17.28%	73,248	0.0102	23.64%
Power purchased	9,442	0.0015	3.45%	13,785	0.0022	4.95%	15,961	0.0024	5.51%	15,600	0.0023	5.37%	15,881	0.0022	5.13%
Other costs	80,827	0.0129	29.50%	101,832	0.0163	36.56%	93,144	0.0139	32.13%	87,832	0.0129	30.23%	91,083	0.0127	29.40%
Interest	98,903	0.0158	36.09%	95,327	0.0152	34.23%	96,868	0.0144	33.42%	92,788	0.0137	31.94%	88,547	0.0124	28.58%
Regulated earnings	25,132	0.0040	9.17%	(3,647)	-0.0006	-1.31%	5,850	0.0009	2.02%	11,918	0.0018	4.10%	9,742	0.0014	3.14%
Total	$ 274,027	0.0438	100.00%	$ 278,515	0.0445	100.00%	$ 289,860	0.0432	100.00%	$ 290,520	0.0428	100.00%	$ 309,803	0.0433	100.00%

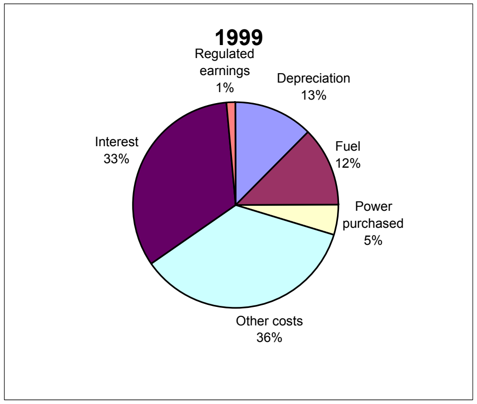
Newfoundland and Labrador Hydro
Comparison of Costs as a Percentage of kWh Sold and Used

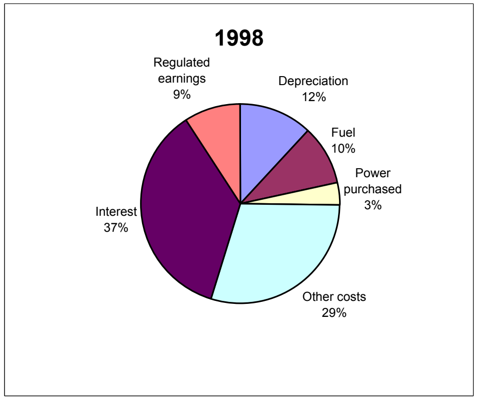
Schedule 2B











Schedule 2C

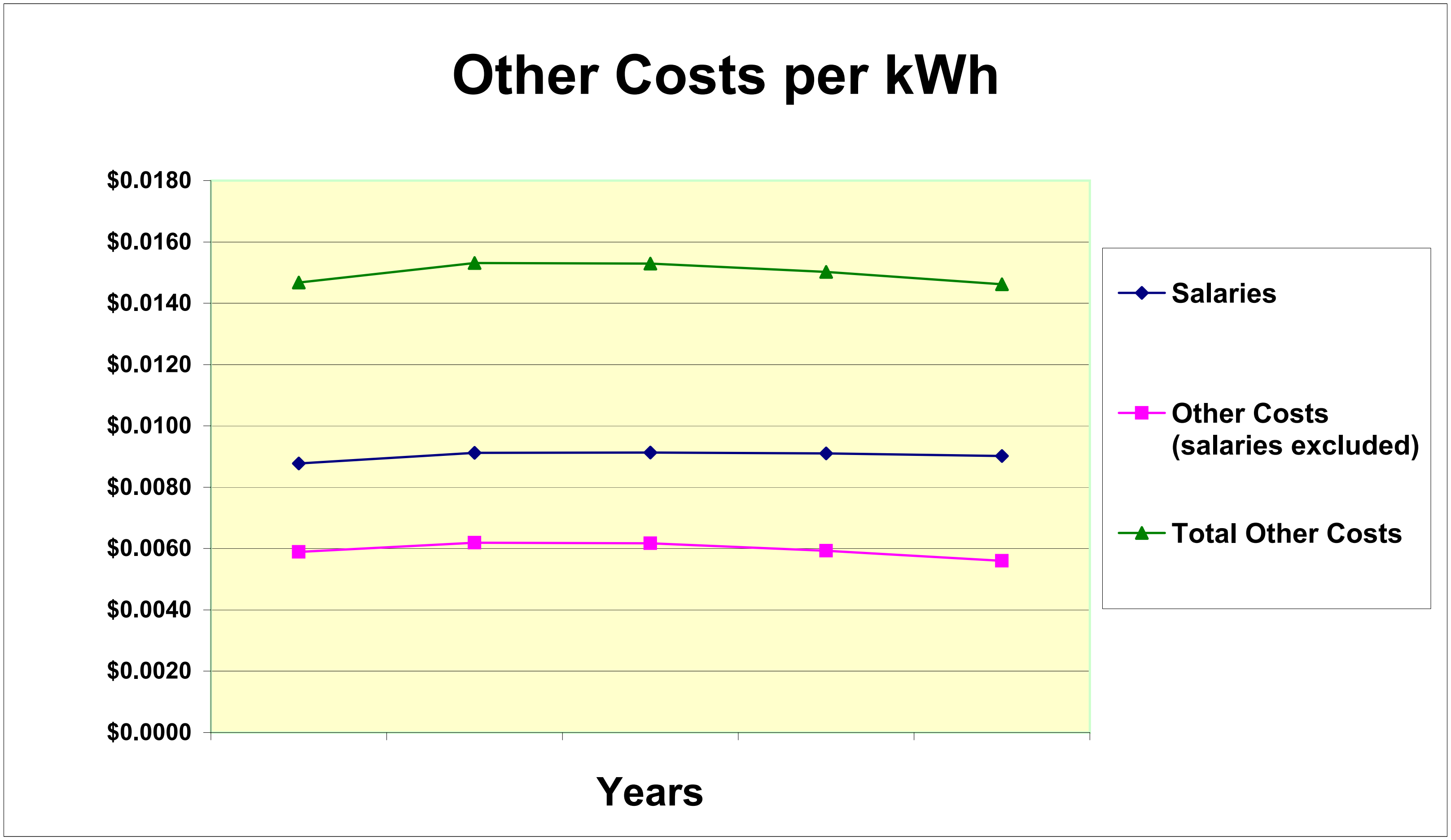
Newfoundland and Labrador Hydro
Comparison of Other Costs by Breakdown
1998 to 2002

	1998			1999			2000			2001			2002		
kWh sold and used	6,254,000			6,257,000			6,712,000			6,783,000			7,158,000		
	Cost	Cost per kWh	% of Total	Cost	Cost per kWh	% of Total	Cost	Cost per kWh	% of Total	Cost	Cost per kWh	% of Total	Cost	Cost per kWh	% of Total
Salaries	$ 54,904	0.00878	100.00%	$ 57,070	0.00912	100.00%	$ 61,267	0.00913	100.00%	$ 61,729	0.00910	100.00%	$ 64,559	0.00902	100.00%

	1998			1999			2000			2001			2002		
kWh sold and used	6,254,000			6,257,000			6,712,000			6,783,000			7,158,000		
	Cost	Cost per kWh	% of Total	Cost	Cost per kWh	% of Total	Cost	Cost per kWh	% of Total	Cost	Cost per kWh	% of Total	Cost	Cost per kWh	% of Total
System equip. maint.	$ 11,323	0.00181	30.73%	$ 14,955	0.00239	38.62%	$ 18,976	0.00283	45.84%	$ 17,445	0.00257	43.41%	$ 17,179	0.00240	42.88%
Insurance	1,056	0.00017	2.87%	1,068	0.00017	2.76%	1,037	0.00015	2.50%	949	0.00014	2.36%	1,198	0.00017	2.99%
Transportation	3,641	0.00058	9.88%	3,481	0.00056	8.99%	2,892	0.00043	6.99%	2,332	0.00034	5.80%	2,464	0.00034	6.15%
Office supplies	2,715	0.00043	7.37%	2,858	0.00046	7.38%	2,081	0.00031	5.03%	1,872	0.00028	4.66%	1,856	0.00026	4.63%
Bldg. rentals and maint.	3,226	0.00052	8.75%	2,897	0.00046	7.48%	998	0.00015	2.41%	704	0.00010	1.75%	900	0.00013	2.25%
Professional services	3,398	0.00054	9.22%	3,756	0.00060	9.70%	3,815	0.00057	9.22%	5,530	0.00082	13.76%	5,318	0.00074	13.27%
Travel	2,211	0.00035	6.00%	2,459	0.00039	6.35%	2,835	0.00042	6.85%	2,778	0.00041	6.91%	2,337	0.00033	5.83%
Equipment rentals	2,000	0.00032	5.43%	1,602	0.00026	4.14%	1,400	0.00021	3.38%	1,369	0.00020	3.41%	1,372	0.00019	3.42%
Miscellaneous	6,142	0.00098	16.67%	4,729	0.00076	12.21%	5,179	0.00077	12.51%	5,371	0.00079	13.36%	4,674	0.00065	11.67%
Loss on disposal	1,137	0.00018	3.09%	923	0.00015	2.38%	2,186	0.00033	5.28%	1,839	0.00027	4.58%	2,769	0.00039	6.91%
Total	$ 36,849	$ 0.00589	100.00%	$ 38,728	$ 0.00619	100.00%	$ 41,399	$ 0.00617	100.00%	$ 40,189	$ 0.00592	100.00%	$ 40,067	$ 0.00560	100.00%

Grand Total	$ 91,753	$ 0.01467	100.00%	$ 95,798	$ 0.01531	100.00%	$ 102,666	0.01530	100.00%	$ 101,918	0.01503	100.00%	$ 104,626	0.01462	100.00%

Schedule 2C



Other Costs per kWh
$0.0180
$0.0160
$0.0140
$0.0120
$0.0100
$0.0080
$0.0060
$0.0040
$0.0020
$0.0000
Years
Salaries
Other Costs
(salaries excluded)
Total Other Costs

Newfoundland and Labrador Hydro **Schedule 3**

Non-Regulated Operations

Statements of Earnings and Retained Earnings - December 31

(000)'s

	2002 Forecast	2002 Actual	2001 Actual
Revenue			
Energy Sales	$ 35,426	$ 38,408	$ 34,667
Operations and Administration			
Net Operating	206	3,325	2,880
Power Purchased	4,024	4,010	4,457
Interest	-	-	(1,183)
	4,230	7,335	6,154
Net Operating Income	31,196	31,073	28,513
Other Revenue			
Equity in CF(L) Co.	12,046	11,825	9,474
Preferred Dividends	7,870	7,555	6,038
Interest Share Purchase Debt	(2,262)	(2,264)	(2,523)
	17,654	17,116	12,989
Net Income	$ 48,850	$ 48,189	$ 41,502
Retained earnings, beginning of year		$ 253,741	$ 260,904
Less: Adjustment CF foreign exchange			(5,693)
Net Income		48,189	41,502
Dividends			
Hydro		(55,443)	(32,972)
CF(L)Co.		(6,788)	(10,000)
		(62,231)	(42,972)
Retained earnings, end of year		$ 239,699	$ 253,741

Newfoundland and Labrador Hydro

Schedule 4A

Rate Stabilization Plan Summary - "Old Plan"

2000 to 2002

(000)'s	2002 Current Variation	2002 Current Interest	2002 Prior Interest	2002 Total	2001	2000
Balance, beginning of year				$85,246	$35,606	$34,331
Water variation	$ (57)	$ 54	$ 11,633	11,630	23,639	1,390
Load variation	(5,114)	(130)	(37)	(5,281)	(3,467)	762
Fuel variation	32,383	854	(8,413)	24,824	41,098	10,896
Recovery	(13,921)		3,336	(10,585)	(8,894)	(10,788)
Rural rate alteration	(305)	(8)	(123)	(436)	(70)	(1,046)
Labrador interconnected	12	1	5	18	41	61
Net change	$ 12,998	$ 771	$ 6,401	20,170	52,347	1,275
Rate adjustment for industrial customers				(1,148)	(2,707)	
Balance, as of December 31, 2002				$104,268	$85,246	$35,606

Comprised of:

Water variation	$255,834
Load variation	(6,005)
Fuel variation	(151,773)
Recovery	13,012
Rural rate alteration	(3,048)
Labrador interconnected	103
Rate adjustment for industrial customers	(3,855)
Balance, end of year	$104,268
Current receivable	$16,702
Long-term receivable	87,566
	$104,268

Newfoundland and Labrador Hydro **Schedule 4B**
Rate Stabilization Plan Summary - "New Plan"
September 1, 2002 to December 31, 2002

(000)'s	**2002** Current Variation	Current Interest	Total
Balance, Sept 1/02 **(1)**			$0
Water variation	$ 7,024	$ 52	7,076
Load variation	(198)	(1)	(199)
Fuel variation	13,730	96	13,826
Recovery			0
Rural rate alteration	(21)		(21)
Labrador interconnected	(186)		(186)
Net change	$ 20,349	$ 147	20,496
Balance - December 31, 2002			$20,496

<u>Comprised of:</u>

Water variation	$7,076
Load variation	(199)
Fuel variation	13,826
Recovery	
Rural rate alteration	(21)
Labrador interconnected	(186)
Balance, end of year	$20,496
Current receivable	$0
Long-term receivable	20,496
	$20,496

(1) As noted in our report, the Board fixed the outstanding balances as of August 31, 2002 and directed that these amounts be recovered over a five-year period beginning in 2003. The balance effective September/02 was $0 as a new plan was established. The outstanding balance for this plan noted above as at December 31/02 is to be recovered from ratepayers over a two-year period beginning in 2004.