

1 Q. **Reference: Appendix D – Summary of Proposed Regulatory Accounting for Muskrat Falls**
2 **Project Charges**

3 On page 1 of 2 under the Muskrat Falls PPA, the regulatory mechanism for O&M, payments
4 pursuant to Real Property, Leases, Licenses or Easements, Indemnity payments, and Taxes states
5 “N/A- Treat consistent with IFRS”, but the same costs for the LTA payments states “IFRS
6 Deviation – Treat consistent with commercial payment”. Why are these costs being treated
7 differently?

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10 A. In order to determine the accounting treatment of each of the particular costs element
11 described in Appendix D – Summary of Proposed Regulatory Accounting for Muskrat Falls
12 Project Charges, the contracts involved were assessed under International Financial Reporting
13 Standards (“IFRS”) 15 – *Revenue from Contracts with Customers*.¹ Under this standard, the
14 Lower Churchill Project (“LCP”) companies must recognize revenues consistent with the transfer
15 of goods or services to a customer in an amount that represents the consideration to which the
16 entity expects to be entitled in exchange for those goods or services, irrespective of the
17 contractual timing of cash payments. This recognition of revenue in the LCP entities results in a
18 corresponding purchased power expense for Newfoundland and Labrador Hydro (“Hydro”).
19 Under the Muskrat Falls Power Purchase Agreement (“Muskrat Falls PPA”), a portion of the
20 charges from Muskrat Falls Corporation to Hydro relate to the recovery of the Muskrat Falls
21 generating plant’s operating and maintenance (“O&M”) costs. In addition, under the Muskrat
22 Falls PPA, the Muskrat Falls Corporation recovers its costs incurred under the Generator
23 Interconnection Agreement (“GIA”), which include the O&M costs of the Labrador Transmission
24 Assets (“LTA”). Both of these elements make up a portion of the transaction price or
25 consideration which the Muskrat Falls Corporation charges Hydro under the Muskrat Falls PPA

¹ Please refer to PUB-NLH-029, Attachment 1 – Muskrat Falls Power Purchase Agreement Under IFRS 15.

1 in exchange for promised goods and services. The O&M for the Muskrat Falls plant and the LTA
2 meet the definition of variable consideration under IFRS 15.

3 Under IFRS 15, variable consideration must be estimated at the start of the contract and then
4 recognized as revenue as the goods and services are delivered to the customer under the
5 contract. Therefore, the Muskrat Falls Corporation must estimate all variable consideration at
6 the start of the contract, including the variable portion of the recovery of GIA payments (which
7 incorporate LTA O&M), and recognize the associated revenue as the goods and services are
8 delivered to Hydro under the Muskrat Falls PPA. This pattern or timing of revenue recognition
9 may differ from the timing of the commercial cash payments associated with the transaction.

10 Under IFRS 15 there is an exemption (IFRS 15.85) whereby some variable consideration need not
11 be estimated at the beginning of the contract. The variable consideration related to the O&M of
12 the Muskrat Falls Plant relates specifically to Muskrat Falls Corporation's efforts to produce the
13 goods and provide the services required under the Muskrat Falls PPA and, therefore, this
14 portion of consideration can be recognized as incurred or consistent with the contractual cash
15 payments required from Hydro. As a result, no IFRS deviation is required.

16 The recovery of GIA payments, which include the LTA O&M, do not qualify for this exemption as
17 the O&M and other costs associated with the LTA do not directly correlate with Muskrat Falls
18 Corporation's efforts to produce the goods and services required under the Muskrat Falls PPA.
19 Therefore, the pattern or timing of revenue recognition will differ from the contractual cash
20 payment requirements under the Muskrat Falls PPA. As a result, an IFRS deviation is required.