**Q. What material changes are anticipated in NP's financial statements as a result of the requirements that may result from the changes proposed in this Exposure Draft?**

A. The effect of the exposure draft would be to eliminate from the CICA Handbook all specific accounting guidelines with respect to rate regulated entities.

In the absence of Canadian guidance, rate regulated entities in Canada would look to corresponding accounting guidance in the United States. US accounting guidance for rate regulated entities is contained in Statement of Financial Accounting Standard Nos. 71 and 109 ("FAS 71 and 109") issued by the US Financial Accounting Standards Board.[1]

FAS 71 and 109 would require Newfoundland Power to disclose all of its future income tax assets (liabilities) on its balance sheet. They would have no effect on the Company's other financial statements.

Currently, Newfoundland Power recognizes future income tax liabilities in connection with temporary timing differences between depreciation expense and capital cost allowance. It also recognizes future income taxes on its regulatory reserves, such as the weather normalization reserve. Otherwise, it recognizes only current (ie. cash) taxes.[2]

In this Application, Newfoundland Power proposes to recognize future income taxes in connection with its employee future benefits effective January 1, 2008. Details of Newfoundland Power's proposal in this regard are provided at Volume 1, Finance Evidence, page 79.

Although FAS 71 and 109 would require Newfoundland Power to recognize all remaining future income tax assets (liabilities) on its balance sheet, it does not require Newfoundland Power to recognize a corresponding decrease (increase) in future income tax expense. Rather, Newfoundland Power would recognize on its balance sheet a regulatory liability (asset) equal to its remaining future income tax assets (liabilities).

To illustrate, at December 31, 2006 Newfoundland Power had future income tax liabilities totaling $77.5 million that, in accordance with its PUB approved income tax accounting policy, were not recognized on its balance sheet. This unrecognized future income tax liability is disclosed in note 2 to Newfoundland Power's 2006 audited financial statements filed in Return 1 of the Company's Annual Report to the PUB.

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[1] In effect, US GAAP would become Canadian GAAP for rate regulated entities. Adherence to US GAAP, and in particular FAS 71 and 109, is contemplated (i) in sections 1100.04 and 1100.23 – 1100.31 of the CICA Handbook, (ii) in the AcSB's May 3, 2006 Decision Summary which gave rise to the Exposure Draft and (iii) in the Background Information and Basis for Conclusions which underlies, and was issued with, the Exposure Draft.

[2] For further information on Newfoundland Power's income tax accounting, see *A Report on Employee Future Benefits*, Volume 2, Supporting Materials, Tab 4, pages 8 - 10.

Under FAS 71 and 109, Newfoundland Power would recognize on its balance sheet a regulatory asset of $77.5 million and a future income tax liability of the same amount.[3] In effect, the disclosure of the unrecognized $77.5 million future income tax liability is merely shifted from the financial statement notes to the balance sheet.[4]

3 FAS 71 and 109 permit rate regulated entities to record a regulatory asset if it is probable that future revenue will be provided for the payment of the related liability. In the case of future income taxes, both the regulatory asset and the future income tax liability are recognized as current income tax when the timing differences to which they relate are reversed, ie. when the income tax they represent is actually paid. As current income tax expense is a component of Newfoundland Power's revenue requirement, it would recognize a regulatory asset on its balance sheet until the related future income taxes are paid.

4 In May 2005, the AcSB issued accounting guidelines AcG-19 "Disclosures By Entities Subject To Rate Regulation" (accounting guidelines are a source of Canadian GAAP). The effect of AcG-19 was to require rate regulated entities like Newfoundland Power to recognize regulatory assets and liabilities, other than those related to future income taxes, on their balance sheet. Newfoundland Power is in compliance with AcG-19. Like AcG-19, the impact of the Exposure Draft is limited to Newfoundland's balance sheet. Effectively, the exemption for recognizing regulatory assets and liabilities associated with future income taxes would disappear under the Exposure Draft.