

1 **Q. Why change to an accrual basis of accounting for pensions but not for other**  
2 **employee future benefits? Please provide calculations illustrating the cost to change**  
3 **to an accrual basis of accounting in relation to both pensions and other employee**  
4 **future benefits and the effect this change will have on revenue requirements.**

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6 **A. *Pension Expense***

7 In Order No. P.U. 17 (1987), the Board approved the adoption of the Canadian Institute  
8 of Chartered Accountants' (CICA) best estimates approach to accounting for pension  
9 expense. The best estimates approach is an accrual-based method. Since that time,  
10 Newfoundland Power has been recording pension expense on an accrual basis.  
11 Consequently, revenue requirement already reflects the accrual basis of accounting for  
12 pensions.

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14 The Company's proposal on pension accounting in this proceeding, found on page 66 of  
15 the *Finance & Accounting Evidence* is to change from the fair market value method of  
16 valuing pension assets to the market-related value method. Both of these methods are  
17 recognized approaches to calculating and recording pension expense as per Section 3461  
18 of the CICA Handbook. The comparative effect on pension expense of these two  
19 methods of valuing pension assets is illustrated in Table 18, on page 66 of the *Finance &*  
20 *Accounting Evidence*. The net impact of prospectively adopting the market-related value  
21 method of valuing pension assets will be a forecast \$1.2 million reduction in pre-tax  
22 revenue requirement for 2003 and a forecast \$0.2 million reduction in pre-tax revenue  
23 requirement for 2004.

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25 As noted by J.T Browne at page 6 of his report filed with the Company's 2003 General  
26 Rate Application, adoption of the market-related method of valuing pension assets in  
27 determining pension expense, "...will smooth out the impact on NP's pension expense  
28 from changes in the market value of its pension plan assets. It recognizes the variability  
29 in the market value of the assets in relation to their long-term growth trend."

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31 Mr. Browne also states on page 6 of his report that, "...it would be appropriate to apply  
32 the change prospectively for rate setting purposes."

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34 ***Employee Future Benefits Other Than Pensions (OFEBs)***

35 Effective January 1, 2000, Section 3461 of the CICA Handbook deals with all future  
36 employee benefits. As noted in the evidence of J.T. Browne, at pages 9 to 11, continuing  
37 on the cash basis of recognizing employee future benefits is not what generally accepted  
38 accounting principles (GAAP) would normally require. However, GAAP recognizes  
39 exceptions for regulated businesses. According to Mr. Browne's evidence, as long as it  
40 can reasonably be expected that rates will produce sufficient additional revenue to cover  
41 the cost of the future employee benefits in rates when payment is required, and such rates  
42 will be chargeable and recoverable from customers, Newfoundland Power's current  
43 policy of, and its proposal to continue, accounting for its OFEBs on the cash basis for rate  
44 setting purposes would be in accordance with GAAP.  
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1 As noted on pages 11 to 13 of J.T. Browne's evidence, regulatory practice in Canada is  
2 not consistent with respect to accounting for OFEBs.

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4 As noted in the *Finance & Accounting Evidence*, at page 71, lines 15 to 18, the result of  
5 adopting the accrual basis of accounting for OFEBs would be an increase in revenue  
6 requirements in 2003 of approximately \$4.1 million, or 400 per cent. Due to the large  
7 impact on revenue requirement as a result of a shift to the accrual basis, and based on the  
8 expectation that rates will produce sufficient additional revenue to cover the future costs  
9 when payment is required, Newfoundland Power is proposing to maintain the current  
10 basis of accounting for employee future benefits other than pensions on the cash basis.

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12 The increase in revenue requirement for 2003 and 2004 as a result of changing to the  
13 accrual basis of accounting for OFEBs is shown in Exhibit BVP-25.