

UNDERTAKING

Undertaking

TO PROVIDE A DESCRIPTION OF THE WORK-BASED BUDGET ACCOUNTING SYSTEM

Response

Introduction

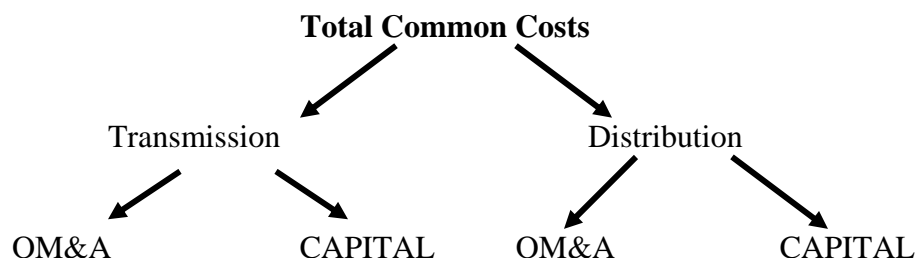
This note provides a high level overview of Hydro One's accounting system. There are two major classifications of costs, common and direct. Common costs (which are allocated to Transmission and Distribution and further to Operation, Maintenance and Administration and Capital Expenditures) make up approx. ¼ of the total costs at H1 while the direct costs (cost which are directly charged to Transmission and Distribution Operation, Maintenance and Administration and Capital work programs) make up the remainder.

Hydro One uses a 'standard costing' approach for its direct costs to charge costs to work programs (Reference Exhibit C1, Tab 4, Schedule 1 – Costing of Work). This 'standard costing' approach is commonly used in manufacturing industries and has been utilized at Hydro One since 1999. Hydro One uses a standard costing approach due to its joint Transmission and Distribution work force and the large nature of its business. A standard costing approach is more efficient in terms of cost attribution and reporting for large complex organizations with multiple business units.

This approach has been the basis of Hydro One's costing approach in our past Distribution and Transmission applications to the OEB.

Common costs

Common costs are first allocated between Transmission and Distribution consistent with the OEB approved Rudden common cost allocation methodology (Reference: Exhibit C1, Tab, 5, Schedule 1) and then secondly, allocated between OM&A & CAPITAL consistent with the OEB approved Overheads Capitalization Rudden methodology. (Reference: Exhibit C1, Tab 5, Schedule 2).



Common Cost Example:

Work programs (or activities) are developed in each common cost unit to support corporate objectives. After the activities are defined a resource budget is put together to ensure the activities can be completed. There are two major cost elements of a common cost unit.

<u>Cost Element</u>	<u>Charged to Transmission/Distribution OM&A and CAPITAL</u>
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- | | |
|---|------------------------------------|
| • Labour (e.g. salaries, benefits) | Consistent with Rudden Methodology |
| • General Expenses(e.g. travel, training) | Consistent with Rudden Methodology |

Example: Corporate Finance

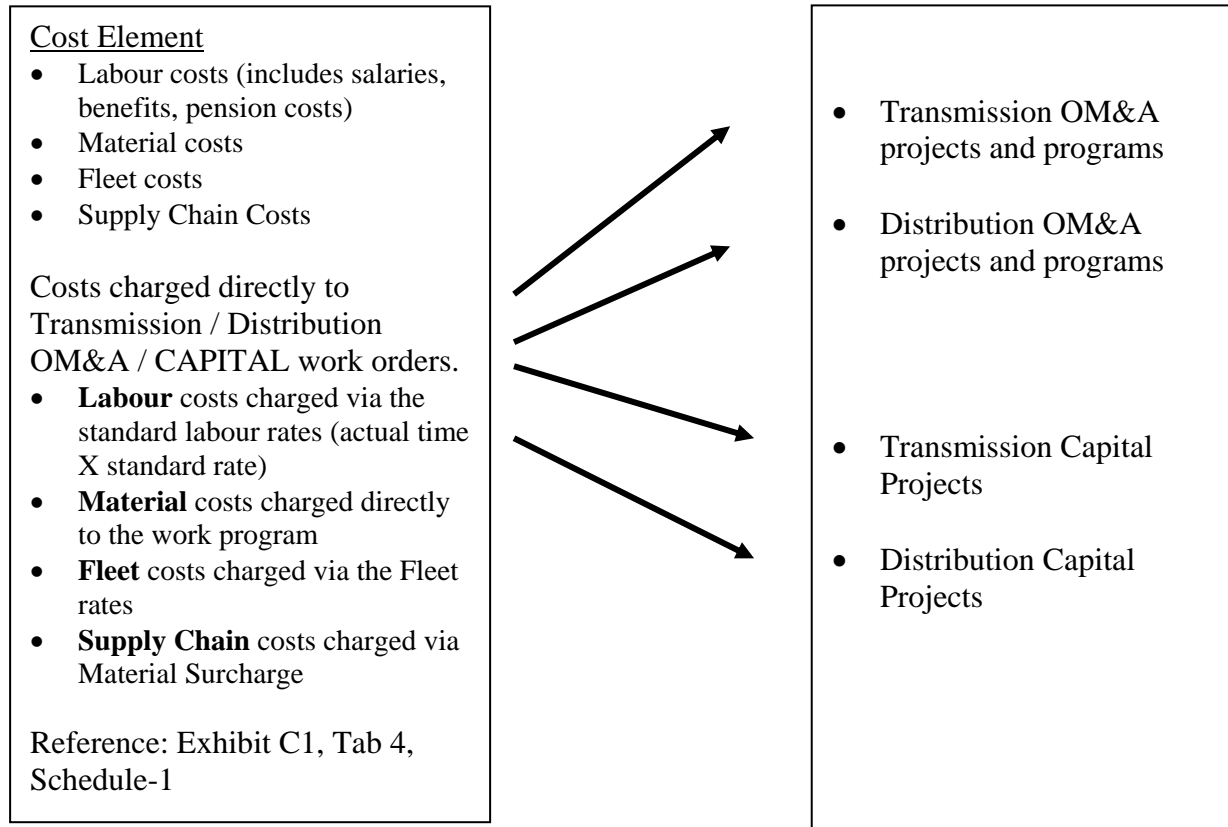
Total cost in 2008 Test year (including labour and general expenses) = \$26.9m (gross cost)

- Amount charged to OM&A = \$26.9 less \$13.4 (i.e. the amount capitalized: approx 50%)= \$13.5m
- Amount charged to CAPITAL= \$13.4m (=26.9 - \$13.5m)

Please note that the adjustment to the finance costs to allocate the appropriate amount to OM&A and Capital is not done on a unit basis but is done on a bottom line basis. Reference Exhibit C1, Tab 2, Schedule 6 and Exhibit C1, Tab 5, Schedule2.

Direct costs

Direct costs are charged to Transmission or Distribution OM&A or Capital work orders.
There is no allocation involved.



Direct Cost Example

Vegetation Management work program. Distribution test year total \$ = 119.4 million

The vegetation management work program is developed consistent with Hydro One's planning process as outline in Exhibit A-14-1 During the development of the work program the work to be accomplished in each year, consistent with Asset Condition Assessment (ACA) information and asset strategies and other inputs is determined. In the case of vegetation management this includes kilometres of lines to be cleared and kilometres of brush to be maintained. These (and other accomplishments) associated with the vegetation management program are then priced.

	<u>Units</u>	<u>\$ (millions)</u>
Brush Control	12,500 km	28.2
Line clearing	12,500 km	76.8
Customer Notification	12,500 km	7.9
Unplanned Maintenance & ACA		<u>6.5</u>
Total		<u>119.4 m</u>

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1 On an actual basis the costs of doing this work is charged directly to Transmission and
2 Distribution OM&A work orders. The labour costs are charged on a basis of actual time
3 spent X standard labour rates. Any material costs are charged directly to the work order.
4 Appropriate Fleet and Supply chain costs are charged to the work order using the
5 standard Fleet and Material Surcharge rates. Reference Exhibit C1, Tab 4, Schedule1 –
6 Costing of work.
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