



Board of Commissioners of Public Utilities Newfoundland and Labrador Hydro

IFRS Changes associated with 2012 Capital Budget Application
Financial Consultants Report – Supplementary Report

November 28, 2011

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Introduction and Scope

On August 3, 2011, Newfoundland and Labrador Hydro (“the Company”) (“Hydro”) submitted an Application to the Board of Commissioners of Public Utilities (“the Board”) requesting approval for the 2012 Capital Budget (“the Application”). For the purposes of the 2012 Capital Budget Application, the Company applied certain International Financial Reporting Standards (“IFRS”) to its 2012 capital proposals. The Application described the impact of the IFRS requirements and identified five areas of the 2012 Capital Budget Application that are affected by the move to IFRS. The net impact on capital identified in the Application totaled a \$3.3 million increase.

The Board requested that we undertake a review of the information included in the Application relating to Hydro’s proposed changes to its capital expenditure methodology as a result of incorporating the requirements of IFRS. Based on our report submitted on September 7, 2011, the Board issued several “Requests for Information” (“RFI’s) to Hydro requesting additional information.

On November 24, 2011, the Board requested that we prepare a supplementary report addressing the following questions:

1. Re: PUB-NLH-140 and PUB-NLH-14:- If AFUDC (“Allowance for Funds Used During Construction”) is removed from the amounts to be capitalized and IDC (“ Interest During Construction”) is included, would it not be normal to anticipate that IDC would be a lower number than AFDUC?
2. Re: PUB-NLH-139:- In responding to PUB-NLH-139, Hydro gave an estimate of hours to be charged to capital in 2012, instead of giving the dollar value of the hours. Does the response address your question, or does it add to the information that you have available so that you are comfortable with the numbers. If not, do you recommend that we go back to Hydro to obtain further information?
3. Re: PUB-NLH-137:- Will the derecognition of these amounts, when netted out against the capital expenditures serve to reduce the capital expenditures to be recorded in 2012, or have these amounts to be derecognized already been included in the estimated capital expenditures?
4. “Hydro has adopted the following policies and guidelines with respect to capitalizing Major Inspections and Overhauls:
 - 1) The overhaul or inspection will occur at regular intervals throughout the life of the asset, and would occur on a frequency of greater than one year;
 - 2) The total cost of the overhaul or inspection will be greater than \$50,000; and
 - 3) Any remaining carrying amount of the previous overhaul or inspection will be derecognized when a new overhaul or inspection occurs.Hydro believes that it is appropriate to capitalize Major Inspections and Overhauls under these conditions as they represent a benefit that will last over periods of greater than one year and to include the full cost in the year the work was performed would result in volatility in operating costs.”

Can you comment on why Hydro would choose \$50,000 to be the level of overhaul costs over which costs will be capitalized, and whether this is reasonable?

Observation and Findings

PUB-NLH-140 and 141

Question: If AFUDC (“Allowance for Funds Used During Construction”) is removed from the amounts to be capitalized and IDC (“Interest During Construction”) is included, would it not be normal to anticipate that IDC would be a lower number than AFUDC?

Answer: We would expect IDC to be a higher number than AFUDC, which is consistent with the information provided. The reason for this is that AFUDC contains both an equity component and a debt component, in effect blending the costs of both components. Hydro’s cost of equity is lower than its cost of debt; therefore, removal of the equity component results in a higher overall cost.

PUB-NLH-139

Question: In responding to PUB-NLH-139, Hydro gave an estimate of hours to be charged to capital in 2012, instead of giving the dollar value of the hours. Does the response address your question, or does it add to the information that you have available so that you are comfortable with the numbers. If not, do you recommend that we go back to Hydro to obtain further information?

Answer: The response does not provide the dollar impact of the change in methodology. However, the methodology itself appears to be appropriate. We do not believe that going back to Hydro for further information would provide any substantive benefit.

PUB-NLH-137

Question: Will the derecognition of these amounts, when netted out against the capital expenditures serve to reduce the capital expenditures to be recorded in 2012, or have these amounts to be derecognized already been included in the estimated capital expenditures?

Answer: Derecognition of these amounts will result in an accounting entry only. There would be no cash flow arising from derecognition of formerly capitalized expenditures. Consequently, we do not believe that these amounts are, or should be, included in estimated capital expenditures for 2012.

Hydro's Capitalization Policy regarding Major Overhauls and Inspections

Question: Can you comment on why Hydro would choose \$50,000 to be the level of overhaul costs over which costs will be capitalized, and whether this is reasonable?

Answer: We have reviewed the capital budget application for Hydro for 2012. Hydro includes in its budget the following categories: projects \$500,000 and over, projects \$200,000 and over but less than \$500,000, and projects over \$50,000 but less than \$200,000. Hydro's choice of \$50,000 for a threshold over which overhaul costs are capitalized appears to be consistent with including in the capital budget application projects over \$50,000.

Conclusion

Based on our review of Hydro's responses to the "Requests for Information" noted in this supplementary report, Hydro has correctly applied the new accounting standards under International Financial Reporting Standards in the preparation of its 2012 Capital Budget Application.