

1 **Q. Reference: “2022/2023 General Rate Application,” Newfoundland Power, May 27,**
2 **2021, Volume 2, Report 6, Section 3.5, Page 10 of 13, Footnote 34.**

3
4 Newfoundland Power’s evidence states:

5
6 **See Attachment 1, Appendix E, Page E-3, Question 7. Expressed as a**
7 **percentage, overhead construction costs averaged 10% among the survey**
8 **respondents in relation to the utilities’ total capital expenditures in 2019.**
9 **This compares to 9% for Newfoundland Power (adjusted to remove the**
10 **impact of pension costs). Capitalized overhead for Newfoundland Power**
11 **includes GEC, Allowance for Funds Used During Construction (“AFUDC”),**
12 **and vehicle and inventory overheads.**

13
14 **a) Please provide the breakout as a percentage and dollars of the capitalization rate**
15 **between components (e.g., GEC, vehicle allowance, inventory overheads). Please**
16 **provide 2017–2023 Test Years (excluding pension costs in all periods for**
17 **comparative purposes).**

18
19 **b) Please provide the methodology used to determine inventory overheads and how**
20 **it is applied to overheads.**

21
22 **c) Please provide the rationale why Newfoundland Power uses an inventory**
23 **overhead allocation rather than following the incremental method in GEC.**

24
25 **d) Please provide the quantity of full-time equivalents that would be reduced if**
26 **Newfoundland Power followed the incremental approach for inventory**
27 **overheads and if there would be any revenue requirement impact of switching**
28 **from the inventory overhead method to the incremental method.**

29
30 **A. a) Table 1 on the following page provides a breakdown of capitalized overheads, as a**
31 **percentage of total capital expenditures.**

**Table 1:
Capitalized Overheads by Percentage**

	GEC¹	AFUDC	Vehicle	Inventory	Total
2017	3.3%	1.1%	2.6%	1.9%	8.9%
2018	3.4%	1.1%	3.0%	1.7%	9.2%
2019	3.0%	1.8%	2.4%	1.6%	8.8%
2020	3.5%	1.0%	2.8%	1.6%	8.9%
2021F	3.1%	1.2%	2.5%	1.4%	8.2%
2022T	3.2%	1.8%	2.6%	1.5%	9.1%
2023T	3.0%	2.4%	2.4%	1.4%	9.2%

1 Table 2 provides a breakdown of capitalized overhead amounts.

**Table 2:
Capitalized Overheads
(\$000s)**

	GEC²	AFUDC	Vehicle	Inventory	Total
2017	3,001	1,025	2,330	1,672	8,028
2018	3,060	951	2,679	1,507	8,197
2019	3,311	1,936	2,648	1,709	9,604
2020	3,347	949	2,702	1,563	8,561
2021F	3,406	1,317	2,776	1,606	9,105
2022T	3,498	1,943	2,860	1,654	9,955
2023T	3,687	2,964	2,941	1,701	11,293

2 b) Inventory overhead costs are capitalized because the purchasing, storing and handling of
3 inventory is an integral aspect of the provision of material for capital projects. These
4 costs are reallocated to the cost of items issued from inventory, and items purchased
5 directly by purchase order, through a loading rate.³ Each item is loaded at a rate of 15%,
6 up to a maximum of \$1,350.

¹ Excludes pension costs.

² Excludes pension costs.

³ A loading rate is applied to a base cost as a method of allocating certain costs to the same general ledger account as the base cost. Loading rates are assessed on an annual basis to ensure they are reasonably allocating the total overhead cost. Any over or under-recovery of allocated costs vs. the total cost is trued up at year end.

- 1 c) The use of an appropriate charge, or loader, enables inventory overhead cost to be
2 allocated to individual projects in a systematic way that is not administratively
3 burdensome.⁴ This approach is consistent with utility industry practice as reflected, for
4 example, in accounting instructions under the Federal Energy Regulatory Commission
5 (“FERC”) Uniform System of Accounts.⁵ As inventory overhead costs are allocated to
6 projects by an equitable method, they are not required to be included in Newfoundland
7 Power’s GEC calculation.
8
- 9 d) Inventory overhead costs can be directly attributed to capital projects and, therefore,
10 subject to capitalization under generally accepted accounting principles in the United
11 States (“U.S. GAAP”). An indirect method is used simply to reduce the administrative
12 burden of directly charging these costs to individual projects.⁶ In Newfoundland Power’s
13 view, it would be contrary to both U.S. GAAP and the purpose of capitalizing *general*
14 *expenses* “to switch to the incremental method” to allocate inventory overhead costs to
15 capital projects.⁷ Accordingly, the Company has not completed any analysis on the
16 matter to be able to provide the requested impacts on employees and revenue
17 requirements.

⁴ This approach is consistent with other cost allocations, such as AFUDC.

⁵ See *FERC Uniform System of Accounts – Electric Plant Instructions, Sections 3 and 4*. FERC is an independent agency in the United States that regulates utilities. One of FERC’s functions is the administration of accounting and financial reporting regulations for rate-regulated entities.

⁶ For further information on indirectly allocated capital costs, see the *2022/2023 General Rate Application, Volume 2, Supporting Materials, Tab 6, Review of General Expenses Capitalized, Attachment 1, Section 3.3 Capital Costs*.

⁷ U.S. GAAP *Accounting Standard Codification 360 Property, Plant, and Equipment* provides that “the historical cost of acquiring an asset includes the costs necessarily incurred to bring it to the condition and location necessary for its intended use.”