

1 Q. At page 13 of the 2013 Capital Projects Overview, Hydro proposes that Phase I
2 engineering costs incurred in 2012 be included in the capital costs sought to be
3 approved in this Application. Hydro notes that, in previous years, “high level
4 engineering work” had been completed prior to the filing of the Capital Budget
5 Submission.

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7 (a) Explain how “high level engineering work” differs from “Phase I engineering”.

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9 (b) Why did Hydro not consider “Phase 1 Engineering” as being essential prior to its
10 being “advanced” in 2012 to improve the quality of its capital budget
11 applications? What considerations did Hydro apply to determine that a change
12 in methodology was appropriate in 2012 in preparation for its 2013 Capital
13 Budget Application?

14
15 (c) In previous Capital Budget Submissions, did Hydro seek to have the costs of
16 “high level engineering work”, completed prior to the filing of the Capital
17 Budget Submission, capitalized and approved as capital costs? If not, explain
18 why these costs were not previously claimed as capital costs. Under IFRS IAS 16,
19 can “high level engineering work” be capitalized?

20
21 (d) In the current Application, in relation to the Projects where Hydro proposes to
22 include Phase I engineering costs as part of its capital costs to be approved for
23 the 2013 Capital Budget, did Hydro incur any costs for “high level engineering
24 work” that are not being claimed as part of the Phase I engineering costs
25 (excluding any Phase I costs falling below the \$1,000 threshold)?

(e) In the current Application, in relation to the Projects where Hydro proposes to include Phase I engineering costs as part of its capital costs to be approved for the 2013 Capital Budget, did Hydro incur any of those costs prior to 2012? If yes, provide the pre-2012 cost incurred for each Project, and the date or range of dates when these pre-2012 costs were incurred.

(f) At page 13 of the 2013 Capital Projects Overview, Hydro states that the “Costs associated with compiling and reporting the capital budget are not directly attributable to bringing an asset into operation and as such would be considered an operating expense.” In relation to the Projects where Hydro proposes to include Phase I engineering costs as part of its capital costs to be approved for the 2013 Capital Budget, provide a breakdown of the costs of compiling and reporting the capital budget which were not included in the claimed capital costs, and which were considered an operating expense.

A. Hydro has included, in its 2013 Capital Budget Submission, a proposal for Front End Engineering and Design work to be incurred in 2013 for 2014 capital projects. Hydro has previously capitalized these costs in its Capital Budget Submissions under Canadian generally accepted accounting principles (GAAP) but the engineering work occurred during the execution year of the projects. Hydro has recognized some weaknesses in its past estimates due to inadequate scoping and design work; and estimation of the materials required at the time of the Capital Budget Submission. To improve the quality of its estimates and to effectively frame its project work at the budget authorization stage, Hydro has now dedicated specific resources within the Project Execution and Technical Services department to the preparation of the capital budget with the front end engineering and design work being completed prior to the submission of the budget. This dedication of resources was permitted

1 through a change in the structure of the department and how Hydro was resourcing
2 its work and was not a change as the result of International Financial Reporting
3 Standards (IFRS), as these costs were eligible to be capitalized under both Canadian
4 GAAP and IFRS. The submission of this proposal illustrates Hydro's deliberate effort
5 to improve the quality of its capital budget while maintaining openness and
6 transparency with the Board.

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8 The responses to the specific questions are as follows:

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10 a) High level engineering work would consist of an overview of the scope, limited
11 investigation of the work to be carried out and a high level schedule for a
12 project. In the past, the detailed engineering work was not carried out until the
13 execution year.

14
15 With Phase I front end engineering design, the engineering begins during the
16 preparation stage of the Capital Budget Submission and would consist of
17 engineering around the conceptual design and then a basic design. This is actual
18 engineering including compilation of detailed material lists, layout
19 configurations, and detailed site visits. These costs are necessary to bring the
20 asset to its intended condition and location and are considered to be capital in
21 nature.

22
23 (b) Hydro has always considered Phase I front end engineering design important
24 but due to limited resourcing and previous staffing structure was unable to
25 advance the Phase I engineering work to the Capital Budget Submission stage.
26 Within the current structure of Project Execution and Technical Services,
27 dedicated engineering resources from the Technical Services section are
28 engaged in the preparation of the Capital Budget Submission. The change was

1 prompted as Hydro recognized that there were gaps in its previous budgeting
2 process and the revised process allowed Hydro to complete front end
3 engineering and design during the preparation of the project proposal. Hydro
4 has decided to adopt this practice as a result of lessons learned from these
5 projects.

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7 (c) In previous Capital Budget Submissions, Hydro did not separately seek to have
8 all costs of high level engineering work capitalized as they were not considered
9 by Hydro to be capital under Canadian GAAP (or IFRS).

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11 (d) The costs Hydro is seeking to capitalize are only those associated with Phase I
12 front end engineering design. Hydro does not specifically track high level
13 engineering activities associated with the preparation of estimates, building of
14 budgets and supporting documentation.

15
16 (e) Hydro did not incur any of these costs prior to 2012. All the costs being
17 reported in "Table 1: Front End Engineering Design 2012 Costs" on Page 14 and
18 Page 15 were incurred in 2012.

19
20 (f) Only the Phase I engineering costs were tracked and the costs associated with
21 compiling and reporting the capital budget were charged to general overhead
22 expenditures and were not specifically identified.