Q. How will these proposed changes impact cost recovery particularly as it relates to accrual accounts that have been and may be proposed to be used to maintain rate stability ie the Weather Normalization Account?

A. The changes proposed in the Exposure Draft will not impact cost recovery because their effect is limited to Newfoundland Power's balance sheet. Accordingly, there would be no impact on customers because (i) Newfoundland Power's earnings would not be affected and (ii) Newfoundland Power's rate base would not be affected.[1]

With respect to the weather normalization reserve in particular, Newfoundland Power already recognizes future income taxes.

For example, at a 35% income tax rate, a $100 transfer of purchased power expense to the weather normalization reserve is recognized as (i) a $100 reduction in purchased power expense, (ii) a $35 increase in income tax expense and (iii) a $65 increase in the reserve. Because the $100 reduction in purchased power expense is not recognized as a taxable event under the *Income Tax Act (Canada)*, the transfer to the reserve does not affect Newfoundland Power's cash taxes. Rather, the $35 increase in income tax expense that occurs upon the transfer to the reserve is future income tax expense.

Following the guidance in FAS 71 and 109 referenced in the response to PUB-NP-3 will not affect the operation of the weather normalization reserve. However, the manner in which the reserve is disclosed on Newfoundland Power's balance sheet would change.

In the example provided, the $65 increase in the reserve is a net-of-tax amount. It is composed of a $100 regulatory asset (the gross balance of the reserve) and a $35 future income tax liability. Under FAS 71 and 109, these amounts would have to be disclosed separately on Newfoundland Power's balance sheet.

[1] Under the asset rate base method for determining rate base, Newfoundland Power would add future income tax assets to its rate base, and subtract from rate base the corresponding regulatory liability. Similarly, future tax liabilities would be subtracted from rate base, and the corresponding regulatory asset would be added. The net impact on rate base, and therefore on Newfoundland Power's return and revenue requirement, in both cases is nil.