Q. [Net Salvage] – As it relates to instances where plant is replaced upon retirement and the Company incurs both costs for removal and cost for replacement of the retired asset, please provide a detailed narrative along with all corresponding documentation and support for how the Company determines what portions are assigned to the replacement asset. To the extent the process differs by account or subaccount, or circumstances, provide the information by each separate account or subaccount and/or circumstance and justify why they are treated differently. The response should include all underlying studies, memos, repots, etc. that was relied upon to establish this practice or procedure, and what the practice or procedure was before the change.

A. Typically, the allocation of costs between installation and replacement is determined from submitted contractor invoices and, for internal costs, from timesheets.

Contractor pricing is structured to separately identify the cost of installation and removal.

The allocation of internal costs is generally straightforward, in that there is usually a clear distinction between installation and removal. However, instances arise where the distinction is not as clear and, although there has been no change in the Company's cost allocation practices or procedures, inconsistencies in their application have occurred.

To eliminate inconsistencies among the Company's three operating regions in circumstances where the distinction between installation and removal is unclear, the Company issued a formal capitalization policy in 2011.

Attachment A contains a copy of Newfoundland Power's Capitalization Policy which includes additional guidelines on page 2 for cost of removal and retirement.

Capitalization Policy

CAPITALIZATION POLICY

This Capitalization Policy provides guidelines for the allocation of costs to either Capital, Retirement or Operating Expense. These principles are intended to conform to accounting principles generally accepted in the United States ("U.S. GAAP"), as well as industry best practices.

Newfoundland Power's capital spending policy provides uniformity and consistency throughout the organization for the accounting of assets that are acquired, built, developed, installed, retired, removed or replaced. This policy should be used to complete both the operating and capital budgets.

Capitalization Principles

1. All expenditures are considered Operating Expense until it is proven that they meet the capital criteria.

2. In certain cases, US GAAP will not provide definitive rules that apply to every possible situation. In these cases, prior to approval of the expenditure, the Manager of the department initiating the project should confirm with the Manager, Finance whether the project is capital or operating.

3. Costs include the amount to acquire, construct, develop or better an asset.

4. Capital assets include but are not limited to land, buildings, property, equipment, machinery, poles, wires, fittings, underground cable, furniture and fixtures, tools and instruments, computers, software, motor vehicles, reservoirs, dams and waterways, water wheels and turbines.

5. All capital assets will be shown at historical cost.

6. Capitalization of all costs will be based on effort (including all support functions) associated with the capital work being performed.

7. Staff will direct charge to projects, where possible.

Capital Expenditures are expenditures in excess of $1,000 and that meet all of the following criteria

1. Provide substantial benefits for a period of more than one year.

2. Extend the useful life of an asset or increase the capacity of an asset or the quality of output efficiency and may reduce operating costs.

3. Are held for use to conduct business/generate income.

Capital Expenditures include the following costs [1]

- internal labour costs directly charged
- contract work directly charged
- materials & supplies directly charged
- overhead recoveries as outlined below
- AFUDC (Allowance for Funds Used During Construction)

Additional Guidelines

Cost of Removal and Retirement

1. When an asset is retired from service, the asset account will be credited with the historical cost of the asset being removed.

2. If the asset being retired is a depreciable asset, the historical cost less any net salvage value and/or any insurance recovered will be charged to accumulated depreciation.

3. If any material is salvaged, the net salvage value is the salvage value less any removal costs.

4. Salvage value is, if the material is sold, the selling price, or if the material is retained for use by the Company, the original cost.

5. The labour charged to retirements should reflect the actual time associated with removal of the plant from service. Percentages have been developed for the following projects:

Project	Percentage of Internal Labour Charged to Retirements
Reconstruction Distribution Reliability Initiative Rebuild Distribution Lines Upgrades of Distribution Lines Transmission Line Rebuild	25%
Replacement of Services Replacement of Street Lights	50%

[1] GEC rules under separate policy.

Staff Training & Development

1. Initial training to operate or maintain a new plant facility (e.g. substation) being constructed may be capitalized as a part of construction costs.

2. General training, once a plant facility is in service, must be treated as an operating expense.

3. Training and other ongoing support costs related to IT software projects must be treated as an operating expense.

Repairs and Improvements

Ordinary Repairs (Normally Operating Expenses)

Recurring or routine costs for parts, labour etc. that do not extend the useful life of the capital asset but are necessary to keep the asset in normal operating condition (preventative maintenance costs/high wear items) are to be expensed.

Extraordinary Repairs (Normally Capital Expenditures)

Large significant expenditures (relative to the total capital cost of the asset) for major repairs that extend the useful life of the capital asset and are not recurring in nature are generally to be capitalized.

Improvements (Normally Capital Expenditures)

Involves the installation of a new part that is a betterment to the old part and will provide benefit in the form of greater output or lower operating costs for many years.

Overhead Recoveries

1. Vehicle costs will be charged to capital through a labor overhead rate.

2. The cost of Stores and the purchasing function is charged to materials cost through a loading rate.

Questions

Should you have any questions pertaining to the above policy, please contact the Manager, Finance.

Effective Date

This policy is dated and effective as of February 9, 2011.

(Revised August 7, 2012.)