Q. Please provide a copy of Newfoundland Power's policy for General Expenses Capitalized including a copy of the most recent review supporting the policy development.

A. On August 11, 1995, Newfoundland Power requested that the Board approve a change in the basis of allocation of costs to General Expenses Capitalized ("GEC") from the full cost method to the incremental cost method of allocation. The resulting Order No. P.U. 3 (1995-96), a copy of which is provided as Attachment A, sets forth the guidelines approved by the Board and used by the Company to determine expenses included in the GEC category.

The guidelines approved by the Board in Order No. P.U. 3 (1995-96) were confirmed in Order No. P.U. 36 (1998-99). That Order states:

> *"The Board agrees that there is no reason to revise or modify the accounting methodology regarding GEC and, therefore, concludes that its previous order adequately addresses the situation."*

Attachment B provides a copy of pages 25 to 27 of Order No. P.U. 36 (1998-99).

The most recent review supporting the policy development was the *Board of Commissioners of Public Utilities 2000 Annual Financial Review of Newfoundland Power Inc*. The review states:

> *"Based upon the results of our review and assessment, we have determined that the Company is in compliance with Board Order P.U. 3 (1995-96) for 2000."*

Attachment C provides a copy of the *Board of Commissioners of Public Utilities 2000 Annual Financial Review of Newfoundland Power Inc.*[1]

[1] See pages 15-16.

Order No. P.U. 3 (1995-1996)

NEWFOUNDLAND AND LABRADOR

AN ORDER OF THE BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

NO. P.U. 3 (1995-96)

IN THE MATTER OF THE PUBLIC UTILITIES ACT, 1990

AND

IN THE MATTER OF THE APPLICATION OF NEWFOUNDLAND LIGHT AND POWER CO. LIMITED FOR AN ORDER APPROVING CERTAIN POLICIES CONCERNING CAPITALIZATION OF GENERAL EXPENSES, INCOME TAX ACCOUNTING, PENSION FUNDING AND ACCOUNTING, AND RELATED MATTERS.

THE APPLICATION

On August 11, 1995, Newfoundland Light and Power Co. Limited (the Applicant) filed an application requesting an Order of the Board:

(i) approving for regulatory purposes, effective January 1, 1995, the Applicant's allocation of deferred taxes to account for timing differences arising out of differing treatment of General Expenses Capitalized (GEC) for the purposes of regulatory accounting and income tax accounting, except for that part of GEC which is related to pensions;

(ii) approving for regulatory purposes the Applicant's provision in 1995 of additional funding of its defined benefit pension plan in the amount of $12,000,000;

(iii) approving for regulatory purposes the Applicant's provision in 1996 of additional funding of its defined benefit pension plan in the amount of $6,000,000;

(iv) approving for regulatory purposes a change in the basis of the Applicant's allocation of costs to GEC which will result in the Applicant's allocation to GEC of only those costs which are incremental costs of capital projects; and

(v) granting such alternate, additional or further relief as after consideration of the Applicant's submission and all relevant matters shall, in the opinion of the Board, appear fit and proper in the circumstances.

On September 6, 1995, the Applicant filed an amendment to its application previously filed on August 11, 1995 requesting an Order of the Board:

(i) approving for regulatory purposes a change in the basis of the Applicant's allocation of costs to GEC which will result in the Applicant's allocation to GEC of only those costs which are incremental costs of capital projects;

(ii) approving for regulatory purposes the Applicant's provision in 1995 of additional funding of its defined benefit pension plan in the amount of $12,000,000;

(iii) approving for regulatory purposes the Applicant's provision in 1996 of additional funding of its defined benefit pension plan in the amount of $6,000,000; and

(iv) granting such alternate, additional or further relief as after consideration of the Applicant's submission and all relevant matters shall, in the opinion of the Board, appear fit and proper in the circumstances.

On September 7, 1995, the Applicant submitted its evidence and the exhibits it intended to enter through its witnesses at the public hearing. Notice of the application and hearing was given in the newspapers circulated throughout the Applicant's service territory. This notice advised the public that the Board would conduct Phase 1 of the Hearing on the application in its Hearing Room, in St. John's on September 8, 1995.

The Phase 1 Hearing was called by the Board to bring together the Applicant and the Intervenors of record at the time. The purpose of the Phase 1 Hearing was to give each party an opportunity to indicate the nature of their evidence, to obtain or give notice of their intention to obtain information, to indicate whether they intended to call expert witnesses and to agree on a time, date and place for commencement of Phase 2 of the Hearing into the application.

At Phase 1 of the Hearing, Peter Alteen, LL.B., appeared for the Applicant; Geoffrey Young, LL.B., appeared for Newfoundland and Labrador Hydro Corporation (Hydro); and Sean Hanrahan, LL.B. was present as Counsel to the Board.

It was decided to commence Phase 2 of the Hearing in the Hearing Room of the Board at 9:30 A.M. on October 23, 1995.

The application was heard by the Board on October 23, 24 and 25, 1995.

Peter Alteen, LL.B., appeared for the Applicant.

There were no intervenors present.

The Board was assisted by Sean Hanrahan, LL.B., Legal Counsel, Raymond G. Noseworthy of NKHK, Chartered Accountants and Keith S. Vance of BDO Dunwoody Chartered Accountants, Financial Consultants to the Board.

Evidence was given for the Applicant by the following officers and management:

A.F. Ryan, President and Chief Executive Officer;

K.S. Warr, Vice -President, Finance & Treasury;

L.C. Henderson, Planning Engineer;

K.P. Lawrence, Manager of Corporate Accounting.

The Applicant also called as a witness:

Mr. Keith Boocock, CA,CFE, Senior Partner, Deloitte & Touche, Chartered Accountants.

Mr. Boocock is “National Partner, Litigation Support” of Deloitte & Touche and is his firm’s Chairman of the Telecommunication Industry Service Group. Mr. Boocock served as Chairman of the CICA task force on The Application of Accounting Principles by Regulated Enterprises.

The Board called as a witness:

K.S. Vance, FCA, Executive Partner, BDO Dunwoody, Chartered Accountants.

STATUTORY GUIDELINE

The Board is constituted by way of the *Public Utilities Act, 1990* which under Section 16 thereof, mandates that it "shall have the general supervision of all public utilities..."

As to the specific application before it, the Board is guided primarily by the following provisions of the *Act*:

> "58. The board may prescribe the form of all books, accounts, papers and records to be kept by a public utility and a public utility shall keep its books, accounts, papers and records and make its returns in the manner and form prescribed by the board and comply with all directions of the board relating to those books, accounts, papers, records and returns."
>
> "64. (1) The board may, with the assistance of the engineers, accountants, valuators, counsel and others that it thinks advisable to employ, inquire into and determine the extent, condition and value of the whole or a portion of the property and assets of a public utility used and useful in providing or supplying a particular service to or for the public, as of a date to be fixed by the board.
>
> "(2) The board may determine the value of the property and assets of a public utility in accordance with the following rules:
>
> (b) where the property and assets are new property and assets created or acquired on or after January 1, 1950, the value shall be determined on the basis of the prudent original cost, with depreciation since the date of creation or acquisition;

"(2) (c) where the property and assets are property and assets other than those referred to in paragraphs (a) and (b) and were acquired on or after January 1, 1950, the value shall be determined on the basis of the prudent cost at the time of the acquisition, with depreciation since the date of acquisition.

"(4) The board may make those rules and regulations to facilitate inquiries under this section that it may consider convenient, and the rules and regulations so made are binding on all public utilities."

"78. (1) Except as otherwise provided in this Act, the board may fix and determine a separate rate base for each kind of service provided or supplied to the public by a public utility, and may revise the base.

"(2) In fixing a rate base the board may, in addition to the value of the property and assets as determined under section 64, include...

(h) other fair and reasonable expenses which

(i) the board thinks appropriate and basic to the public utility's operation, and

(ii) has, with the approval of the board, been charged to capital account,

but the expenses shall be allowed only to the extent not amortized in previous years."

"80. (3) Reasonable payments each year to former employees of a public utility who have retired and are receiving payments of supplemental income from the public utility are expenses that the board may allow as reasonable and prudent and properly chargeable to the operating account of the public utility.

(4) The board may use estimates of the rate base and the revenues and expenses of a public utility."

The Board interprets the foregoing statutory provisions to mean that the Board has the responsibility to ensure that public utilities provide reasonably adequate service responsive to public need. Operating and capital expenditures of the public utility must be reasonable and prudent for the purpose of providing such services and the means of recording those expenses and capital expenditures may be prescribed by the Board. Expenses relating to retired former employees, that are reasonable and prudent, are properly chargeable to the operating accounts of the public utility.

The Board will be guided by the foregoing provisions in its consideration of this application.

BASIS OF APPLICATION

By Order No. P.U. 6 (1991) the Board ordered the Applicant to continue to apply the previously approved basis of accounting for GEC without any reduction to its annual allocation. The full cost method of capitalizing general expenses has been utilized by the Applicant since 1967. This basis of accounting has been reviewed in the past and currently involves the capitalization of such expenses as: Tools and Instruments, Operating Supervision and Miscellaneous, Linesmen's Rubber Goods Testing, Free Issue, Head Office Accounting, Printing and Stationery, Corporate Effectiveness, Management Information System Expenses, Human Resources, Safety Meetings, Training and Educational Costs, Apprentice Training, Coffee and Lunch Room Supplies, Administration, Internal Audit and Building Operations. These allocations to capital assets have risen from $0.4 million in 1967 to a high of $11.5 million in 1992. The percentage of GEC as a percentage of Gross Capital Expenditures has risen from

6% in 1967, rising sharply to 13% in 1978 and more sharply in 1984 to 22%. In 1994, GEC was 28% of Gross Expenditures. (See Exhibit 1 on the page opposite.) The Applicant seeks approval of a change in its accounting allocation methodology for GEC from the full cost method to the incremental method. The change in accounting methodology is proposed to be phased in gradually, to minimize the effects on rates.

In 1993, the Applicant implemented an early retirement program in its overall effort to control costs and avoid rate increases. This program was undertaken to reduce the size of its work force in line with the low sales growth and its attempt to achieve greater efficiency. A total of 120 employees retired under the terms of the program. In 1992, the Applicant had total labour costs of permanent, temporary and contract staff, including overtime, of $54 million. These costs in the Applicant's 1995 forecast are now $46 million. The Board approved of the program in December 1993, however, the Board stated at that time that the program costs and benefits would be reviewed at the Applicant's next public hearing. The Applicant seeks approval of its early retirement program and its related expenses, as a prudent and reasonable program.

By Order No. P.U. 37 (1984) the Board ordered that past service costs under the contributory funded defined benefit pension plan, adopted April 1, 1984, were reasonable and prudent expenses properly chargeable to its operating account. By Order No. 17 (1987), the Board approved the use of the "management best estimate approach", which was in accordance with the CICA recommendations, as the accounting methodology for pension costs. In 1984 the Applicant's past service unfunded liability was approximately $48 million, which was to be funded over a 25 year period. The Applicant proposes to accelerate the funding in 1995 and 1996. The Applicant has filed net present value analysis in support of this accelerated funding plan.

GENERAL EXPENSE CAPITALIZED

The Applicant, a distribution utility primarily, annually undertakes a capital construction program. During a period of high growth, this program can be a significant portion of the Applicant's operation. In more recent years, however, sales growth has been low, therefore resulting in a smaller capital program. At previous hearings the Applicant has petitioned the Board to reduce the allocation of GEC. The Applicant believes that less general expenses should be allocated to capital assets. Also the Applicant believes that its capitalization policy results in approximately three and one half times more capitalization of general expenses than other similar utilities. The Applicant seeks a more moderate policy, through the use of the incremental basis of capitalization.

The Board has identified four issues with respect to the accounting for GEC arising from the hearing. These issues are:

(i) the theoretical basis upon which GEC should be allocated, namely the appropriateness of full cost accounting versus incremental accounting;

(ii) the identification of general expenses which are related to the capital program and therefore should be allocated to capital;

(iii) the allocation percentages to be applied to capital assets; and

(iv) if a change in methodology should be deemed appropriate, over what period should a transition in policy take place.

(1) **Theoretical basis for allocating General Expenses to capital assets**

Accounting theory has developed two appropriate bases on which to capitalize general expenses to capital assets in companies which carry out self-construction. These bases are the full cost method or the incremental method. Both methods have equal acceptability in theory, however, the current trend amongst utilities appears to favour the adoption of the incremental basis.

The full cost basis suggests that general overhead, required to run an enterprise capable of carrying out a capital program, would be eligible for allocation. Any expense directly related to carrying out a capital program would be capitalized, as would common costs that benefit both the operation and capital program of the utility. The rate of allocation would be determined on a rational basis related to the accounts involved. These common costs would include expenses that may be affected in any way by the size or extent of the capital program.

The incremental basis is similar to full cost in that all costs directly attributed to a capital program would be allocated but it also allocates certain common costs as well. The difference is that the costs allocated must be expenses that are incremental to the utility as a result of carrying out a capital program. The following item is an example that distinguishes the two bases of account. If a utility must employ a general accountant, regardless of whether a capital program was carried out, then the incremental basis would not allocate any portion of that staff accountant's salary or benefits. The full cost method may allocate a portion of the accountant's salary and benefits, because the accountant spends some time accounting for the capital program. Consequently, the incremental basis of accounting capitalizes fewer general expenses than does the full cost method.

Mr. Boocock conducted a survey of 12 other utilities in Canada and determined that five of twelve utilities use the incremental approach, two use a hybrid approach and five appear to use a full cost basis. Ten utilities capitalize general expenses at a rate of less than 12% of the gross capital expenditure. The Applicant indicates GEC is approximately 28% of their gross capital expenditure. The Applicant is the only utility which includes pension costs in the GEC allocation. There is a trend of utilities switching from full cost to the incremental basis over the last twenty years. Mr. Boocock recommends that the utility follow the incremental approach. Costs which are not incremental would be expensed.

Mr. Vance also provided evidence before the Board. Mr. Vance provided the following direct testimony:

"The two basic observations that we made in this regard were that firstly, the General Expenses Capitalized did not seem to bear any direct relationship to the amount of construction activity undertaken and secondly, the allocation of these costs amongst the capital asset categories was such that the amount that ultimately ended up being charged to distribution assets was merely by difference as for a number of other asset categories, the amounts of GEC's to be added to these categories were restricted to specified percentages and then the remaining balance of General Expenses Capitalized was merely added to distribution assets regardless of the relative level of construction activity."...

"I felt that the amounts being allocated to GEC were somewhat excessive and that the manner of allocating these costs to the various departments or assets categories did not seem to have a logical rationale. Neither bore any relationship to the acquisition of capital assets in a given year."....

"...from the perceptive of generally accepted accounting principles (GAAP), I feel the proposed changes would result in the Applicant's accounting policies more closely parallelling generally accepted accounting principles than would be the case if the Applicant remained on a full-cost allocation to GEC."

The Board has considered the evidence before it and the final argument of the Applicant. It appears that while the full cost method is acceptable and theoretically sound, the manner in which it has been applied has resulted in an excessively high allocation of general expenses, particularly when compared with other utilities. Regulatory practice has seen a noticeable shift toward the incremental method. The risk of a method that capitalizes high amounts of overhead, would be to disadvantage future generations who would ultimately be asked to bear these costs. Consequently, the Board accepts the proposal of the Applicant to change its accounting policy with respect to GEC to the incremental basis.

(2) **Incremental accounts to be capitalized**

During the hearing the Board heard evidence with respect to which accounts were incremental to the capital program. The Applicant had conducted a survey of its staff involved in the departments that had previously capitalized overhead. These staff were asked to consider which of their accounts and staff would be truly incremental to the capital program, i.e. which costs would not be incurred if there were no capital program. The Applicant submitted Exhibit KB-6, which details the result of the survey and its consequential effect of allocating general overhead on an incremental basis.

The Applicant has presented the accounts presently being transferred through general expenses capitalized to capital asset accounts in Exhibit KSW-1. These costs have been reviewed by the Applicant's Corporate Accounting Division in preparation for the public hearing.

Demand for particular PUB-9 states:

"Exhibit KB-6 was prepared by the Applicant's Corporate Accounting Department and is an analysis on a department by department basis, of costs which would be incurred if there were no capital program. If costs would be incurred by the Applicant even if there were *no* capital expenditures, then those costs do not vary with the level of capital expenditures. Put another way, annually occurring costs which do not vary with capital expenditures ought to be treated as operating expenses."

During the course of the hearing attention was drawn to these accounts, the manner in which incremental accounts were selected and the manner in which incremental items were valued.

The Board is persuaded to approve the incremental basis for accounting for General Expenses Capitalized. It believes the numbers must be based on sound judgement of what is incremental from the theoretical position of absolutely no construction or capital program. The Board had accepted in the past the merits of full costs, however, in light of low sales growth and diminished capital programs, full cost appears to be excessive. This does not mean the Board wishes to minimize capitalization, since to do so would burden today's customers with the costs associated with delivering services long into the future.

Evidence was provided by Mr. Ken Lawrence. On page 47 of the transcript of October 25, 1995 Mr. Lawrence indicated how the Applicant determined how much incremental costs would be for a particular incremental item.

Question:

"Does that go against the basic philosophy of what incremental represents, which is the incremental effect of not having the capital program and the incremental effect is to lose the full salary, because we're no longer worried about full cost?"

The answer of Mr. Lawrence was:

"Technically speaking you are correct if we had no construction; however, this isn't intended to show a picture of if we had absolutely no construction, this is intended to show what would happen in 1995 if we were following the incremental method. You know, the amount of work was the same regardless of the accounting treatment of it, and that technician would be on and the other people would be on."

Hence, the Board believes some of the potentially incremental costs were not fully picked up by the Applicant in Exhibit KB-6. These omissions occurred through capitalizing only a portion of an incremental staff person's salary, overhead and benefits, which is inconsistent with the philosophy of the incremental basis; or through dismissing items summarily without a full theoretical analysis. The Board has reviewed the accounts and evidence and considers the following items to be appropriately included as incremental.

CONSTRUCTION ACTIVITIES

Direct charges to GEC by Time Sheet Employees:

The Exhibit KB-6, pages 2 and 3 disclose the time sheet employees who have charged time directly to the capital program. The Applicant assigned an incremental value to these staff costs. The incremental theory applied suggests that these staff members would not be required if there was no capital construction. It was evident from the evidence that the rule was not appropriately applied to the staff that do not spend their full job hours at capital programs. This is in error. If these staff were not required, Mr. Lawrence explained the balance of their non-construction work assignments would be shared amongst other staff. Therefore, the Board is convinced the full cost of those staff persons, including benefits, shall be capitalized under the incremental program. The staff considered to be incremental are:

Power System Development

- Five engineering technicians
- Assistant Property negotiator
- Surveyor

Avalon Region

* Two engineering technicians

Eastern Region

* Two engineering technicians

Since only labour charges greater than $10,000 were analysed, the Applicant increased their figure by an equal proportion for those charging less than $10,000. This increase amounted to $158,000. This proportion also must be equated to full positions in a reasonable manner.

Exhibit KB-6, pages 4 - 8 detail the costs associated with incremental general expenses related to capital programs. Once again, the Board is of the opinion that the incremental method dictates all of the salary and benefits and allocated percentage overhead per staff person required for the capital program should be capitalized, not a portion of their salary.

Incremental costs are deemed to include:

Distribution systems and services:

*	Superintendent of Distribution Standards	$56,871
*	Engineering Technician	$50,470

St. John's Region

*	Technical Supervisors	$60,285

Eastern Region

*	Engineering Technician	$50,471
*	Engineering Technician	$50,471
*	Technical and Maintenance Supervisor	$60,287

Western Region

*	Three Engineering Technicians	$154,413

Power System Development

*	Technical Specialist	$56,284

Tools, Equipment and Clothing, Linesmen's Rubber Goods and Free issue appears reasonable as proposed, but capitalized labour should include any adjustments referred to in this Order as well as any consideration for free issue or tools and the like to any contractors engaged to conduct construction activities.

NON-CONSTRUCTION ACTIVITIES

Accounting:

The Applicant has argued on KB-6, page 9 that there would be no reduction in accounting staff if gross capital expenditures were reduced to zero. This is a reduction of $35 million in expenditures. The Board notes that total curtailment of construction would also eliminate the need to come before the Board for a capital budget review and should eliminate the need for many new Bond issues other than refinancing. It seems unrealistic to suggest that such a dramatic reduction in expenditures, approximately 70% of "other expenses", would not eliminate even one staff member and the associated benefits and overhead. Therefore the Board does not accept the

Applicant's position on this matter and requires that the matter be addressed and included in GEC's.

Printing:

The Applicant has provided a similar argument for printing as it did for accounting. The Applicant recognizes that some capital related work is still performed by the Printing Department. If the vast majority of printing is customer service related, then a nominal rate of 10% of printing costs seems an appropriate and reasonably expected amount to be eliminated if no capital program was undertaken. The Board accepts such a nominal rate as reasonable.

Corporate Effectiveness:

In Exhibit KB-6 the Applicant provided its rationale for not capitalizing corporate effectiveness costs. The Board accepts this rationale.

Management Information System Costs:

The rationale for not capitalizing any supervision, computer operations and system development and support is provided on page 10 of Exhibit KB-6. The Board accepts the rationale for the computers and software expense provided that the portion of these expenses associated with the staff identified earlier as incremental staff are included in the benefits and overhead associated with their costs.

Personal Illness, Employee Welfare, Employee Relations, Safety Meetings, Training and Education, Apprentice Training and Coffee Supplies:

These accounts should be allocated to capital on the basis of "capital labour" plus all labour transferred through GEC as a percentage of total labour costs. Presumably these costs vary in relation to staff employed. Hence, the Board deems this overall approach to be reasonable.

Human Resources Planning and Administration and Services:

These costs comprise: publishing Tie Lines, Human Resources Planning and Administration, Health and Safety, Training Sections, Employee Relations. According to Exhibit KB-6, the Applicant suggests these costs are unaffected by the capital program.

The Board accepts this logic with respect to Tie Lines and health and safety costs. However, the Board notes that 50% of the utilities who provided GEC details in the Deloitte Touche survey, capitalized a portion of human resources. The Board believes the staff involved in a minimum capital program of $35 million would still attract overhead costs through human resources. The Board deems it necessary for the

Applicant to review these departments again to determine, if there was no capital program, to identify which costs would be eliminated.

Administration:

The Board agrees that administration is not likely to incur incremental costs.

Internal Audit and Miscellaneous Administrative Costs:

The Board agrees that there would be no incremental costs in these areas that would be material.

Building Rental, Operation and Repairs, Ground Maintenance, Snow Clearing and Warehouse Operation and Repairs:

In the event of no capital program, all direct construction employees and an identifiable number of general employees would be eliminated. Therefore, less office and warehouse space is required and any surplus space could be eliminated from space currently leased. It does not appear reasonable with $35 million of activity eliminated, the Applicant would still require as much rented space elsewhere. A rational approach should be used to determine how much rental space could be eliminated for the purpose of this incremental cost exercise.

Applicant Pension Plan:

The rationale provided for $362,000 being charged to capital from pension expenses appears reasonable and is deemed acceptable by the Board.

In summary, the Board accepts the approach provided by the Applicant in identifying their incremental cost with some aforementioned adjustments. The Applicant shall make all identified adjustments and file the revised schedule similar to Exhibit KB-6, together with explanatory notes, with the Board on or before February 28, 1996. The changes identified in this section should be compiled from January 1, 1995 and phased in as specified in the later section of this Order on Transition and Phase-In.

ALLOCATION TO CAPITAL ASSETS

The Applicant has allocated GEC on the basis of: 10% to hydro assets, 10% to diesel assets, 20% to substations, 22% to transmission, 5% to general property, 5% to transportation, 20% to communication, and 5% to computer and software costs. Any balance in GEC not allocated to the aforementioned accounts is transferred to Distribution Assets. In periods with minimum capital programs, less is allocated to the specific assets and a disproportionate share is thereby transferred to distribution. (See Boocock's direct evidence page 29.)

Mr. Boocock recommended a flat GEC percentage common to all asset classes.

The percentage would vary each year in accordance with the value of the underlying incremental general expenses. Mr. Vance stated in his direct evidence on GEC, page 3, that the manner of allocating these costs to the various departments or asset categories did not seem to have a logical rationale. Mr. Vance concurred with Mr. Boocock's proposal to apply a flat rate to each asset category.

The Board has considered the evidence and expert opinions on the allocation to the various capital asset classes and approves of the proposed flat rate allocation of GEC.

Transition and Phase-In of the New Incremental Approach to Allocating GEC

Due to the significant impact of changing to the incremental method, which could result in a rate impact of 3.9% according to the evidence of K.S. Warr, page 9, a phase-in period has been recommended by the Applicant and expert witnesses. In order to accomplish the phase-in, the Applicant must keep track of both the full cost allocation and incremental allocation throughout the period.

The Applicant and its expert witness recommend a phase-in period of three years, including 1995. The Board's expert witness believes a transition period of three years is on the aggressive side and recommended a five year time frame as more suitable.

The Board is concerned with a rate impact of 3.9% caused only by a change in accounting methodology. As both accounting methods are in use by Canadian utilities, and both methods are theoretically sound, it does not seem appropriate to implement the method on a fast track. Therefore, the Board concludes a five year phase-in beginning at January 1, 1995 is appropriate.

During the phase-in period, the Applicant shall maintain records of the GEC using both methods. In 1995, GEC will be the incremental amount plus an adjustment of 80% of the difference between full cost and incremental amounts. Each year thereafter, the adjustment will be reduced by 20% until 1999 when only incremental costs will be allocated. The Applicant may determine how specific general expense costs may be adjusted over this period, providing the total impact arrives at the phase-in schedule described in this paragraph.

With respect to allocation to specific capital assets, the Applicant's proposal is deemed to be appropriate, bringing the benefit of transition to the distribution assets first.

FUNDING OF THE UNFUNDED PAST SERVICE PENSION PLAN

The Applicant has proposed to accelerate their payments toward their Unfunded Pension Plan at a rate of $12 million as of December 31, 1995 and $6 million as of December 31, 1996. This proposed payment would have an impact on the Applicant's after tax net income for those years.

Mr. Lorne Henderson presented a net present value analysis of the proposed additional funding. This analysis concluded that as long as pension assets earned an average annual return of 8.4%, this funding plan would not cost the Applicant any more than the present schedule of funding. The net present value analysis utilized a discount rate of 8.88%. This discount rate uses a 9.5% before tax cost of debt and a 12.25% return on common equity.

Mr. Vance agreed with the evidence presented and explained that the additional payments serve to earn income as pension assets, which directly reduces the pension expense in subsequent years, as compared to paying according to the present schedule of payments. This reduced pension expense would offset the interest expense incurred from the borrowing necessary to finance the additional funding.

The Board has evaluated the evidence set before it regarding the proposed additional funding to the defined benefit pension plan. The Board notes that Consent Exhibit No. 1 indicates for each year commencing in 1996 through to 2020, the pension expense is reduced significantly. This fact, together with the favourable net present value analysis, indicates the funding will not impact adversely on any ratepayer group.

The Board approves of additional pension funding of the defined benefit pension plan up to $12 million as of December 31, 1995 and up to $6 million in additional pension payments as of December 31, 1996. The Applicant shall file an affidavit indicating the amounts actually paid and a revised net present value statement to indicate the actual amounts disbursed. These affidavits shall be filed on February 28, 1996 and again on February 28, 1997, respectively.

EARLY RETIREMENT PROGRAM

In 1993, the Applicant undertook an early retirement program in which 120 of the Applicant's employees retired. The Applicant had filed all information leading up to the early retirement program with the Board. The Board approved of the Applicant proceeding with the program with the results to be reviewed at the Applicant's next public hearing.

The Applicant has filed information in support of the reasonableness and prudence of the program. Consent Exhibit No. 18 indicates contractor costs appear to be consistent or below levels in place in the early 1990's, with the exception of 1994 when unusual expenses arose with respect to the December sleet storm as well as with a special brush clearing program. Consent Exhibit No. 17 indicates that both gross and net early retirement savings in salaries and pension costs were above those originally forecast and presented to the Board in 1993. This is true for 1993, 1994 and 1995. Consent Exhibit No. 16 provides a pay back analysis on the early retirement program. This pay back analysis employed a net present value approach. This analysis indicates that as of December 31, 1995 the early retirement program already had netted more benefits ($259,773) than its all associated costs through to 2004. Each year that follows will increase the net present value to the Applicant. If the present trend continues, the program should exceed the benefits originally filed with the Board, amounting to approximately $14 million as its net present value.

Consent Exhibit No. 11 indicates that from June 1993 until June 1995 staff positions have fallen by 128 full time equivalents, after giving affect to increases in temporary positions in "full time position." Consent Exhibit No. 12 indicates from December 1992 to August 1995, approved positions have decreased by 160 positions, total regular positions filled by full time or temporary staff have decreased by 145 positions and total employees including temporary staff in temporary positions have decreased by 118 positions.

The Board finds the program has proven to be reasonable and prudent to date. The Board requires the Applicant to continue to file Exhibits in the format shown in Consent No. 12, and Consent Nos 16 - 18 by April 30 of each year indicating the annual progress of the early retirement program.

COSTS

The Applicant will be ordered to pay the expenses of the Board arising out of the hearing.

IT IS THEREFORE ORDERED THAT:

1. The accounting policy to be applied for the purpose of capitalization of general expenses, will be the incremental basis which will result in the Applicant's allocations to capital assets of only those costs which are incremental costs of capital projects.

2. Overhead costs will be considered to be incremental costs of capital projects to the extent they vary with the level of construction as compared to no capital projects whatsoever. Otherwise the overhead costs are expenses of the period in which they are incurred.

3. The guideline for capitalization of general expenses are set out on pages16 - 22 of this Order. The Applicant will follow these guidelines to the extent practicable.

4. General Expenses Capitalized will be allocated to hydro assets, diesel assets, substations, transmission, general property, transportation, communication, computer and software assets, and distribution assets through a flat rate.

5. The change in accounting policy for general expenses capitalized to the incremental basis, from the full cost method, will be phased in over the period January 1, 1995 to December 31, 1999. In 1995, GEC will be the incremental

5. (con't)

amount plus an adjustment of 80% of the difference between full cost and incremental amounts. Each year thereafter, the adjustment will be reduced by 20% until 1999 when only incremental costs will be allocated. The Applicant may determine which specific general expense costs are adjusted during the period of transition, providing the total impact arrives at the phase-in schedule described above. With respect to allocation to specific capital assets during the period of transition, the Applicant shall allocate the reduction in GEC to distribution assets first.

6. Additional pension funding toward the Applicant's Unfunded Pension Liability is approved up to a limit of $12 million in 1995 and $6 million in 1996. The Applicant shall file an affidavit with the Board subsequent to each years funding indicating the actual additional amounts contributed together with a revised net present value analysis reflecting the actual additional contribution.

7. The Applicant shall file annually with the Board a report tracking the results of the early retirement program.

8. The Applicant shall pay the expenses of the Board arising out of this hearing.

Dated at St. John's, Newfoundland this 11th day of December, 1995.

David A. Vardy,
Chairperson.

Leslie E. Galway, C.A., ~~M.B.A.~~,
Vice-Chairperson.

Wallace S. Read
Commissioner.

Carol Horwood,
Clerk.

Order No. P.U. 36 (1998-1999)
Pages 25-27

conductors, connections and equipment, and permits pro-active measures to be taken to avoid outages and improve overall quality of service.

In 1998, a Telephony Video Data ("TVD") system was implemented to improve customer service by providing automated voice messages to 255 callers simultaneously in each of NP's eight operating areas during widespread power outages. In 1999, further development of the TVD system will enable it to send automatic notices to specified customers who are highly dependent on their power supply.

Combined with new call centre technologies, NP has undertaken the cross-training and development of employees in order to facilitate the implementation of a number of improvements in the customer service area.

General Expenses Capitalized ("GEC")

During a hearing in 1989, NP informed the Board that it was studying its GEC policy because it was capitalizing costs that other Canadian utilities normally treat as expenses and, therefore, its GEC policy was out of line. NP was ordered to carry out a further study and report to the Board at the next rate hearing. The results of that study were presented at the 1991 rate hearing at which time the Board ordered that NP present a more detailed and documented proposal at the next hearing.

In the fall of 1995, after completing a detailed study, NP applied to the Board, *inter alia*, to seek approval of a more moderate policy for capitalization of general expenses. They proposed to abandon the full allocation method, which had been in effect since 1969, in favour of allocation on an incremental basis. Since changing to the incremental method could result in a rate impact of 3.9%, a phase-in period of three years was recommended by NP and expert witnesses. The expert witness appearing for the Board, at the time, proposed a phase-in period of five years which the Board felt was less aggressive, and subsequently ordered the five-year phase-in period to commence on January 1, 1995[P.U.3 (1995-96)].

P.U. 3 (1995-96) also set out guidelines for the capitalization of general expenses and, ordered that overhead costs would be considered to be incremental costs of capital projects, to the extent that they vary with the level of construction, as compared with no capital projects whatsoever, and that otherwise the overhead costs are expenses of the period in which they are incurred.

GEC will be allocated to hydro assets, diesel assets, substations, transmission, general property, transportation, communications, computer and software assets, and distribution assets through a flat rate.

The consumer advocate argued that, "these GEC figures should be re-calculated using the actual ratios for 1999, and these new ratios will indicate that more money should be sent to capital than is presently booked for 1999, and that this will, accordingly, lower the operating expenses of the company for 1999, and with that lower the revenue requirement".(transcript, Dec. 8, p. 28 and 29)

In P.U. 3 (1995-96), the Board recognized that the company would have to determine how specific general expense cost ratios may have to be adjusted over the period of the five year phase-in from a full cost basis to an incremental cost basis and, thereafter, any adjustments to the ratios was intended to be at the discretion of NP.

Prior to the commencement of this hearing the Board, in accordance with its usual practice, commissioned its financial consultant to carry out a financial analysis of the pre-filed evidence of NP and submit a report to the Board, which became a part of the official record of this hearing. At page 47, the report states that the change in accounting policy, from full cost allocation to incremental cost allocation, directly impacts the level of net operating expenses and net earnings through a reduction of transfers to GEC. The impact of this change on the financial results of NP is as follows:

Transfers to GEC/DSM/Stores (000's)

	Actual			Forecast	
	1995	**1996**	**1997**	**1998**	**1999**
Full cost accounting	$8,800	$7,913	$7,362	$6,859	$7,035
Incremental cost accounting(phase-in)	7,392	5,317	4,103	2,836	2,054
Increase in operating expenses	**$1,408**	**$2,596**	**$3,259**	$4,023	$4,981

Source: Grant Thornton report, p.48, Oct. 23, 1998

Grant Thornton concluded that GEC as forecast for 1998 and 1999 appears reasonable.

The Board agrees that there is no reason to revise or modify the accounting methodology regarding GEC and, therefore, concludes that its previous order adequately addresses the situation.

<u>**Labour Costs**</u>

Mr. Ludlow testified that total labour costs, which include permanent, temporary,

2000 Annual Financial Review

Grant Thornton LLP
Chartered Accountants
Management Consultants
Canadian Member of
Grant Thornton International

Grant Thornton

Board of Commissioners of Public Utilities
2000 Annual Financial Review of Newfoundland Power Inc.

Contents

Introduction

This report to the Board of Commissioners of Public Utilities ("the Board") presents our observations, findings and recommendations with respect to our 2000 Annual Financial Review of Newfoundland Power Inc. ("the Company") ("Newfoundland Power").

Scope and Limitations

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

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

2. Review the Company's calculations of return on rate base, return on equity and capital structure and interest coverage to ensure that they are in compliance with Board Orders.

3. Conduct an examination of operating and general expenses, purchased power, depreciation, interest and income taxes to assess their reasonableness and prudence in relation to sales of power and energy and their compliance with Board Orders.

   Our examination of the foregoing will include, but is not limited to, the following expense categories:
   - advertising,
   - bad debts (uncollectible bills),
   - company pension plan,
   - costs associated with curtailable rates,
   - demand side management,
   - donations,
   - general expenses capitalized (GEC),
   - income taxes,
   - intercompany charges (including review of compliance with paragraphs 19-23 of Order No. P.U. 7 (1996 - 97)),
   - interest and finance charges,
   - membership fees,
   - miscellaneous,
   - non-regulated expenses,
   - purchased power,
   - salaries and benefits (including executive salaries),
   - travel, and
   - amortization of regulatory costs as per P.U. 36 (1998-99).

4. Review the Company's 2000 capital expenditures in comparison to budget and follow up on any significant variances.

5. Review the Company's 2000 revenue from rates in comparison to budgets and prior years and follow up on any significant variances.

6. Review the Company's rates of depreciation and assess their compliance with the 1995 Gannett Fleming Depreciation Study. Assess reasonableness of depreciation expense.

7. Conduct an examination of rates charged to customers to determine whether any of the Company's rates are preferential and the impact, if any, on revenue requirement.

8. Review Minutes of Board of Director's meetings.

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

10. Review the Company'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 nature and extent of the procedures which we performed in our analysis 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 in the Company's records;
- examining, on a test basis where appropriate, documentation supporting amounts included in the Company's records;
- assessing the reasonableness of the Company's explanations; and,
- assessing the Company's compliance with Board Orders.

The procedures undertaken in the course of our financial analysis do not constitute an audit of the Company's financial information and consequently, we do not express an opinion on the financial information.

The financial statements of the Company for the year ended December 31, 2000 have been audited by Deloitte & Touche, Chartered Accountants, who have expressed their unqualified opinion on the fairness of the statements in their report dated January 17, 2001. 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.

System of Accounts

Scope: ***Examine the Company's system 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* permits the Board to prescribe the form of accounts to be maintained by the Company.

During our review, we examined the latest changes to the system of accounts which were filed with the Board during 2000. These revisions were related to the addition of new accounts, the deletion of older unused accounts, as well as account description changes. None of the changes are considered to be significant.

Based upon our review of the Company's financial records we have found that they are in compliance with the system of accounts prescribed by the Board. The system of accounts is comprehensive and well structured and provides adequate flexibility for reporting purposes.

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

Scope: ***Review the Company's calculations of return on rate base, return on equity, capital structure and interest coverage to ensure that they are in compliance with Board Orders.***

Calculation of Average Rate Base

The Company's calculation of its average rate base for the year ended December 31, 2000 is included on Return 3 of the annual report to the Board. The average rate base for 2000 was $520,979,000 (1999 - $505,688,000). 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 2000; and
- agreed the methodology used in the calculation of the average rate base to the Public Utilities Act to ensure it is in accordance with established policy and procedure.

Based upon the results of the above procedures we did not note any discrepancies in the calculation of the average rate base, and therefore conclude that the average rate base included in the Company's annual report to the Board is accurate and in accordance with established practice.

Return on Rate Base

The Company's calculation of the return on rate base is included on Return 10 of the annual report to the Board. The return on average rate base for 2000 was 11.19% (1999 – 10.04%). 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 established practice and Board Orders.

In P.U. 25 (1999-2000) the Board ordered that a just and reasonable return on rate base for 2000 to be in the range of 10.10% to 10.46% with 10.28% as the midpoint of the range. As noted above, the Company's actual return on rate base for 2000 was 11.19%, which was in excess of the upper limit of the approved range.

In order to comply with the regulated maximum return on rate base allowed by the Board, the Company provided for excess revenue of $6.552 million. As a result net income was reduced by $3.81 million (after tax) which reduced the return on rate base to 10.46%, the maximum allowed.

As a result of completing our procedures, we can advise that no discrepancies were noted and therefore conclude that the calculation of 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. 25 (1999-2000).

Automatic Adjustment Formula

The automatic adjustment formula that was ordered by the Board in P.U. 36 (1998-99) has been in operation for rate setting purposes since 2000. The purpose of this formula is to set an appropriate rate of return on rate base for the Company on an annual basis.

The forecast 2000 information submitted by the Company for the purpose of setting the allowed range of return on rate base of 10.10% to 10.46%, included a forecast return on equity in the range of 9.40% to 10.13%, and a cost of equity for the purpose of the automatic adjustment formula of 9.59%. Based on the actual results for 2000, the Company was able to earn a rate of return on equity of 10.80% while staying within the allowed range of rate of return on rate base.

While we have observed the differing results between return on rate base and return on equity described above we are not suggesting that this arises as a result of the utilization of the automatic adjustment formula. Overall, the use of the formula appears to work well for purposes of adjusting the allowed rate of return on rate base on an annual basis. The observed differences noted above would most likely have occurred even if the formula had not been applied. Still, the differing results for the two measures of rate of return are unexpected and merit further analysis and review.

The Company has prepared an analysis of 2000 return on rate base and return on equity which adjusts both returns for the impact of the favourable tax reassessments and the resulting excess earnings in the year. Based on this analysis, they offer the explanation that this one-time gain is a significant factor in the spread between the two rates of return. The relationship between return on equity and return on rate base is tighter with the impact of the tax reassessment removed. We agree with this observation, however, the analysis does not fully explain the widening spread between the two measures of return. As part of the required review of the operation of the automatic adjustment formula in 2002, we suggest that this matter be analyzed in more detail.

Capital Structure

In P.U. 16 and 36 (1998-99) the Board deemed the following capital structure for the Company:

Common equity: The lesser of:
(a) 45% and
(b) the projected average value of common equity

Preferred equity: Projected average value of preferred equity and any projected average common equity in excess of 45%.

In addition, the Board ordered that to the extent the common equity exceeds 45%, the excess will be deemed as preferred equity and will be allowed a rate of return of 6.33%.

Average common equity calculated for 2000 is below the approved maximum, and accordingly, no calculation for deeming excess common equity as preferred equity is required.

The Company's actual regulated average capital structure for 2000 is as follows:

	Actual 2000	
	(000's)	Percent
Debt	$ 301,108	53.46%
Preferred shares	9,890	1.76%
Common equity	252,275	44.78%
	$ 563,273	100.00%

Based on the information indicated above, we conclude that the capital structure included in the Company's annual report to the Board is in compliance with Board Orders P.U. 16 and 36 (1998-99).

Calculation of Regulated Average Common Equity and Return on Regulated Average Common Equity

The Company's calculation of regulated average common equity and return on regulated average common equity for the year ended December 31, 2000 is included on Return 19 of the annual report to the Board. The regulated average common equity for 2000 was $252,275,000 (1999 - $241,079,000). The Company's actual return on regulated average common equity for 2000 was 10.80% (1999 - 9.81%).

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 (earnings applicable to common shares; dividends; regulated earnings; etc.) to supporting documentation;
- checked the clerical accuracy of the continuity of regulated common equity, including the deemed capital structure per P.U.36 (1998-99); and,
- recalculated the rate of return on common equity for 2000 and ensured it was in accordance with established practice and P.U. 36 (1998-99).

In P.U. 36 (1998-99) the Board addressed the 1992 and 1993 excess earnings issue by ordering that an amount of $1,908,000 be established as a component of common equity on which no return would be allowed for the period 1999 – 2003. In setting rates for 2000 (under the automatic adjustment formula), the Company reduced its revenue requirement to reflect the disallowed return in compliance with the Board's Order. We reviewed these adjustments at the time rates were adjusted and found them to be appropriate. The Board's Order further states that the total amount to be recovered is $954,000 and that a review will take place before the end of the year 2003 as to the disposition of any outstanding amount. We will continue to monitor this matter on behalf of the Board as part of our annual financial reviews.

Interest Coverage

The level of interest coverage experienced by the Company over the last three years is as follows:

	(000's)		
	1998	1999	2000
Net income	$ 22,197	$ 23,484	$ 27,099
Income taxes	16,027	16,927	13,296
Interest on long term debt	24,261	27,168	26,943
Other interest	1,978	423	950
Total	$ 64,463	$ 68,002	$ 68,288
Interest on long term debt	$ 24,261	$ 27,168	$ 26,943
Other interest	1,978	423	950
Capitalized interest	563	409	338
Total	$ 26,802	$ 28,000	$ 28,231
Interest coverage (times)	2.41	2.43	2.42

In P.U. 16 (1998-99) the Board determined that a reasonable range of interest coverage is between 2.4 and 2.7 times. The Company's level of interest coverage for 2000 is 2.42 times, which is in the lower end of the above range.

Capital Expenditures

Scope: ***Review the Company's 2000 capital expenditures in comparison to budgets and follow up on any significant variances.***

The variances for the 2000 capital expenditures relative to the approved budget (P.U. 18 (1999-2000)) are as follows:

	(000's)			
	Budget	Actuals	Variance	%
Energy supply	$ 8,878	$ 8,430	$ (448)	(5.05%)
Substations	3,500	4,000	500	14.29%
Transmission	1,526	1,334	(192)	(12.58%)
Distribution	16,358	18,928	2,570	15.71%
General property	1,585	930	(655)	(41.32%)
Transportation	2,390	2,276	(114)	(4.77%)
Telecommunications	537	506	(31)	(5.77%)
Computing equipment	4,147	3,754	(393)	(9.48%)
General expenses capital	2,850	2,678	(172)	(6.04%)
Total	$ 41,771	$ 42,836	$ 1,065	2.55%

The explanations provided by the Company indicate that the capital expenditure variances for 2000 were caused by a number of factors. The more significant variances noted above were as a result of the following:

- The decrease in energy supply expenditures were primarily related to lower than expected contractor costs for the replacement of the Horsechops penstock and the deferral of the replacement of the governor and controls at Greenhill. However, offsetting these reductions were costs related to the new SCADA system and higher installation costs for sanitary holding tanks at hydro plants.

- Substations experienced an increase in capital expenditures due to public safety initiatives to upgrade fencing and signage at substations, additional site preparation work for the new St. Catherine's substation project, and higher costs related to the re-build of the Gander Bay substation. Partially offsetting these higher costs was a reduced requirement for the purchase of replacement and spare substation equipment.

- The increase in Distribution resulted primarily from increased requests for residential and commercial extensions and cottage developments, higher costs related to transformer replacements, and costs to finish the Old Perlican project delayed from 1999. Offsetting these increases were certain project deferrals, and lower than anticipated costs for rebuilds and distribution reliability projects. With respect to the customer requested extensions which account for approximately $1.7 million of the overall increase, these projects generally involve customer contributions (CIAC's) which are netted against the cost for rate base purposes.

- General property decreased in comparison to budget. This decrease reflects the fact that no projects were charged to the allowance for unforeseen items during the year, as all additional projects were included in the appropriate budget category.

While the significant overspending in Distribution appears unusual, based on our review nothing has come to our attention to indicate that the capital expenditures are imprudent or unreasonable in relation to the approved budgets included in P.U. 18 (1999-2000).

Revenue

Scope: ***Review the Company's 2000 revenue from rates in comparison to budgets and prior years and follow up on any significant variances.***

The comparison of 2000 actual revenues from rates to prior year by rate class is as follows:

	(000's)			
	2000 Actual *	1999 Actual	Difference	%
Residential	$201,825	$202,069	($244)	(0.12%)
General Service				
0-10 kW	10,400	10,342	58	0.56%
10-100 kW	44,926	44,739	187	0.42%
110-1000 kVA	51,185	50,651	534	1.04%
Over 1000 kVA	18,612	19,454	(842)	(4.52%)
Street Lighting	10,270	10,311	(41)	(0.40%)
Forfeited Discounts	2,101	2,180	(79)	(3.76%)
Total Revenue	339,319	339,746	(427)	(0.13%)
Adjustment	6,552		6,552	
Unadjusted revenue	$345,871	$339,746	$6,125	1.80%

* Revenues for 2000 are adjusted by $6.552 million to reflect the provision for excess revenue.

The actual revenues in 2000 are $427,000 lower than 1999. As noted above, revenues have been reduced by $6.552 million to adjust for the provision for excess earnings arising primarily as a result of the interest refund from Canada Customs and Revenue Agency. Without this adjustment, revenue for 2000 actually increased by $6.125 million (1.8%). Residential energy sales experienced a growth in number of customers, while commercial energy sales experienced a decrease due to the shutdown of a significant commercial customer which was substantially offset by an increase due to the growth in the fishing and oil industries.

The comparison by rate class of 2000 actual revenues to those forecast is as follows:

	(000's)			
	2000 Actual *	2000 Forecast	Difference	%
Residential	$201,825	$205,972	($4,147)	(2.05%)
General Service				
0-10 kW	10,400	10,627	(227)	(2.18%)
10-100 kW	44,926	45,185	(259)	(0.58%)
110-1000 kVA	51,185	51,413	(228)	(0.45%)
Over 1000 kVA	18,612	19,926	(1,314)	(7.06%)
Street Lighting	10,270	10,363	(93)	(0.91%)
Forfeited Discounts	2,101	2,197	(96)	(4.57%)
Total Revenue	339,319	345,683	(6,364)	(1.88%)
Adjustment	6,552		6,552	
	$345,871	$345,683	$188	0.05%

* Revenues for 2000 are adjusted by $6.552 million to reflect the provision for excess revenue.

We have also compared the forecast GWh for 2000 to the actual GWh sold in 2000.

	Actual 2000 GWh	Forecast 2000 GWh	Variance	%
Residential	2,707.0	2,713.2	(6.20)	(0.23%)
General Service				
0-10 kW	96.6	96.8	(0.20)	(0.21%)
10-100 kW	566.0	560.6	5.40	0.95%
110-1000 kVA	802.0	789.1	12.90	1.61%
Over 1000 kVA	347.8	363.9	(16.10)	(4.63%)
Street Lighting	35.4	34.9	0.50	1.41%
Total Revenue	4,554.8	4558.5	(3.70)	(0.08%)

As shown in the two preceding tables, the revenue forecast for 2000 was reasonable in terms of both dollars and GWh, showing overall differences of 0.05% (before the $6.552 million adjustment) and (0.08%) respectively.

Operating and General Expenses

Scope: ***Conduct an examination of operating and general expenses, purchased power, depreciation, interest and income taxes to assess their reasonableness and prudence in relation to sales of power and energy and their compliance with Board Orders.***

According to the Company's 2000 Annual Report, the operating cost per customer has decreased by 20% since 1991 and the 2000 gross operating cost per customer was reduced to $237 from $252 in 1999.

Schedule 1 of our report provides details of operating and general expenses (excluding purchased power) by "breakdown" for the years 1998 to 2000. This schedule shows that total gross operating expenses (before transfers to GEC) have decreased in 2000 relative to 1999 by approximately $316,000 ($54,466,000 - $54,782,000).

On a net basis (after transfers to GEC), operating expenses have decreased slightly from $52.709 million in 1999 to $52.486 million in 2000. The GEC impact is consistent with the expectation and information previously reviewed at both the GEC hearing and the 1996 rate hearing.

The forecast expenses for 2000 were $51.284 million. We have compared the 2000 actual operating and general expenses to the 2000 forecast. On a net basis, actual expenses are higher than forecast by approximately $1.2 million ($52,486,000 - $51,284,000). The overall increase in actual operating expenses in 2000, as compared to forecast, is primarily attributable to increased system operations costs, company pension costs, operating materials and vegetation management. The increase in system operations resulted from site remediation activities in substations, public safety initiatives, building repairs in the Gander area, and the re-decking of the Lookout Brook bridge. Increased pension costs resulted from additional charges associated with the early retirement programs which were partially offset by a decrease in pension expense due to the implementation of the recommendations contained in Section 3461 of the CICA Handbook. The cost of operating materials increased in comparison to the forecast due to the Company converting a number of traditional warehouse operations to bulk replenishment and distribution locations for lower value items. This conversion resulted in higher material costs at the point of initial stocking, however, according to the Company it should result in productivity savings. Higher costs in this category are also attributed to increases in substation and distribution maintenance in the Western Region and storm repairs in St. John's. The increase in vegetation management was due to changes implemented with respect to vegetation management practices.

Our detailed review of operating expenses was conducted using the breakdown as documented in Schedule 1. This breakdown provides for more relevant analysis of the Company's operating expenses and does agree to the schedule of operating expenses in the Company's annual report to the Board. It should also be noted that our review is based upon gross expenses before allocation to GEC.

Schedule 2 of our report shows the trend in operating expenses by breakdown for the period 1998 to 2000. There is a trend of declining labour costs since 1999. Other than this item, the trend in operating expenses appears to be relatively stable for 2000 as compared to 1999.

The relationship of operating expenses to the sale of energy (expressed in kWh) is presented in Schedule 3.The table and graph show that the cost per kWh remains relatively stable over the period.

Our observations and findings based on our detailed review of the individual expense categories are noted below.

General Expenses Capitalized (GEC)

On December 11, 1995 Board Order P.U. 3 (1995-96) was issued as a result of an application made by the Company. As part of our procedures we assessed the Company's compliance with this Order.

More specifically, with respect to GEC we have determined:

- The accounting policy applied for the purpose of capitalization of general expenses is the incremental basis, subject to the phase in requirements, which has resulted in the allocation to capital assets of only those costs which are incremental costs of capital projects.

- Overhead costs are considered to be incremental costs of capital projects to the extent they vary with the level of construction, as compared to no capital projects whatsoever. Otherwise the costs are expenses of the period in which they are incurred.

- The guidelines for capitalization of general expenses, as approved by Board consultants NKHK Chartered Accountants in letters dated January 17, 1996 and January 30, 1996, have been followed to the extent practicable.

- GEC have been allocated to hydro assets, diesel assets, substations, transmission, general property, transportation, communication, computer and software assets, and distribution assets through a flat rate.

- The change in accounting policy for GEC to the incremental basis, from the full cost method, was being phased-in over the period January 1, 1995 to December 31, 1999. In 2000, GEC has been accounted for using the incremental basis at 100% with no adjustment for the difference between full cost and the incremental amount as the phase-in period is now over.

This change in accounting policy, from full cost to incremental allocation, directly impacts the level of net operating expenses and net earnings through a reduction of transfers to GEC. The impact of this change on the financial results of the Company is as follows:

	(000)'s			
	1997	1998	1999	2000
Transfers to GEC/DSM/Stores				
Full Cost Accounting	$ 7,362	$ 6,970	$ 5,162	$ 5,212
Incremental Cost Accounting (including phase-in)	4,103	2,718	2,073	1,980
Increase in operating expenses	$ 3,259	$ 4,252	$ 3,089	$ 3,232

Based upon the results of our review and assessment, we have determined that the Company is in compliance with Board Order P.U. 3 (1995-96) for 2000.

Intercompany Charges

Our review of intercompany charges included the following specific procedures:

- assessed the Company's compliance with P.U. 7 (1996-97);
- compared intercompany charges for the years 1998 to 2000 and investigated any unusual fluctuations;
- reviewed detailed listings of charges for 2000 and investigated any unusual items;
- vouched a sample of transactions for 2000 to supporting documentation; and,
- assessed the reasonableness and appropriateness of the amounts being charged.

The most significant observations from our analysis of intercompany charges for 1997 to 2000 are as follows:

- insurance costs of $83,829 were charged to Fortis Inc. in 2000 (1999 - $154,930). The large decrease in 2000 resulted from premiums for certain policies with three year terms being paid in full in 1999.
- staff costs of $308,163 (1999-$Nil) and miscellaneous costs of $124,415 (1999-$Nil) were charged to Belize Electricity in 2000. These amounts related to the work of Newfoundland Power employees who assisted in the relief effort to help restore electricity after the impact of Hurricane Keith.
- staff costs of $6,660 (1999-$161,210) were charged to Canadian Niagra Power ("CNP"). The large decrease in 2000 was due to the removal of Mr. Mardon Erbland from Newfoundland Power's payroll effective July 1, 1999.

In Board Order P.U. 7 (1996-1997), the Board provided several instructions to the Company with respect to the recording and reporting of intercompany transactions. We have reviewed these items and report that the Company is in compliance with P.U. 7 (1996-97).

Overall, as a result of completing our procedures in this area we conclude that intercompany charges for 2000, are reasonable.

Salaries and Benefits (including executive salaries)

A detailed comparison of the number of full-time equivalent (FTE) employees by category for 1998 to 2000, including the forecast for 2000, is as follows:

	1998	**1999**	**2000**	**Forecast 2000**
Executive group	10.1	13.8	11.8	19.0
Corporate Office	40.1	32.7	37.8	38.7
Regulatory affairs	7.9	7.0	5.0	5.0
Finance	94.1	105.4	75.6	80.4
Engineering and operations	497.8	488.2	454.3	463.0
Customer service	54.7	56.2	71.6	76.6
	704.7	703.3	656.1	682.7
Temporary employees	71.4	65.1	47.9	47.1
Total	776.1	768.4	704.0	729.8

During 2000, there were changes made to the organizational structure that would impact the comparability of the numbers shown above. These should be considered when reviewing the FTE chart.

- Two executives were transferred to related companies
- Corporate Office includes the Safety group (previously shown in Engineering) and the Environmental Group (previously shown in Executive)
- Two Regulatory Affairs employees were transferred to Executive
- Customer Accounting was moved from Finance to Customer Service

The number of FTE's in 2000 compared to 1999 indicates an overall decrease of 64.4 FTE's. This is primarily a result of the Early Retirement Programs offered to employees. The number of FTE's in 2000 compared to the 2000 forecast indicates a decrease of 25.8 FTE's. These decreases are a result of redundancies created by productivity initiatives and staff leaves and resignations not refilled. In addition, the reduction of 17.2 FTE's for temporary employees from 1999 to 2000 was due to operating efficiency gains and improvements in workflow processes.

An analysis of salaries and wages by type of labour and by function within the Company from 1998 to 2000, including the forecast for 2000, is as follows:

	(000)'s			
	1998	**1999**	**2000**	**Forecast 2000**
Type				
Internal labour	$ 39,511	$ 41,291	$ 39,126	$ 40,616
Overtime	3,146	3,773	3,379	2,556
	42,657	45,064	42,505	43,172
Contractors	2,599	3,107	4,049	1,394
	$ 45,256	$ 48,171	$ 46,554	$ 44,566
Function				
Operating	30,833	30,813	27,994	28,509
Capital and miscellaneous	14,423	17,358	18,560	16,057
	$ 45,256	$ 48,171	$ 46,554	$ 44,566

Our review of salaries and benefits included an analysis of the year to year variance, consideration of the trends in labour costs, and discussion of the significant variances with Company officials. As indicated in the table, overall labour costs for 2000 were $2 million higher than forecast and $1.6 million lower than 1999.

Internal labour costs in 2000 have decreased compared to 1999 by $2.2 million. This is primarily a result of retirements, resignations and leaves. In comparison to 2000 forecast, this category is down approximately $1.5 million.

Overtime costs were less than last year but were $0.8 million higher than the forecast. The overtime costs exceeded the forecast because of storm-related damage repairs and additional work required to address customer driven requests and public safety initiatives.

Contractor costs were higher than in 1999 and they exceeded the forecast by approximately $2.65 million. The company has indicated that this was attributable to a significant increase in pole construction in 2000. An amount of $1.2 million related to pole and line construction for regular customers while an additional $1.5 million was spent on pole construction for outside parties.

Operating costs were $2.8 million lower than in 1999 primarily due to the savings associated with the 1999 early retirement program and the capital costs were $1.2 million higher due to the increase in pole and line construction as noted above.

Short Term Incentive (STI) Program

In 1999, the Company implemented the following changes to the STI performance categories:

- A performance category to measure disabling injury severity was added to the STI program. This performance category is an industry standard that measures productive time lost due to injury as opposed to the number of accidents.

- The Company removed the performance category relating to attendance/absenteeism from the STI program. The Company had made significant progress in this area and determined that the probability of future improvements would be low.

In 2000, there was a change to the STI formula for the "# of Lost Times, Medical Aids and Vehicle Accidents". This was changed to an "All Injury/Illness Frequency Rate" which is a combination of the two previously used measures used by the Canadian Electricity Association. It measures the number of accidents per 200,000 hours of work and is a combination of the number of medical aids and lost time injuries incurred.

The following table outlines the actual results for 1998 to 2000 and the targets set for 2000:

Measure	**1998 Actual**	**1999 Actual**	**2000 Actual**	**2000 Target**
Controllable Operating Costs / Customer	$234	$226	$212	$221
Reliability - Duration of Outages	4.89	9.36	5.3	9.3
Customer Satisfaction	84%	88%	89%	85%
Safety - # of Lost Time Accidents, Medical Aids, & Vehicle Accidents	N/A	N/A	6.3	7.5
Disabling Injury Severity	N/A	81.3	35.2	81

The Company's STI program also includes an individual performance measure for Executives and Managers. This measure is used to reinforce the accountability and achievement of individual performance targets.

The weight between corporate performance and individual performance differs between the managerial classifications, as outlined in the following table.

Classification	Corporate Performance	Individual Performance
President and CEO	**75%**	**25%**
Vice Presidents	**50%**	**50%**
Managers	**25%**	**75%**

The individual measures of performance for Managers are developed in consultation with the individuals and their respective executive member. Performance measures for the Vice-Presidents and President and CEO are approved by the Board of Directors. Each measure is reflective of key projects or goals, and focuses on departmental or divisional priorities.

The program operates to provide 100% payout of established STI pay if the Company meets, on average, 100% of its performance targets. The STI pay for 2000 is established as a percentage of base pay for the three employee groups. The results of the STI program improved in 2000 with all payouts being made based on the achievement of 150% for corporate performance.

The following table illustrates the target as a percentage of base pay, together with the actual STI payouts for 1998 to 2000:

	1998 STI Target Payout	1998 STI Actual Payout	1999 STI Target Payout	1999 STI Actual Payout	2000 STI Target Payout	2000 STI Actual Payout
President	30%	34.8%	30%	38.5%	30%	45.0%
Vice Presidents	20%	23.2%	20%	21.5%	20%	29.4%
Managers	10%	11.6%	12%	14.6%	12.3%	17.4%
Managerial	5%	5.8%				
Union	4%	4.6%				

As noted in the prior year, the STI program for union staff was negotiated out of the collective agreement. STI target payout rates remained consistent compared to the prior year. However, the actual payment percentage based on the 1999 STI results for corporate performance was 90% as compared to 150% for 2000.

In dollar terms the STI payouts for 2000 compared to 1999 and 1998 are as follows:

	1998	1999	2000
Executive	$ 202,000	$ 234,000	$ 316,000
Managers	144,400	213,000	275,000
Managerial	857,300		
Union	810,200		
	1,667,500		
Total	$ 2,013,900	$ 447,000	$ 591,000

Executive Compensation

The following table provides a summary and comparison of executive compensation for 1998 to 2000.

	Base Salary	Short Term Incentive	Other	Total
2000				
Total executive group	$ 887,239	$ 316,408	$ 107,973	$ 1,311,620
Add: Annualize VP Finance & CFO	43,079			43,079
Normalized compensation	$ 930,318	$ 316,408	$ 107,973	$ 1,354,699
Average per executive (5)	**$ 186,064**	**$ 63,282**	**$ 21,595**	**$ 270,940**
1999				
Total executive group	$ 824,887	$ 234,000	$ 153,915	$ 1,212,802
Add: Annualize VP Finance & CFO	54,000			54,000
Add: Annualize VP Customer and Corporate Service	7,113			7,113
Normalized compensation	$ 886,000	$ 234,000	$ 153,915	$ 1,273,915
Average per executive (5)	**$ 177,200**	**$ 46,800**	**$ 30,783**	**$ 254,783**
1998				
Total executive group	$ 702,000	$ 202,000	$ 95,822	$ 999,822
Average per executive (4)	**$ 175,500**	**$ 50,500**	**$ 23,956**	**$ 249,956**
% Average increase (decrease) 2000 vs. 1999	**5.0%**	**35.2%**	**(29.9%)**	**6.3%**

The increase in the total executive group base salary in 2000 versus 1999 is due increases in base salary effective January 1, 2000. The compensation for 2000 has been annualized to account for the vacancy of the Vice President of Finance and Chief Financial Officer until April 2000.

The decrease in the "Other" category is a result of the following factors:

- There were no lump sum vacation payments during 2000. When this policy was introduced in 1999, a total of $61,200 was paid out to three executive members.

- There was a decrease of $14,400 in RRSP contributions. In 2000, the employer's contribution was terminated when the maximum of $6,750 was reached. The employer's contribution in excess of the CCRA limits was discontinued with the adoption of the Supplementary Employee Retirement Plan in 2000. The excess of salary over the limits established by CCRA is multiplied by 13% and placed in a notional account in the employee's name to be paid on retirement.

These decreases were offset by one executive member exercising outstanding stock options with a benefit of $13,750 and a relocation allowance of $12,000 paid to the Vice President, Finance and Chief Financial Officer who was recruited during 2000. It is important to note that while the stock option benefits noted above are included in the total compensation, they are not a cost to the Company.

The increase in short-term incentive is due to the fact that all corporate goals were achieved at the maximum scale limit of 150% in 2000 as compared to 90% in 1999.

The compensation packages for executives were approved by the Board of Directors based on a recommendation of the Human Resources (HR) Committee as a result of its annual compensation review.

Based on the results of our procedures, nothing has come to our attention to indicate that the salary and benefit costs are imprudent or unreasonable in relation to sales of power and energy.

Company Pension Plan

For 2000, we analyzed the transactions supporting the gross charge of $4.2 million for pension expense in the accounts of the Company. As a result of our analysis we determined that the company pension expense for 2000 was in compliance with Board Orders. The 2000 expense was 9.1% higher than the forecast and 14.3% higher than the 1999 actual of $3.7 million.

The components of pension expense are as follows:

	1998	1999	2000	Forecast 2000
Pension expense per actuary	$ 3,224,100	$ 2,997,300	$ 3,368,768	$ 3,026,975
Pension uniformity plan	54,995	128,470	402,285	254,000
Group RRSP @ 1.5%	483,154	504,648	469,632	544,000
Individual RRSP's	55,492	34,409	46,902	
Consultants fees	90,991	9,305	27,005	25,000
Less: Refunds	(75,804)	(199)	(115,442)	
Total Pension Expense	$ 3,832,928	$ 3,673,933	$ 4,199,150	$ 3,849,975

The actuarial determined pension costs decreased by $2.3 million as a result of the adoption of the recommendations contained in Section 3461 of the CICA Handbook and changes in the plan assets. However, this decrease is offset by $2.3 million due to the 2000 early retirement program and $384,000 as an adjustment for the 1999 program due to the late participation of several employees.

The Company's pension uniformity plan is meant to eliminate the inequity in the regular pension plan related to the limitation on the maximum level of contributions permitted by income tax legislation. In effect, the pension uniformity plan tops up the benefits for senior management so that they receive benefits equivalent to the benefit formula of the registered pension plan. The Board ordered in P.U. 7 (1996-97) that the pension uniformity plan be allowed as reasonable and prudent and properly chargeable to the operating account of the Company. The increase is due to an adjustment of $189,000 related to the 2000 early retirement program and $42,000 for the Supplementary Employee Retirement Program.

The employer's portion of the contributions to the Group RRSP is calculated as 1.5% of the base salary paid to the plan participants. The decrease in the 2000 costs as compared to 1999 is a result of the reduction in the number of employees participating in the plan due to the 1999 early retirement program.

Refunds have increased in 2000 as compared to 1999 due to a refund that was received for $44,217, which has been applied against this category of pension expense. Also, the input tax credits relating to the expenses incurred by the pension plan were claimed for the first time and a refund of $71,225 was received for 2000 and prior years.

Based on the results of our procedures, nothing has come to our attention to indicate that the costs associated with the Company's pension plan are imprudent or unreasonable in relation to sales of power and energy. We have also determined that the company pension expense for 2000 was in compliance with Board Orders

Retirement Allowance

The retiring allowance costs to the Company over the period from 1998 to 2000 are as follows:

	(000)'s		
(000)'s	1998	1999	2000
Early Retirement Program		$ 817	$ 712
Terminations and Severance		183	142
Other Retiring Allowance Costs	$ 19	30	31
Total	$ 19	$ 1,030	$ 885

The 1999 early retirement program was approved by the Board in P.U. 24 (1999 – 2000) and forty employees availed of this program. In 2000, there were an additional six employees that availed of the 1999 program and twenty-one employees who participated in the 2000 early retirement program resulting in retirement allowance of approximately $712,000. These programs are designed to achieve salary and pension savings (before tax).

The early retirement program cost for 2000 was consistent with the 1999 cost despite the fact that there were thirteen less retirees in 2000. Two managers were included in the retirees of 2000 and received retirement allowances of $100,000 each.

Included in P.U. 24 (1999-2000), the Board ordered that the Company file with the Board, as a part of the 1st Quarterly Report, beginning in March 2001, and for each of the next two years, information on the effect that the early retirement program has had on: the capital and operating expenses of the Company; the level of service; and the reliability of power supply.

The 2000 expense associated with terminations and severance costs represents severance costs paid to three employees during the year.

The $31,000 expense included in other retiring allowance costs represents the costs of normal retirements, retirement gifts, career counseling, retirement dinners and retirement seminars.

Based on the results of our procedures, nothing has come to our attention to indicate that the retirement allowance costs are imprudent or unreasonable in relation to sales of power energy.

Advertising

Our procedures in this category included a review of the advertising transactions for 2000 and vouching of a sample of individual transactions to supporting documentation.

Advertising costs in 2000 were $259,700 compared to the 2000 forecast of $247,050 and $246,000 in 1999. The small increase this year is primarily related to an increased emphasis placed on safety program advertising.

The breakdown of these advertising costs by program for 1998 to 2000, including the 2000 forecast in accordance with the 2000 Advertising and Marketing Report , is as follows:

	1998	1999	2000	Forecast 2000
Customer Service	$24,000	$13,000	$900	$20,000
Safety	92,700	51,700	81,700	57,000
Personnel	17,400	16,200	4,000	10,000
Regional	12,900	12,700	11,300	19,550
Charitable & Non –regulated	156,400	132,300	129,000	129,200
Miscellaneous	3,600	20,100	32,800	11,300
TOTAL	**$307,000**	**$246,000**	**$259,700**	**$247,050**

Advertising costs relating to customer service costs are lower than forecast and 1999 as a result of using more internal sources for customer advertising. The increase in the safety program is due to the Company's increased emphasis on public safety awareness. The decrease in the personnel program is a result of less external hiring in 2000 and the increase in miscellaneous is due to the external advertising of executive and board appointments.

Based on the results of our procedures, we conclude that 2000 advertising expenses are reasonable.

In an advertising report to the Board dated March 28, 2001, the Company provided an overview of its 2001 advertising and marketing plans and it has estimated advertising costs to be $258,650. No major changes or new advertising strategies have been contemplated to date according to this report. However, the budget does have an increased provision for marketing costs directed toward safety.

Travel

Travel costs for 2000 were $1,209,000 as compared to the 2000 forecast of $1,141,000 and 1999 costs of $1,213,000.

The procedures performed for travel expenses included a review of the transactions in the discretionary expense classes and vouching of a sample of individual transactions to supporting documentation.

Based on the results of our procedures, we conclude that the 2000 travel expenses are reasonable.

Fees and Dues including Consulting Fees

The procedures performed for this category included a review of the transactions for 2000 and vouching of a sample of individual transactions to supporting documentation.

	(000's)		
	Actual		
	1998	1999	2000
Other company fees	$ 1,028	$ 1,034	$2,278
Regulatory hearing costs	483	35	48
Deferred regulatory costs		384	384
Year 2000 related fees	492	78	
Total other company fees	$ 2,003	$ 1,531	$ 2,710

In 2000 fees and dues (including consulting fees) were $2,710,000 as compared to 1999 costs of $1,531,000.

The "other company fees" are significantly higher in 2000 due to the following projects and studies that were completed during the year:

- pole yard clean-up - $394,000,
- income tax reassessment - $268,000,
- hydrology study – $217,000, and
- productivity studies in Operations and Engineering - $130,000

The above projects or studies are non-recurring by nature and it would be anticipated that costs in this category would return to more historical levels in the future. We suggest that this category be monitored closely in the future given the increasing trend in costs.

In P.U. 36 (1998-99), the Board approved the amortization of 1998 regulatory costs of $1,150,000 to begin in 1999 and to occur for three years. The amount of $384,000 is the second year of amortization of these costs and is correctly included in the above table as "Deferred regulatory hearing costs". These costs will be fully amortized in 2001.

Taxes and Assessment

Taxes and assessments in 2000 were $741,000 compared to $742,000 forecast for 2000 and an actual of $852,000 in 1999. The decrease of $111,000 in 2000 as compared to 1999 is attributable to a lower Board assessment mill rate this year.

Uncollectible Bills

We reviewed the Company's analysis of the allowance for doubtful accounts for 2000. As well, we reviewed a schedule which compares the percentage of uncollectible bills to revenue for the last five years. The 2000 expense of $500,000 has decreased by $200,000 from the 1999 expense of $700,000, primarily due to continuing improvements in the Company's collection procedures. These improvements include all staff being trained to handle collection issues (versus only a select few staff in the past), a shorter time period in which accounts are sent to a collection agency and a shorter time period for follow up with customers who have overdue accounts.

Demand Side Management (DSM)

Our approach with respect to demand side management expenses was to review the 2000 Demand Side Management Report for anything unusual. The amortization of deferred amounts carried forward from prior years ended in 1999. We also checked to ensure that no additional amounts after 1995 have been deferred pursuant to P.U. 7 (1996-1997).

In compliance with P.U. 1 (1990) and P.U. 7 (1996-97), the Company filed the 2000 Demand Side Management Report with the Board (as noted above). This report provided a summary of 2000 DSM activities and costs as well as the outlook for 2001.

Based upon the results of our procedures we concluded that DSM is in compliance with Board Orders.

Miscellaneous

The breakdown of items included in the miscellaneous expense category for 1998 to 2000 is as follows:

	1998	**1999**	**2000**
Miscellaneous	$1,209,700	$ 886,700	$ 1,035,600
Employee computer purchase plan	52,700	35,300	91,700
Computer software	37,700	32,600	32,600
Donations and community relations	347,900	373,200	359,000
Books, magazines	77,700	68,600	59,000
Damage claims	100,800	202,300	133,000
Miscellaneous lease payments	22,500	29,300	19,000
	$1,849,000	$1,628,000	$1,729,900

The employee computer purchase plan was introduced in 1997, and employees were given the opportunity to receive a grant every three years. This expense category has increased by $56,000 in 2000, due to many employees being re-eligible to participate in the plan after a three year period.

Our procedures in this expense category for 2000 included vouching a sample of transactions within the "miscellaneous category" to supporting documentation. Based upon the results of our procedures nothing has come to our attention to indicate that the 2000 expenses are unreasonable.

Non-regulated items included in the above miscellaneous breakdown have been appropriately included in the Company's non-regulated expenses.

Vegetation management

Commencing in 2000 the Company is using a separate expense breakdown for costs associated with vegetation management. In prior years these costs were primarily included in the contract labour category. In order to allow a proper comparison of these costs to prior years, the 1998 and 1999 expense breakdowns have been restated to provide detail on the vegetation management costs.

The total cost in this category in 2000 was $1,077,000 compared to $421,000 in 1999. All of the costs reported in this category relate to contract labour. An additional amount of $173,000 in vegetation management costs has been charged to internal labour in 2000, which is comparable to 1999.

The costs in 2000 increased by $656,000 or 156% in comparison to 1999. The Company has indicated that the rising costs in this category results from implementation of a more formalized and comprehensive approach to vegetation management practices in the past year. Specifically, they have noted the following changes in their practices:

- Adoption of a comprehensive four-year tree trimming cycle for distribution feeders. Previously, trimming was not carried out on a fixed cycle.
- More stringent environmental standards have resulted in reduced use of herbicides. Consequently, vegetation control must be undertaken more frequently than in the past.
- For environmental reasons, brush that is trimmed or cut is now chipped rather than burned which increases overall labour costs.
- Increased expectations for contractors which require them to follow internal safety and environmental standards and provide adequately trained staff has put upward pressure on costs.

Overall, considering the significant increase in these costs and the recent changes in vegetation management practices, it is difficult to assess what is a reasonable level of expenditure for this category on a continuing basis. We recommend that this category be monitored closely and, if appropriate, a more detailed explanation of the vegetation management practices and their cost be requested from the Company.

Other Expense Categories

In addition to the various categories of expenses commented on above, the other categories of operating expenses by breakdown were also analyzed for any unusual variances. From this analysis, the following observations were made with respect to the more significant fluctuations.

The System Operations expense for 2000 is $2,291,000 as compared to the 2000 forecast of $1,738,000 and 1999 costs of $1,617,000. This increase is attributable to a number of items including building repairs in the Gander area, public safety initiatives, the re-decking of the bridge at Lookout Brook and preventative maintenance in substations.

The cost of Operating Materials for 2000 is $1,904,000 as compared to the 2000 forecast of $1,441,000 and 1999 costs of $1,629,000. This increase is due to the Company converting a number of traditional warehouse operations to bulk replenishment and distribution locations for lower value items. This conversion resulted in higher material costs at the point of initial stocking, however, according to the Company it should result in productivity savings. Higher costs in this category are also attributed to increases in substation and distribution maintenance in the Western Region and storm repairs in St. John’s.

Interest and Finance Charges

The following table summarizes the various components of finance charges expense:

	Actual (000's)			
	1997	1998	1999	2000
Interest				
Long-term debt	$ 25,107	$ 24,824	$ 27,577	$ 27,281
Other	722	1,740	166	717
	25,829	26,564	27,743	27,998
Amortization				
Debt discount	179	158	179	161
Capital stock issue	109	80	78	72
Interest charged to construction	(240)	(563)	(409)	(338)
Interest earned	(928)	(1,006)	(1,103)	(1,252)
Total finance charges	$ 24,949	$ 25,233	$ 26,488	$ 26,641

As per our analysis of the detailed transactions, interest earned is comprised substantially of interest earned on bank accounts and on overdue accounts receivables.

Our procedures with respect to interest on long term debt and other interest included a recalculation of interest charges and assessment of reasonableness based on debt outstanding.

The increase in other interest is a result of the increase in the short term debt balance throughout the year.

Based upon our analysis, the finance charges for 2000 appear reasonable.

Income Tax Expense

We have reviewed the Company's income tax expense for 2000 and have investigated the reasons for any fluctuations and changes.

The effective tax rate on accounting income for 2000 is 32.9%, this percentage has decreased in comparison with prior years (1999 - 41.9%; 1998 - 41.9%) and with the statutory corporate tax rate of 43.1%.

The lower effective tax rate is due primarily to the deductibility of GEC for 2000 and 1999 which were previously not permitted to be deducted by Canada Customs and Revenue Agency (CCRA). The difference in pension expense for tax versus accounting purposes also contributes to the lower effective tax rate.

Based upon our review of the Company's calculations, and considering the impact of timing differences, the income tax expense for 2000 appears reasonable.

Purchased Power

We have reviewed the Company's purchased power expense for 2000 and have investigated the reasons for any fluctuations and changes. We recalculated the cost per kilowatt-hour charged by Newfoundland and Labrador Hydro and found purchased power charges to be consistent with 1999.

Based upon our analysis, purchased power for 2000 appears reasonable.

Costs Associated with Curtailable Rates

In P.U. 7 (1996-97), the Board ordered that, beginning January 1, 1997, all costs associated with curtailable rates shall be charged to regulated expenses, and not to the Rate Stabilization Account. The Board ordered that the demand credit for curtailment continue at $29/kVA until April 30, 1998. In P.U. 30 (1998-99), the Board ordered that this rate be extended until a review of the curtailment service option is presented at a public hearing. The total of the curtailment credits for the year was $204,376, which is a decrease from the 1999 amount of $234,612. This decrease in credits is attributable to milder weather in 2000 relative to 1999.

In relation to these instructions of the Board, nothing has come to our attention to indicate that the Company is not in compliance with the applicable orders of P.U. 7 (1996-97) and P.U.30 (1998-99).

Non-Regulated Expenses

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

- assessed the Company's compliance with P.U. 7 (1996-97);
- compared non-regulated expenses for 2000 to prior years and investigated any unusual fluctuations;
- reviewed detailed listings of expenses for 2000 and investigated any unusual items;
- assessed the reasonableness and appropriateness of the amounts being charged.

In the calculation of rates of return the following items are classified as non-regulated.

	Actual		
	1998	1999	2000
Charged from Fortis Companies:			
Annual report	$ 194,700	$ 207,900	$ 210,500
Directors fees and travel	190,100	171,900	223,100
Listing and filing fees	17,100	21,000	38,900
Miscellaneous	121,900	163,300	122,100
	523,800	564,100	594,600
Donations and charitable advertising	444,600	507,000	435,600
Heat pump project	65,430	-	-
Miscellaneous	211,070	276,200	287,100
Share the Light Program	11,300	-	-
	1,256,200	1,347,300	1,317,300
Less: Income taxes	527,500	565,900	553,300
Total non-regulated (net of tax)	$ 728,700	$ 781,400	$ 764,000

(N.B. The above table groups expenses from various expense classes which have been reconciled to other tables and breakdowns included in our report).

Based upon our review and analysis, the amounts reported as non-regulated expenses, as summarized above, appear reasonable and are in accordance with Board Orders, including P.U. 7 (1996-1997).

Depreciation

Scope: ***Review the Company's rates of depreciation and assess their compliance with the 1996 Gannett Fleming Depreciation Study. Assess the reasonableness of depreciation expense.***

The objective of our procedures in this section was to ensure that the 2000 depreciation amounts and rates are in compliance with P.U. 7 (1996-97), and in agreement with the recommendations of the 1996 Depreciation Study undertaken by Gannett Fleming Valuation and Rate Consultants, Inc.

The specific procedures which we performed on the Company's depreciation expense included the following:

- agreed all depreciation rates, including true-up provision, to those recommended in the depreciation study;
- recalculated the Company's depreciation expense for 2000; and,
- assessed the overall reasonableness of the depreciation and true-up amounts for 2000.

In performing the above procedures, we observed that the Company has followed the true-up calculations provided by Gannett Fleming at the 1996 rate hearing (Exhibit NP-76). This schedule reflects a true-up calculated by dividing the accumulated depreciation variance by five years. This true-up amount is then recorded during each year from 1996 to 2000 (as per the following table) until the variance is reduced to a level less than or equal to 5%.

	1996	1997	1998	1999	2000
True-up (000's)	$ 2,107	$ 2,107	$ 2,189	$ 2,187	$ 3,299

True-up amounts for 2000 have increased significantly over the prior years and has the effect of reducing depreciation expense by the same amount. The change in true-up is due to the accumulated depreciation variance on certain individual categories being reduced to below the 5% level in less than five years.

Depreciation expense for 2000 is $29.625 million which is comparable to the $29.638 million for 1999.

Based on our review of depreciation expense, we conclude that the Company is in compliance with P.U. 7 (1996-97), and the recommendations and results of the 1996 Depreciation Study have been incorporated into the Company's depreciation calculations for 2000.

Preferential Rates

In order to assess whether the Company had provided preferential rates to any of its customers, we selected a sample of customers from different rate classes for the year ended December 31, 2000. Our sample selection was designed so as to include certain Company executives/officers, and also several of the Company's larger customers.

The procedures performed on the selected customer billings included:

- agreed all rates and discounts to approved rate books;
- inquired into the reasons for any non-standard charges, discounts, etc., encountered in our testing;
- checked the clerical accuracy of the customer bill calculations; and,
- ensured that the selected billing was paid on a timely basis or that the account was receiving regular payments.

As a result of completing the above procedures, we confirm that nothing has come to our attention that causes us to believe that any of the Company's rates are preferential.

CIAC Policy

In order to determine if the CIAC policy was being followed correctly by the Company, we selected a sample of 2000 customer quotes. These quotes included amounts for residential, seasonal and general service customers.

The procedures performed on these samples included:

- ensured database was calculating CIAC's correctly:
- reviewed computer system to verify that the two year review process was functioning effectively; and,
- examined customer letters for completeness and accuracy of information.

As a result of completing these procedures, we confirm that nothing has come to our attention that causes us to believe that there are any problems with the administration of CIAC's. The system continues to operate effectively with no significant control deviations noted from our test procedures. It was indicated in the prior year report that substantial changes had been made to the CIAC process in 1999. These changes including the implementation of customer CIAC acceptance forms, the use of a computerized two-year review notification process and the presence of a fully electronic approval system have played an integral part in the enhancement of the CIAC administration system.

Productivity and Operating Improvements

Scope: ***Review the Company'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.***

In its 2000 Annual Report the senior officers indicated that they are committed to making the Company a leading electrical transmission and distribution company in North America, through a continued focus on improving productivity, lowering operating costs and generating revenue from non-traditional resources. In this regard the Company has undertaken several specific initiatives to achieve these goals. Some of the more significant initiatives as represented by the Company are as follows:

- The Problem Call Logging System (PCLS) was enhanced and has improved outage information analysis and reporting functionality. These enhancements along with the "Do it Right the First Time" guidelines introduced in 1999, have improved the Company's customer outage information, overall response time and reduced costs by reducing repeat visits.

- The Company purchased a new remittance processor and changes to internal procedures have improved payment processing, resulting in more accurate and timely records and reduced operating costs.

- The Company switched to a stainless steel transformer design and jointly tendered for pole-mounted transformers with Maritime Electric. The transformers carry a 20-year rust and corrosion warranty and will reduce maintenance costs and environmental risk over the long-term.

- Light-duty material handler trucks have been introduced into the line vehicle fleet, These vehicles have replaced larger line trucks at significantly lower operating and capital costs.

- The Company increased customer participation in its Equal Payment and Pre-authorized plans by 13% and 14% respectively. The Company will continue to encourage participation in these payment programs in an effort to offer customers enhanced options and convenience, and to increase the level of customer service efficiency.

- The consolidation of two electrical maintenance groups (St. John's Region and Topsail Road) improved the scheduling and co-ordination of work and the utilization of employees, tools, equipment and vehicles. It also reduced the resources required to manage maintenance activities.

- The business processes that support new electrical service installations and related requests were re-engineered including single point of contact for customers requesting new services, more effective utilization of engineering staff, streamlining of administration activities and better scheduling of service crews.

- An automated meter reading pilot was launched in 2000. This pilot, with 200 customers participating, will assess the benefits of utilizing wireless radio frequency technology to collect meter readings at locations that are difficult to read. The Company also installed new electronic meters at a number of hydroelectric plants to eliminate manual readings.

- As a productivity and customer service initiative, the Company now permits qualified electricians to remove and replace meters to facilitate the installation of siding on customer premises. This eliminates the requirement for service crews to coordinate site visits to the customer's premise. It also ensures the meter is removed promptly and minimizes the amount of time the customer is without power.

- Electrical technicians within the Company now use AutoCAD Lite, a new software package, to prepare electrical system drawings. Electronic drawings are more easily transferred to consultants and customers, and changes can be completed more efficiently than with the paper drawings. Electronic drawings are also easily incorporated into the SCADA feeder maps.

As part of the annual review process, we will monitor the results of the above initiatives and obtain an update from the Company for 2001.

Newfoundland Power Inc.
Operating Expenses by Breakdown (Table)
(000's)

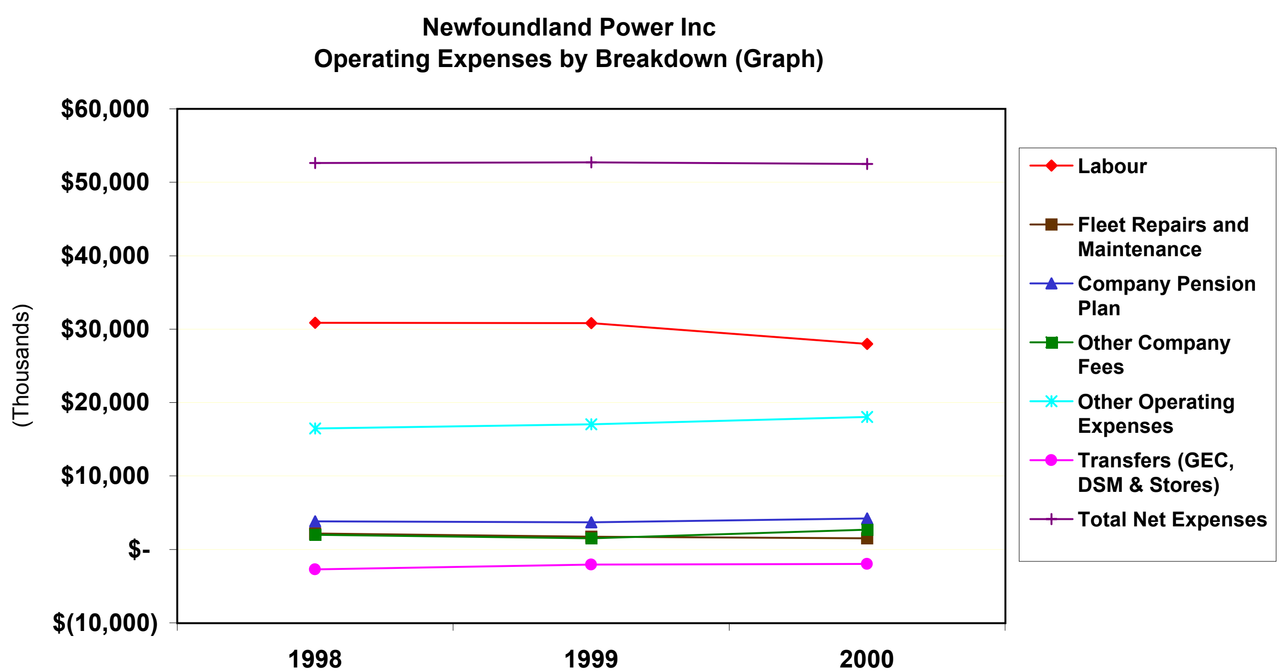
Schedule 1

	Actual		
	1998	1999	2000
Labour	$ 30,833	$ 30,813	$ 27,994
Fleet Repairs and Maintenance	2,183	1,713	1,528
Operating Materials	1,741	1,631	1,904
Inter-Company Charges	700	811	743
System Operations	1,655	1,772	2,291
Travel	1,013	1,213	1,209
Tools and Clothing Allowance	891	931	963
Miscellaneous	1,849	1,628	1,730
Prior Years' DSM Amortization	162	74	-
Taxes and Assessments	681	852	741
Uncollectible Bills	1,200	700	500
Insurances	698	643	580
Retirement Allowance	19	1,030	885
Company Pension Plan	3,833	3,674	4,199
Education and Training	384	423	409
Trustee and Directors' Fees	367	345	356
Other Company Fees	2,003	1,531	2,710
Stationery & Copying	420	405	404
Equipment Rental/Maintenance	964	924	990
Communications	2,368	2,525	2,447
Advertising	307	246	260
Vegetation Management	645	421	1,077
Computer Equipment & Software	443	477	546
Total Other	24,526	23,969	26,472
Total Gross Expenses	55,359	54,782	54,466
Transfers (GEC)	(2,718)	(2,073)	(1,980)
Total Net Expenses	$ 52,641	$ 52,709	$ 52,486

Schedule 2

Comparison of Operating Expenses by Breakdown - 1998 to 2000
(000's)

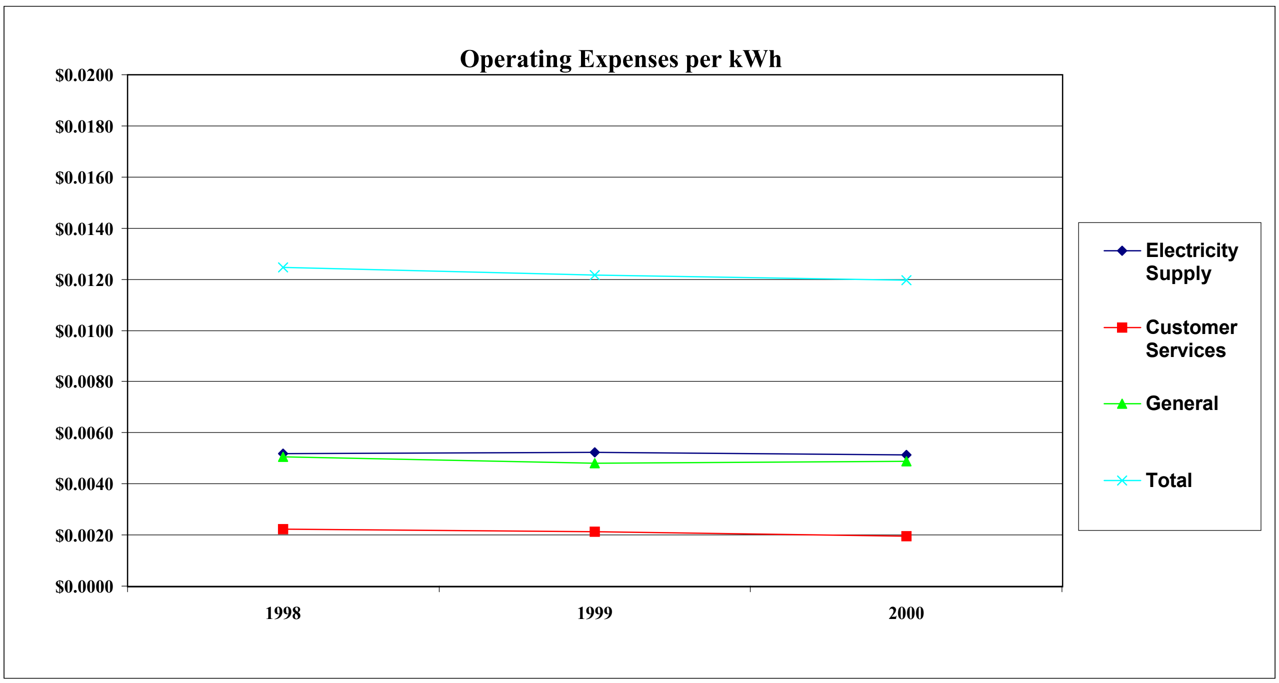
	Actual		
	1998	1999	2000
Labour	$ 30,883	$ 30,813	$ 27,994
Fleet Repairs and Maintenance	2,183	1,713	1,528
Company Pension Plan	3,833	3,674	4,199
Other Company Fees	2,003	1,531	2,710
Other Operating Expenses	16,457	17,051	18,035
Transfers (GEC, DSM & Stores)	(2,718)	(2,073)	(1,980)
Total Net Expenses	$ 52,641	$ 52,709	$ 52,486



Schedule 3

Newfoundland Power Inc
Comparison of Gross Operating Expenses to kWh Sold
(000's)

		Electricity Supply		Customer Services		General		Totals	
Year	kWh sold	Cost	Cost per kWh	Cost	Cost per kWh	Cost	Cost per kWh	Cost	Cost per kWh
1998	4,440,000	$ 22,977	$0.0052	$ 9,900	$0.0022	$ 22,482	$0.0051	$ 55,359	$0.0125
1999	4,500,000	$ 23,581	$0.0052	$ 9,627	$0.0021	$ 21,574	$0.0048	$ 54,782	$0.0122
2000	4,555,000	$ 23,318	$0.0051	$ 8,866	$0.0019	$ 22,282	$0.0049	$ 54,466	$0.0120

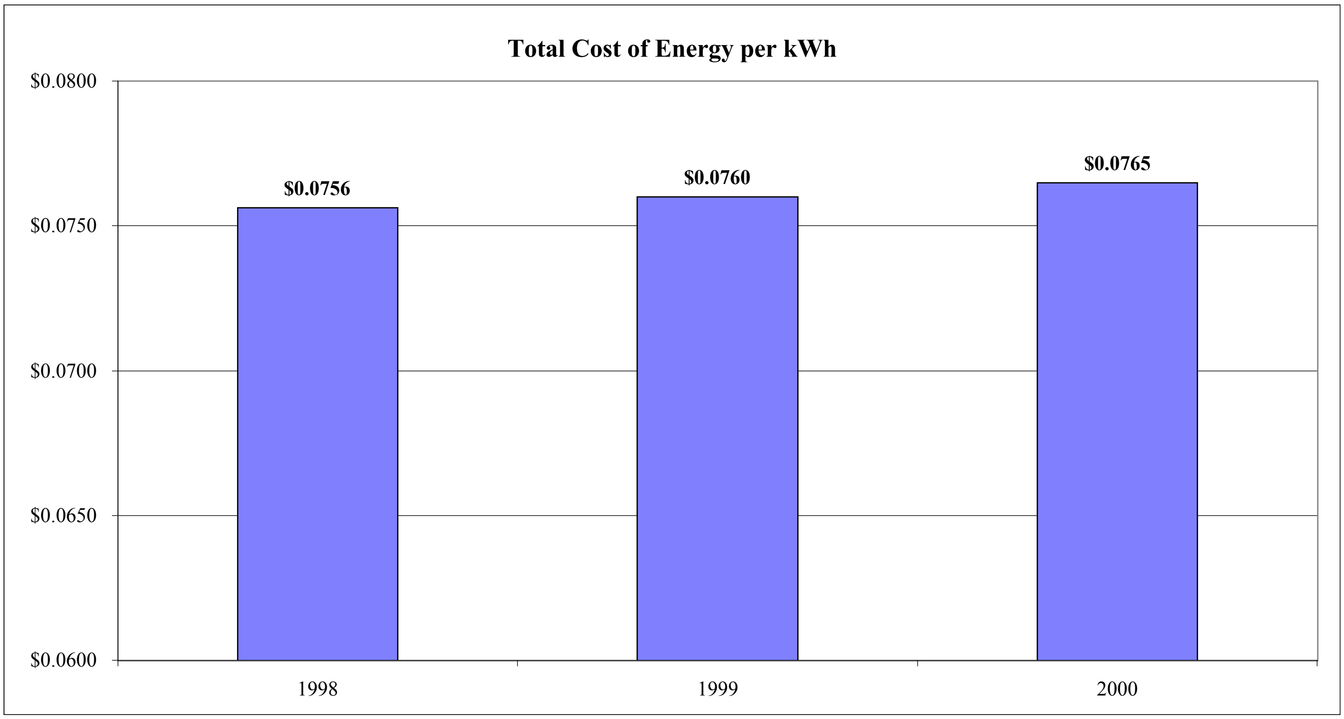


Electricity Supply = Operating Expenses less Purchased Power
General Expenses = General Expenses less Customer Service

Schedule 4

Newfoundland Power Inc
Comparison of Gross Total Cost of Energy to kWh Sold
(000)'s

Year	kWh sold	Operating Expenses	Purchased Power	Depreciation	Finance Charges	Income Taxes	Dividends and Return	Total Cost of Energy	Cost per kWh
1998	4,440,000	$ 52,641	$ 191,586	$ 28,067	$ 25,233	$ 16,027	$ 22,197	$ 335,751	$ 0.0756
1999	4,500,000	$ 52,709	$ 192,755	$ 29,638	$ 26,488	$ 16,927	$ 23,484	$ 342,001	$ 0.0760
2000	4,555,000	$ 52,486	$ 199,266	$ 29,625	$ 26,641	$ 13,296	$ 27,099	$ 348,413	$ 0.0765



Newfoundland Power Inc.
Intercompany Transactions - Fortis Inc. (Regulated)

Schedule 5A

	1998	1999	2000
Charges from Fortis Inc.			
Trustee fees	$ 96,514	$ 126,769	$ 122,040
Listing and filing fees	67,414	32,154	35,714
ESPP\DRIP\CSPP costs	58,440	75,787	33,890
Miscellaneous	2,724	5,355	
	$ 225,092	$ 240,065	$ 191,644
Charges to Fortis Inc.			
Retirement allowance	$ 30,750		
Insurance	77,406	$ 154,930	$ 83,829
Postage and couriers	6,354	8,543	11,766
Printing, stationery and materials	12,162	17,515	17,131
MIS Costs	3,694	3,655	4,015
Staff Charges		193,093	198,880
Miscellaneous	22,175	38,190	11,204
	$ 152,541	$ 415,926	$ 326,825

Newfoundland Power Inc.
Intercompany Transactions - Fortis Inc. (Non-Regulated)

Schedule 5B

	1998	1999	2000
Charges from Fortis Inc.			
Director's fees and travel	$ 190,132	$ 171,906	$ 223,135
Annual and quarterly reports	194,710	207,850	210,510
Listing and Filing fees	17,117	20,950	38,865
Miscellaneous	121,932	108,688	78,706
	$ 523,891	$ 509,394	$ 551,216

Newfoundland Power Inc.
Intercompany Transactions - Other (Total)

Schedule 5C

		1998	1999	2000
Charges to Fortis Trust				
Network costs		$ 187	$ 3,333	$ 2,818
Insurance		18,931	12,551	8,366
Postage		1,539	1,300	2,103
Miscellaneous		2,289	4,868	2,359
		$ 22,946	$ 22,052	$ 15,646
Charges to Fortis Properties				
Insurance		$ 153,010	$ 188,460	$ 189,278
MIS Costs		4,446	30,498	46,651
Miscellaneous		5,846	9,067	8,525
		$ 163,302	$ 228,025	$ 244,454
Charges from Fortis Properties				
Hotel/Banquet Facilities & Meals	(1)	$ 27,298	$ 28,145	$ 17,056
Miscellaneous	(2)	24,317	575	44,435
		$ 51,615	$ 28,720	$ 61,491
Charges from Canadian Niagara Power				
Staff Charges			$ 150	
		$ -	$ 150	$ -
Charges to Canadian Niagara Power				
Insurance		$ 129,497	$ 94,738	$ 92,636
Wages		239,305	161,210	6,660
MIS charges		4,998	2,613	2,310
Miscellaneous		72,986	6	
		$ 446,786	$ 258,567	$ 101,606

(1) Includes non-regulated expenses of 2000- $240; 1999 - $1,120 and 1998 - $8,247
(2) Includes non-regulated expenses of 2000 - $44,119; 1999 - $275 and 1998 - $23,710

Newfoundland Power Inc.
Intercompany Transactions - Other (Total)

Schedule 5C

	1998	1999	2000
Charges to Maritime Electric			
Insurance	$ 241,539	$ 256,930	$ 252,711
Engineering support	4,174		
Staff charges		15,465	13,761
IS charges	9,984	73,784	58,386
Miscellaneous	3,653	5,948	
	$ 259,350	$ 352,127	$ 324,858
Charges from Maritime Electric			
Engineering support			$ 2,647
Moving Expenses	$ 138,224		
Miscellaneous	13,352	$ 11,653	$ 16,535
	$ 151,576	$ 11,653	$ 19,182
Charges from AT&T			
Leased services and long distance	$ 328,539	$ -	$ -
Charges to AT&T			
Pole attachment rental	$ 3,504		
Space rental	2,583		
Miscellaneous	4,775		
	$ 10,862	$ -	$ -
Charges to Belize Electricity			
Staff Charges			$ 308,163
Miscellaneous			124,415
	$ -	$ -	$ 432,578
Charges to Fortis US Energy Corporation			
Insurance	$ -	$ -	$ 25,317