

1 **Q. What is the rationale behind the inclusion of gains and losses in the determination of**
2 **benefit expenses? What objectives does this approach serve? In what way is this**
3 **approach superior to simply using current service cost as the expense number? How**
4 **does this approach impact on the intergenerational equity of customers? How can**
5 **the results calculated under the current approach be expected to differ from the**
6 **current service cost over the long term?**

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8 A. Newfoundland Power has complied with Section 3461 of the CICA Handbook in
9 computing its 2010 employee future benefit expenses including both pension and Other
10 Post Employment Benefits (“OPEBs”). Section 3461 sets out how companies must report
11 their employee future benefit expenses for financial reporting purposes on an accrual
12 basis. This approach is consistent with generally accepted accounting practices.

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14 For regulatory purposes, Newfoundland Power follows Section 3461 to determine its
15 pension expense on an accrual basis. The inclusion of gains and losses, interest costs,
16 and amortization of transitional assets or obligations in the determination of pension
17 expense is in accordance with this accounting standard.

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19 For regulatory purposes, Newfoundland Power currently recognizes costs associated with
20 OPEBs on a cash basis (i.e., pay as you go) rather than an accrual basis. The Company’s
21 proposal to adopt the accrual method of accounting for OPEBs for regulatory purposes
22 will result in its accounting for OPEBs being consistent with the mainstream regulatory
23 practice in Canada.

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25 The primary objective of the accrual method of accounting for employee future benefits
26 is to provide a better matching of costs to the periods for which the costs are incurred.
27 When recognized in setting customer rates, it results in current customers paying for the
28 obligation to provide future benefits that result from providing service in the current
29 period. With rates set based on the cash method for OPEBs, current customers do not pay
30 for obligations that result from the provision of current service. The accrual method is
31 superior to the cash method from an intergenerational equity perspective.

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33 The accrual approach results in determining expense based on the present value of the
34 employee future benefit obligation. Conceptually, no matter which approach is used to
35 recognize employee future benefit costs, the net present value of the costs will be the
36 same. The approach selected only impacts the timing of the recognition of the payments
37 for these costs.