

September 15, 2004

Board of Commissioners of Public Utilities
120 Torbay Road
Prince Charles Building
St. John's, NL A1A 5B2

Attention: Ms. Doreen Dray

Dear Ms. Dray:

**Re: Newfoundland Power Inc.
2004 Capital Budget Hearing**

We have completed our review of the items indicated in your request dated September 7, 2004 relating to Newfoundland Power Inc.'s (the Company's) 2005 Capital Budget Application as it pertains to the calculation of the 2003 actual average rate base, the calculations of 2004 and 2005 forecast average rate base and the calculation of the forecast return on average rate base for 2005.

The results of our review for each required task are noted below:

2003 Average Rate Base Calculation

The actual average rate base for 2003 as calculated by the Company and provided in Schedule D of its Application is \$675,730,000, this has increased from \$573,337,000 in 2002 primarily due to the inclusion of average deferred charges in the calculation commencing in 2003 in accordance with P.U. 19 (2003). This calculation also agrees with the information submitted to the Board in Return 3 of the Company's 2003 annual report.

Our procedures with respect to verifying the calculation of the average rate base were directed towards the verification of the data incorporated in the calculations and 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 (capital expenditures; depreciation; etc.) to supporting documentation;
- checked the clerical accuracy of the continuity of the rate base for 2003; and

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- agreed the methodology used in the calculation of the average rate base to the Public Utilities Act to ensure it is in accordance with Board Orders and established policy and procedure.

Based upon the results of the above procedures we did not note any discrepancies in the calculation of the 2003 average rate base, and therefore conclude that the average rate base included in Schedule D of the Company's Application is accurate and in accordance with P.U. 19 (2003).

Forecast 2004 and 2005 Average Rate Base Calculation

The forecast average rate base for 2004 and 2005 as calculated by the Company and provided in Schedule D of its Application is \$713,072,000 and \$740,142,000, respectively. We confirm that the average forecast rate base for 2004 and 2005 are calculated correctly and in accordance with P.U.36 (1998-99) and P.U 19 (2003).

In regards to the various components of the forecast 2004 and 2005 average rate base, we reviewed the plant investment component and agreed it to the calculation that the Company provided to us and the information provided in the Capital Budget application. The other components of the forecast 2004 and 2005 calculations, which are not susceptible to complete verification, have been compared to the 2002 and 2003 actual figures and have been reviewed for reasonableness. The average rate base is increasing primarily due to increased plant investment, as well as an increase in average deferred charges which will be discussed later in this report. Based on our review, the plant investment component and other components are reasonable in comparison to the prior years.

Forecast Return on Average Rate Base

The forecast rate of return on average rate base for 2005 as determined by the company and provided in Schedule F of its Application is calculated correctly as per Order No. P.U. 19 (2003)

Forecast Deferred Charges

In compliance with P.U. 19 (2003), Newfoundland Power Inc. has filed evidence with the Board relating to its forecast deferred charges, including pension costs, to be included in the calculation of the forecast average rate base for 2004 and 2005.

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We confirm that, as indicated by the Company, the forecast deferred charges for 2004 have increased from the forecast that was filed in conjunction with the Company’s 2003 General Rate Hearing. The increase of \$1.4 million is due to an increase related to the normal operation of the weather normalization account (\$1.9 million) offset by a reduction in deferred pension costs (\$0.5 million).

The deferred charges for forecast 2004 and 2005 as presented by the Company are as follows:

(000’s)	Actual 2003	Forecast 2004	Forecast 2005
Weather Normalization Account	\$ 10,435	\$ 11,368	\$ 10,242
Deferred Regulatory Costs and Other	693	347	0
Unamortized Debt Discount & Expense	3,370	3,171	3,721
Unamortized Capital Stock Issue Expense	392	325	261
Deferred Pension Costs	<u>72,787</u>	<u>79,218</u>	<u>85,973</u>
Total Deferred Charges	<u>\$ 87,677</u>	<u>\$ 94,429</u>	<u>\$100,197</u>

Source: Newfoundland Power Inc.- 2005 Capital Budget Application
Report on and Rate Base Deferred Charges- Table 1 (pg. 1 of 5)

We have reviewed the information provided by the Company relating to the deferred regulatory costs; the unamortized debt discount and expense; and the unamortized capital stock issue expense for continuity and reasonableness. Based on our review, we have not noted any discrepancies or unusual items. As explained by the Company in their submission, the primary reasons for the changes in these balances are as follows:

- The reduction in deferred regulatory costs in 2004 and 2005 is attributable to the amortization of approximately \$1 million in hearing costs that began in 2003.
- The decrease in unamortized debt discount and expense in 2004 is due to regular amortization of these costs over the life of the debt issue. These costs are then forecast to increase in 2005 due to an expected debt issue of \$75 million of 30 year first mortgage bonds late that year.
- The unamortized capital stock issue expense is decreasing due to regular amortization of these costs.

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Our comments with respect to the Weather Normalization Account and Deferred Pensions Costs are noted below:

Weather Normalization Reserve

The changes in the forecast weather normalization reserve for 2004 and 2005 reflect the Board's approval in P.U 19 (2003) to amortize the recovery of the \$5.6 million non-reversing balance in the Hydro Production Normalization Reserve over a period of five years (\$1.126 million annually). The normal operation of the Degree Day Normalization Reserve and the Hydro Production Equalization Reserve up to July 2004 has resulted in an overall increase of \$2.059 million which is reflected in the 2004 forecast. The 2004 and 2005 forecasts assume normal weather conditions from August 2004 through December 2005.

Based on our review of the forecast weather normalization reserve, we confirm that we have not noted any discrepancies or unusual items. The information filed by the Company is consistent with prior years.

Deferred Pension Costs

Deferred pension costs is the most significant component of the deferred charges and is the result of the pension funding exceeding the pension expense as determined in accordance with the recommendations of the Canadian Institute of Chartered Accountants (CICA).

According to table below, the pension plan funding for the 2004 and 2005 forecast is \$9.751 million and \$9.978 million and the forecast pension plan expense is \$3.320 million and \$3.223 million for 2004 and 2005 respectively. The difference between the funding and the expense as indicated below represents the increase in deferred pension costs for forecast 2004 and 2005.

	Forecast 2004	Forecast 2005
Deferred pension costs, January 1 st	<u>\$72,787</u>	<u>\$79,218</u>
Pension plan funding:		
- Current service funding	3,367	3,594
- Special funding	<u>6,384</u>	<u>6,384</u>
Total pension plan funding	9,751	9,978
Pension plan expense	<u>(3,320)</u>	<u>(3,223)</u>
Increase in deferred pension costs	<u>6,431</u>	<u>6,755</u>
Deferred pension costs, December 31	<u>\$79,218</u>	<u>\$85,973</u>

Source: Newfoundland Power Inc.- 2004 Capital Budget Application

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With regards to the pension plan funding, we have agreed the current service funding requirement for 2004 to the information provided by the independent actuary. The 2005 forecast current service funding is reasonable in comparison to 2004. The special funding consists of two components; a special funding requirement of \$5.970 million as determined by previous Board Orders and Letters of Approval; and \$0.414 million of special funding as determined by the Company's actuary in accordance with CICA guidelines. Details of the special funding requirements were reviewed during the 2003 General Rate Hearing. The special funding in the 2004 and 2005 forecasts is consistent with previous years.

In P.U. 35 (2003) the Board directed the Company to file a report addressing the amortization period in respect of the unfunded pension liability (i.e. the special funding). With respect to the amortization period the Board issued several information requests seeking additional information on the implications of the amortization period chosen. These requests were still outstanding at the time this report was finalized and we will review the responses when received and provide further comment on this item, if necessary.

The forecast pension expense for 2004 and 2005 is \$3.320 million and \$3.223 million respectively. Based on our review of information provided by the Company we find that forecast pension expense is calculated in accordance with the recommendations of the CICA, and is determined in a manner consistent with prior years and Board Orders. It is important to note that the final pension expense for 2005 cannot be determined until after December 31, 2004. In accordance with CICA recommendations, the 2005 expense will be determined based on the market value of pension plan assets as of December 31, 2004, and as well the discount rate that is required to be used in the calculation will be the actual market rate of interest at December 31, 2004.

Based on our review of forecast deferred pension costs, we confirm that we have not noted any discrepancies or unusual items. The information filed by the Company is consistent with prior years.

I trust this is the information you requested. If you have any questions please contact me.

Yours truly,

GRANT THORNTON LLP



Bill Brushett, FCA
Partner

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