

1 **Volume 3, Section 2 – Browne, Regulatory Accounting**  
2

3 **Q. In relation to the evidence of John Browne, please confirm that NP's retention of its**  
4 **current method for treating OPEBs expense could also be reasonably considered as**  
5 **consistent with established regulatory principles and appropriate in the context of**  
6 **NP.**  
7

8 A. My report “Newfoundland Power, Regulatory Accounting Issues Related to 2007 Rate  
9 Application”, dated May 4, 2007, set out a number of issues to consider in evaluating  
10 NP’s proposal to transition from the current cash basis for recognizing OPEB costs for  
11 rate-setting purposes. These same issues would be relevant in evaluating a proposal to  
12 retain the cash basis.  
13

14 Cost of service:  
15

16 If NP continued with the cash basis for rate setting purposes, it is assumed that it would  
17 be allowed to recover the benefit payments as they became payable. Therefore,  
18 continuing with the current cash method would be consistent with the cost of service  
19 standard.  
20

21 Intergenerational equity:  
22

23 The cash basis is inconsistent with the cost of service standard; however, transitioning to  
24 the accrual basis and dealing with the transitional costs also raises issues of  
25 intergenerational equity. Ratepayers are not only required to pay for the OPEB costs  
26 related to providing them service in accordance with the accrual method, but also costs  
27 related to the period before the transition that would have been expensed under the cash  
28 basis after the transition.  
29

30 Rate stability and predictability:  
31

32 Based on the evidence I was provided at the time I wrote my report, NP’s proposal would  
33 require an increase in rates that was a little higher than the current inflation rate;  
34 however, not large enough to cause serious concerns about rate stability.  
35

36 Based on information provided to me by NP, retaining the cash basis would result in a  
37 reduction in NP’s revenue requirement in 2008 of about 1.3%. Although this would  
38 improve rate stability, at least in the short-run, given the overall impact on NP’s rates that  
39 has been provided to me, there would not be a significant improvement  
40

41 Industry practice:  
42

43 In the past, industry practice was to recognize OPEB costs on a cash basis. However,  
44 with the issuance of Section 3461, industry practice has been moving towards the accrual  
45 method.

1 Consistency:

2

3 NP uses the accrual method for recognizing its pension expense. Therefore the use of the  
4 cash basis for OPEBs results in an inconsistency in the rate setting treatment of future  
5 employee expense.

6

7 Conclusion:

8

9 If a regulated utility were just starting up, regulatory principles would generally support  
10 the use of the accrual basis for recognizing OPEB costs and not the cash basis. Also  
11 using the accrual basis would provide consistency in NP's regulatory treatment of future  
12 employee benefit costs (i.e., pensions and OPEBs). However, where the cash basis is  
13 currently being used, there is a need to deal with the transitional costs. This can raise  
14 issues of intergenerational equity and rate stability. Therefore, it may be appropriate for  
15 a regulatory board to decide that a utility should continue to use the cash basis.

16

17 Industry practice provides some support for the cash basis. Up until about ten years ago,  
18 it was normal utility practice in Canada to use the cash basis for rate setting purposes,  
19 and some utilities still do. However, with the issuance of Section 3461, industry practice  
20 has been moving towards recognizing OPEB costs on an accrual basis.