**Re: D-96, Application Enhancements – Performance Management Software Budgeting Tool, Hydro Place, $127,100**

Q. Please provide a copy of the recommendations resulting from the review of the budgeting and re-forecasting process undertaken in 2008.

A. **Recommendations**

The review of the budgeting and re-forecasting process was an enterprise-wide review, and the recommendations are therefore addressed to the parent company but are more applicable to Hydro and Churchill Falls (Labrador) Corporation Limited. It should be noted that the above costs ($127,100) relate solely to costs for Hydro and do not include costs assigned to other related companies or lines of business.

The report recommendations are:
It is recommended that Energy Corporation procure a Corporate Performance Management (CPM) application that allows for budgeting and reporting of both financial results and non-financial performance indicators. Ideally, it should operate from a data warehouse that provides common information to all users, a "single version of the truth". Such a system would be expected to improve the availability of data and enhance control in budgeting and reporting of financial information. This will not occur simply by purchasing a tool. There are a number of policy and process changes that must precede or accompany implementation of a performance management/decision support tool.

Some of the policy and process items recommended for review or change are:

i. Standardize and streamline the budgeting and reforecasting process to the extent possible, with the goal of reducing the budget cycle time.

ii. Develop comprehensive financial and non-financial performance measures at the business unit level and use standardized tools to report performance. It is suggested that the balanced scorecard approach, customized to Energy Corporation's needs, be used to communicate strategic initiatives and deploy metrics.

iii. Review of Policy ACC 17 to ensure that it is achieving the desired outcomes and assess the potential of quarterly rolling forecasts as opposed to monthly reforecasting to fiscal year-end.

iv. Implement driver-based budgeting for operating projects.

v. Provide easy-to-access management reporting based on individual needs, including provision of sufficient detail for planning and control of expenditures and staff.

vi. Work toward closer integration among operating plans, strategic plans and budgets.

vii. Provide more detailed reports against operating projects, including time-based reports.

viii. Assess feasibility and benefits of implementing a formalized budget review process and standardized evaluation methods.

Accounting Policy (ACC 17) is attached.

## Corporate Policies & Procedures

**Attachments:**

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| **Category:** | Accounting | **Policy No:** | ACC 17 | **Revision No:** | 1 |
| **Title:** | BUDGETING AND FORECASTING OF OPERATING EXPENSES | | | **Approved 2006, May 17**<br>**Issued 2006, August 21** | |

**Policy:** The Hydro Group of Companies will exercise control of all operating expenditures and shall maintain timely and accurate forecasts of monthly and annual expenses.

**Related Policies:**

**PURPOSE:**

Accurate and timely budgets and forecasts are critical components of the Corporation's overall financial management:

1. **Budgets** – the budget is the primary tool by which the Corporation plans and manages costs. On a monthly basis the Leadership Team and the Board of Directors compare actual performance against the approved budget. It is critical that the monthly and annual budget amounts be as accurate and complete as possible. In addition to its role in performance management, the budget is an important component of the Corporation's rate applications and other filings with the regulator.
2. **Forecasts** – while the budget remains the primary tool used throughout the year to measure performance, accurate and timely forecasts on a monthly basis are critical to assist managers, the Leadership Team and the Board of Directors in monitoring performance throughout the year and taking action as necessary. Accurate and timely forecasts are critical to:
   - Assist managers and others understand and address controllable costs issues and take necessary action to stay within budget;
   - Provide the Leadership Team and Board of Directors with information on where controllable costs are expected to be at year-end so that appropriate adjustments if necessary can be made on a timely basis; and
   - Assist the Corporation in managing its cash flow and borrowing activities.

**SCOPE:**

All employees who have budgetary responsibility will prepare annual budgets and complete budget variance analysis on a monthly basis. Variance explanations will be documented and forecast adjustments made as required. Any forecast that results in an overall increase from the approved budget will be subject to approval by the Leadership Team.

**DEFINITIONS:**

1. The following will provide a description of some of the accounting terms used in this policy:

1.1. Budget - the annual financial projections for a given fiscal year, as determined prior to the commencement of the fiscal year, duly approved by the Leadership Team and the Board of Directors. The Budget remains fixed and is the document for fiscal performance and evaluation by the Leadership Team and Board of Directors.

1.2. Forecast - the revised financial projections for the remainder of the fiscal year, as adjusted from time to time.

1.3. Cost Type - a collection of expense items of a similar nature and identified by a four digit code i.e. 6010 will contain salaries for all employees.

1.4. Expense Group - a collection of cost type accounts of a related nature which are grouped for reporting purposes and are subtotaled in the monthly performance report i.e. accounts for permanent salaries and fringe benefits, etc. are subtotaled as the salary group of expenses.

1.5. Cost Code – a unique identifier for each element of the work breakdown structure.

1.6. Business Unit - facilitates the management of work and/or assets of the corporation. The Business Unit holds primary responsibility and accountability for budget and operating performance.

1.7. Department - a single Business Unit or collection of Business Units that report to the same Department Manager.

1.8. Division - a collection of Departments that report to a Vice President, or in the case of CF(L)Co the General Manager.

1.9. Expenditures - refers to the costs incurred on a monthly basis for which cash resources must be provided. Operating budgets are typically compiled on this basis.

**PROCEDURE:**

**All Persons With Budgetary Responsibility**

2. Personnel with budgetary responsibility will prepare detailed budgets for their Business Unit. These budgets should accurately reflect the month in which expenditure are expected to be made. The budgets will be submitted to the Department Manager and Vice President, or in the case of CF(L)Co the General Manager, for approval prior to submission to the Finance Department. The Finance Department will prepare a Corporate budget package for the Leadership Team. Once approved by the Leadership Team and the Board of Directors, these budgets will be the primary spending authority of each Business Unit.

3. Detailed review of operating expenses shall take place on a monthly basis.

3.1. Variance Analysis:

On a monthly basis, Business Unit Managers are required to complete an analysis of each Business unit having a year-to-date cumulative variance (plus or minus) exceeding the greater of 10% or $5,000, of the approved Budget amount. The budget variance analysis, fully documenting the reasons for the variances, shall be forwarded for the Department Manager's review. Following such review, the variance analysis shall be forwarded to the Division's Vice President, or in the case of CF(L)Co the General Manager, and the Finance Department.

3.2. Forecast Approvals:

With the exception of cost types which are budgeted by the Finance department, referenced in Section 4, Managers shall have the responsibility and authority to manage their approved budget and to reallocate funds within their approved budget to ensure that forecasts to year-end remain an accurate reflection of anticipated results.

**Business Unit Managers** shall forecast amounts among Cost Types and Cost Codes, and change the month in which an expenditure is forecast, with no additional approval being required, provided there is no increase in that Business unit's overall annual budget (ignoring the impacts of transferred salaries and overtime – cost types 6035, 6036, 6040 & 6041).

**Department Managers** shall have the further authority to reallocate funds between Business Units under their control, with no additional approval being required, provided there is no increase in that Department's overall annual budget (ignoring the impacts of transferred salaries and overtime – cost types 6035, 6036, 6040 & 6041).

**Vice-Presidents**, or in the case of CF(L)Co, the General Manager, may reallocate amounts among Departments within the same Division, with no additional approval being required, provided there is no increase in that Division's overall annual budget (ignoring the impacts of transferred salaries and overtime – cost types 6035, 6036, 6040 & 6041).

Amounts may be forecast between Divisions with the approval of the affected Vice-Presidents, provided there is no increase in the Corporation's overall annual budget. All persons with budgetary responsibility can initiate a forecast that results in an overall decrease in the Corporation's annual budget without any additional approval being required.

**Any forecast that results in an overall increase in expenditures above the Corporation's annual budget requires the approval of the Leadership Team and, where necessary, the Board of Directors**.

3.3 Documentation:

All forecasts shall include detailed explanations, and shall be reported, in a timely manner, to the Finance Department, to be reflected in the financial reporting system. Form 60-0519 – Operating Budget Forecast or a similar format should be used to document forecast requests.

4. Certain costs types are budgeted directly by the Finance department, or pursuant to instructions from Finance, including fringe benefits, group insurance, employee future benefits and capital percentage allocation. The Corporate Controller and Treasurer will initiate any forecasts of these cost types.

5. Annual Variance Analysis

At the end of each fiscal year, Business Unit Managers are required to prepare an analysis of all Cost Types' actual results as compared to budget, and as compared to the prior year, which have a variance (plus or minus) exceeding the greater of 10% or $5,000. This analysis, fully documenting the reasons for the variances, shall be forwarded for the Department Manager's review. Following such review, the variance analysis shall be forwarded to the Division's Vice President, or in the case of CF(L)Co the General Manager, and the Finance Department by February 15th.

**Finance Department**

6. The Finance department will distribute in advance of the regularly scheduled monthly performance meeting :
   - to the Leadership Team, the monthly Performance Report for the Leadership Team,
   - to each Department Manager, reports of operating year-to-date results by department

Information at the Business Unit Level is available to all business unit managers in JDEdwards via the Work Management Information (WMI) screen. Month-end close is normally completed within 7 working days following month-end excepting at year end when entries pertaining to controllable cost information should be completed no later than January 20.