

Grant Thornton LLP  
Chartered Accountants  
Management Consultants

September 5, 2003

Board of Commissioners of Public Utilities  
120 Torbay Road  
Prince Charles Building  
St. John's, NL A1A 5B2

**Attention: Ms. Doreen Dray**

Dear Ms. Dray:

**Re: Newfoundland Power Inc.  
2004 Capital Budget Hearing**

We have completed our review of the items indicated in your request dated August 27, 2003 relating to Newfoundland Power Inc.'s (the Company's) 2004 Capital Budget Application as it pertains to the calculation of the 2002 actual average rate base, the calculations of 2003 and 2004 forecast average rate base and the addition of deferred charges to the average rate base calculation commencing in 2003.

The results of our review for each required task are noted below:

**2002 Average Rate Base Calculation**

The actual average rate base for 2002 as calculated by the Company and provided in Schedule D of its Application is \$573,337,000. This calculation also agrees with the information submitted to the Board in Return 3 of the Company's 2002 annual report.

Our procedures with respect to verifying the calculation of the average rate base were directed towards the verification of the data incorporated in the calculations and the methodology used by the Company. Specifically, the procedures which we performed included the following:

- agreed all carry-forward data to supporting documentation including audited financial statements and internal accounting records, where applicable;
- agreed component data (capital expenditures; depreciation; etc.) to supporting documentation;
- checked the clerical accuracy of the continuity of the rate base for 2002; and

.../pg. 2

P.O. Box 8037  
ICON Building  
187 Kenmount Road  
St. John's  
Newfoundland  
A1B 3M7  
T (709) 722-5960  
F (709) 722-7892  
E StJohns@GrantThornton.ca  
W www.GrantThornton.ca

Board of Commissioners of Public Utilities  
page two...

- agreed the methodology used in the calculation of the average rate base to the Public Utilities Act to ensure it is in accordance with established policy and procedure.

Based upon the results of the above procedures we did not note any discrepancies in the calculation of the 2002 average rate base, and therefore conclude that the average rate base included in Schedule D of the Company's Application is accurate and in accordance with P.U. 36 (1998-99).

### **Forecast 2003 and 2004 Average Rate Base Calculation**

The forecast average rate base for 2003 and 2004 as calculated by the Company and provided in Exhibit BVP-1 of its Application is \$674,464,000 and \$709,066,000, respectively. We confirm that the calculations of the forecast average rate base for 2003 and 2004 are calculated correctly and in accordance with P.U.36 (1998-99) and P.U 19 (2003).

In P.U 19 (2003), the Board ordered the Company to include its average deferred charges in its rate base commencing with 2003. The Company has complied with this Order and further discussion relating to the forecast average deferred charges is included in the next section of this report.

In regards to the remaining components of the forecast 2003 and 2004 average rate base, we reviewed the plant investment component and agreed it to the calculation that the Company provided to us dated September 4, 2003, and the information provided in the Capital Budget Application relating to capital expenditures (2003 Capital Budget Variances – 1<sup>st</sup> Revision July 29, 2003, pg.1 of 12, and Schedule A). The other components of the forecast 2003 and 2004 calculations, which are not susceptible to complete verification, have been compared to the information provided during the 2003 General Rate Hearing and reviewed for reasonableness. Based on our review, the other components are reasonable in comparison to the information submitted during the 2003 General Rate Hearing and prior years.

### **Forecast Deferred Charges**

In compliance with P.U. 19 (2003), Newfoundland Power Inc. has filed evidence with the Board relating to its forecast deferred charges, including pension costs, to be included in the calculation of the forecast average rate base for 2003 and 2004.

Board of Commissioners of Public Utilities  
page three...

We confirm that, as indicated by the Company, the forecast deferred charges for 2003 and 2004, with the exception of the weather normalization reserve, have not changed from the information that was filed February 10, 2003 in conjunction with its 2003 General Rate Hearing.

The deferred charges for forecast 2003 and 2004 as presented by the Company are as follows:

(000's)	<b>Actual 2002</b>	<b>Forecast 2003</b>	<b>Forecast 2004</b>
Weather Normalization Account	\$ 10,919	\$ 9,705	\$ 8,579
Deferred Regulatory Costs and Other	16	816	416
Unamortized Debt Discount & Expense	3,490	3,290	3,092
Unamortized Capital Stock Issue Expense	458	392	325
Deferred Pension Costs	<u>64,684</u>	<u>72,794</u>	<u>79,870</u>
<b>Total Deferred Charges</b>	<u>\$ 79,567</u>	<u>\$ 86,997</u>	<u>\$ 92,192</u>

Source: Newfoundland Power Inc.- 2004 Capital Budget Application  
Changes in Deferred Charges- 2003-2004 (pg. 4 of 5)

We have reviewed the information provided by the Company relating to the deferred regulatory costs; the unamortized debt discount and expense; and the unamortized capital stock issue expense for continuity and reasonableness. Based on our review, we have not noted any discrepancies or unusual items. Our comments with respect to the Weather Normalization Account and Deferred Pension Costs are noted below.

#### Weather Normalization Reserve

The changes in the forecast weather normalization reserve for 2003 and 2004 reflect the Board's approval in P.U 19 (2003) to amortize the recovery of the \$5.6 million non-reversing balance in the Hydro Production Normalization Reserve over a period of five years. The only other change in this reserve in comparison to the information submitted in the Company's 2003 GRA Application is a decrease of \$88,000. The Company has indicated that this change is based on the difference between "normal" weather and that actually experienced to the end of May 2003.

Board of Commissioners of Public Utilities  
page four...

### Deferred Pension Costs

Deferred pension costs is the most significant component of the deferred charges and is the result of the pension funding exceeding the pension expense reported in the Company's income statement. The amount of funding paid into the pension plan is based on Board Orders and Board letters of approval as well as an actuarial determination made in accordance with CICA Guidelines. The calculation of pension expense is in accordance with the recommendations included in Section 3461 of the CICA Handbook.

According to table below, the pension plan funding for the 2003 and 2004 forecast is \$10.939 million and \$9.885 million and the forecast pension plan expense is \$2.829 million and \$2.899 million for 2003 and 2004 respectively. The difference between the funding and the expense as indicated below represents the increase in deferred pension costs for forecast 2003 and 2004.

	<b>Forecast 2003</b>	<b>Forecast 2004</b>
Deferred pension costs, January 1 <sup>st</sup>	<u>\$64,684</u>	<u>\$72,794</u>
Pension plan funding:		
- Current service funding	3,350	3,501
- Special funding	<u>7,589</u>	<u>6,384</u>
Total pension plan funding	10,939	9,885
Pension plan expense	<u>(2,829)</u>	<u>(2,899)</u>
Increase in deferred pension costs	<u>8,110</u>	<u>6,986</u>
Deferred pension costs, December 31	<u>\$72,794</u>	<u>\$79,780</u>

Source: Newfoundland Power Inc.- 2004 Capital Budget Application  
Changes in Deferred Charges- 2003-2004 (pg. 4 of 5)

Based on information provided by the Company, we have agreed the current service funding requirement that was provided by the Actuary. The special funding consists of two components; a special funding requirement of \$7.175 million and \$5.970 million for 2003 and 2004 as determined by Board Orders and Letters of Approval; and \$0.414 million of special funding as determined by the Company's actuary in accordance with CICA guidelines. Details of the

Board of Commissioners of Public Utilities  
page five...

special funding requirement, as determined by Board Orders were provided by the Company as Attachment B in response to U-12 during the 2003 General Rate Hearing. We have included this attachment as Appendix A to this report.

The additional \$0.414 million as determined by the actuary relates to the amortization of experience losses and changes in plan assumptions relating to 1992 and 1993. These amortizations are \$256,000/year until 2006 and \$158,000/year until 2007. This treatment is in accordance with CICA recommendations.

The forecast pension expense of \$2.829 million and \$2.899 million for 2003 and 2004 respectively is calculated in accordance with the recommendations of the CICA, and we have agreed this to information provided to the Company by its actuary.

It is important to note that the Company has also indicated in its Application that the 2004 pension funding and pension expense is subject to change due to the actuarial valuation that is required to be prepared and filed with pension regulators in 2004. Based on this valuation, the actuary will determine the total unfunded pension liability and the appropriate current service funding for 2004. Furthermore, the final pension expense for 2004 cannot be determined until after December 31, 2003. In accordance with CICA recommendations, the expense will be determined based on the market value of pension plan assets as of December 31, 2003 and the discount rate that is required to be used in the calculation will be the actual market rate of interest at December 31, 2003.

We have reviewed the forecast 2003 and 2004 weather normalization reserve and the deferred pension costs for continuity and reasonableness. Based on our review of the information provided by the Company, we have not noted any discrepancies or unusual items. The information filed by the Company is consistent with the information presented in the 2003 General Rate Application.

I trust this is the information you requested. If you have any questions please contact me.

Yours truly,

**GRANT THORNTON LLP**

Bill Brushett, FCA  
Partner

1

<b>Special Pension Funding  2003 and 2004  As Determined by Board Orders and Letters of Approval  (\$000s)</b>			
<b>Year of Regulatory Approval</b>	<b>Event</b>	<b>2003</b>	<b>2004</b>
1984	Creation of the Retirement Income Plan	4,188	4,188
1990	Cost of Living Allowance & Early Retirement Plan	140	140
1993	Early Retirement Program	1,205	-
1997	1997 Early Retirement Program	775	775
1999	Extension of 1997 Early Retirement Program	258	258
1999	2% COLA	88	88
1999	October 1999 Early Retirement Program	<u>521</u>	<u>521</u>
		<b>7,175</b>	<b>5,970</b>

2