NOVA SCOTIA POWER
An Emera Company

June 30, 2010

Nancy McNeil
Regulatory Affairs Officer/Clerk
Nova Scotia Utility and Review Board
1601 Lower Water Street, 3rd Floor
Halifax, NS B3J 3S3

Re: NSPI Accounting Policy 6960 – Accounting for Financial Instruments and Hedges

Dear Ms. McNeil,

NSPI's letter to the Board, dated June 11, 2010, included the following:

> **Introduction of the Fuel Adjustment Mechanism**
>
> The Fuel Adjustment Mechanism ("FAM") which came into effect January 1, 2009, governs the recovery of NSPI's fuel related costs. Subsequently, the Board approved an amendment to NSPI's Accounting Policy 6960 - Accounting for Financial Instruments and Hedges by letter dated December 11, 2009. The approved amendment effectively matches the recognition of the expense at the time the underlying hedge settles for Tuft's Cove fuel hedges that are no longer required. This change provided an appropriate alignment of fuel costs and customer recoveries under the FAM.
>
> The Company, with support from FAM stakeholders, has explored the potential of extending the accounting treatment to all hedges, including fuels and foreign exchange, so that fuel expense corresponds to hedge settlement. This regulatory approach would remove the quarterly effectiveness testing and recognition of any ineffectiveness of hedges. Based on NSPI's assessment of US GAAP reporting, it is evident that the financial instruments and hedge accounting is more stringent than Canadian GAAP which could result in more ineffectiveness recorded as expense. US GAAP recognizes rate regulated accounting standards such that an extension of NSPI's Accounting Policy 6960 accounting treatment to all hedges should align external financial reporting with fuel expense and FAM reporting.
>
> By June 30, 2010, NSPI will file a proposed amendment of its accounting policy for financial instruments and hedges for the

> Board's review and approval in advance of the adoption of US GAAP accounting standards on January 1, 2011. This amendment will limit the volatility in fuel expense and appropriately match the recognition of the expense with the hedge settlement period.

Attached for the Board's approval, please find the proposed revised redlined and final versions of Accounting Policy 6960. Also attached for the Board's information is the accounting opinion regarding this change provided by NSPI external auditors Grant Thornton.

NSPI respectfully requests the Board approve the amended Accounting Policy 6960 by September 1, 2010.

For more information, please do not hesitate to contact the undersigned.

Yours truly,

Eric Ferguson, CMA
Director, Regulatory Affairs

Attach.

c: Claudette Porter, CA
J. René Gallant
Bruce Outhouse, Q.C.
FAM Intervenors

ACCOUNTING FOR FINANCIAL INSTRUMENTS AND HEDGES - 6960

OBJECTIVE

01 The Company's financial instruments will adhere to the requirements of US Generally Accepted Accounting Principles (US GAAP) including ASC 815 – Derivatives and Hedging.

02 This policy sets out general guidance for accounting for certain financial instruments and hedging activities of the Company and the documentation requirements.

DEFINITIONS

03 Derivative instruments designed to mitigate the risk of the Company's exposure to changes in market prices of, for example, natural gas, oil, coal & other commodities, interest rates, and foreign currency exchange rates, will be considered as hedging activities of the Company. All remaining derivative instruments would be considered a part of trading activities.

04 Derivative Instrument: Is a financial instrument or other contract with all three of the following characteristics: (i) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index, or other variable (sometimes called the "underlying"), (ii) it requires little or no initial net investment; and (iii) its terms require or permit net settlement. Derivatives include financial instruments used to mitigate the risk of the Company's exposure to changes in market prices of, for example, natural gas, oil, coal, and other commodities. Derivatives include, but are not restricted to, such items as swaps, options, caps, collars, and forwards.

05 Fair Market Value: Is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties, who are under no compulsion to act.

06 Hedging Relationship: Is a relationship established by the Company's management between a hedged item and a hedging item.

07 Hedged Item: Is all or a specified portion of an asset, liability or an anticipated transaction, or group of assets, liabilities or anticipated transactions, having an identified risk exposure that the Company has taken steps to modify.

08 Hedging Item: Is all or a specified proportion of a derivative financial instrument acquired to modify the changes in cash flows or fair values arising from the risk exposure identified in the hedged item.

09 Hedge Accounting: Is a method for recognizing the gains, losses, revenues and expenses associated with the items in a hedging relationship, such that those gains, losses, revenues and expenses are recognized in income in the same period when they would otherwise be recognized in different periods.

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10 Mark-to-Market Accounting: Under the mark-to-market method of accounting, all financial instruments, other than instruments in a valid hedging relationship, are recorded at fair market value through net earnings.

POLICY

11 The Company engages in risk management activities to manage the Company's exposure to changes in the market prices of commodities, foreign exchange and interest rates.

12 The Company does not use derivative instruments for trading or speculative activities. All derivative instruments are entered into for risk management purposes and should adhere to this policy and these procedures.

13 The Company manages its commodity risk management activities in accordance with its Fuel Manual and Risk Management Policy as approved from time to time by management of the Company.

14 The Company manages its foreign exchange risk management activities in accordance with its Currency Risk Management Policy as approved from time to time by management of the Company.

15 The Company manages its interest rate risk management activities in accordance with its Interest Risk Management Policy as approved from time to time by management of the Company.

16 The Company enters into derivative instruments to manage the impact of market fluctuations on assets, liabilities, contractual commitments, and anticipated transactions. The Company defers the impact of changes in the fair market value of these derivative instruments to a regulatory asset or liability and includes the gains and losses on the derivative instruments in the measurement of the related hedged item when the hedged item is recognized.

17 Physical contracts are not marked to market through net earnings. Examples include contracts for natural gas and heavy fuel oil. Physical contracts are recognized through net earnings as the fuel is consumed or resold. Where a physical contract is considered a derivative instrument under US GAAP, the Company defers the net earnings effect to a regulatory asset or liability as appropriate.

18 The Company does not test or measure the effectiveness of its derivative instruments used as hedges. The derivative instruments used as hedges in accordance with the Company's risk management policies are assumed to be 100% effective.

PROCEDURES

19 Hedge accounting should apply to all hedging activities of the Company in order to ensure gains, losses, revenues and expenses on hedging and hedged items are recognized in the same period(s).

20 To ensure the proper accounting of hedging activities, at the inception of the hedging relationship:

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<#>Where practical, the hedge accounting procedures should follow the accounting guidelines set out in

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a. The front office should ensure the hedging activity is in compliance with the appropriate risk management policy;
b. The front office should document the specific risk exposure being hedged in accordance with its risk management objective and strategy, the hedged item, the hedging item, and the intended term of the hedging relationship;
c. The front office should have the latest quarterly forecast to support the specific risk exposure; and
d. The documentation should be approved by the preparer of the document, the manager of the back office, and the manager responsible for the front office.

21 At each quarter end, the fair value of derivative instruments used to hedge are recognized on the balance sheet as either a held-for-trading asset or a held for trading-for-trading liability. Changes in fair value should be recognized as either a regulatory asset or regulatory liability, as appropriate.

22 At each quarter end, any held-for-trading assets, held-for-trading liabilities, regulatory assets, and regulatory liabilities denominated in a foreign currency should be translated at the month end foreign exchange rate.

23 Realized and unrealized gains and losses on derivative instruments used to hedge risk management activities should be amortized in a systematic and rational basis over the term of the hedged item.

24 Realized and unrealized gains and losses on derivative instruments used to hedge fuel purchases should be included as part of the cost of the fuel as the hedged item is realized.

25 Realized and unrealized gains and losses on derivative instruments used to hedge capital projects should be included as a cost of the project as the hedged item is realized and expensed to depreciation expense as the project is depreciated.

26 Realized and unrealized gains and losses on derivative instruments used to hedge interest rates should be included in the measurement of the hedged interest expense using the effective interest method.

27 Foreign currency denominated financial assets and liabilities should be measured at the period end rate. Any hedged foreign currency exposure should be deferred to a regulatory asset or liability and will reverse when the hedged financial assets and liabilities settle.

28 Option premiums paid are amortized over the term of the option.

29 If the Company is required to pay a fee on the signing of an agreement, the fee should be deferred and amortized over the hedged term. Ongoing fees should be expensed as incurred.

30 If the hedged item no longer exists and the hedging item is no longer required, the hedging relationship is terminated. The hedging item is effectively disposed of and any resulting gains and losses should be deferred in a regulatory asset or regulatory liability and recognized in the same

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balance sheet or income statement item that would have been used had the hedged item still existed in the month the underlying hedging item settles.

31 If the timing of the hedged item moves forward or back, the Company may change the timing of the hedging item in order to ensure continued effectiveness of the hedging relationship. Changing the timing of the hedging item usually involves the effective settlement of the initial hedge and obtaining a new hedging item. Any gains or losses on settling the initial transaction should be deferred as a regulatory asset or regulatory liability until recognition and measurement of the hedged item. Any new hedging item should be accounted for in accordance with this policy.

32 Front Office Staff will be responsible for ensuring the documentation as outlined in this policy is completed. Back Office Staff will be responsible for reviewing documentation to ensure compliance with the accounting policy, and ensuring the appropriate accounting treatment.

33 Due to the complexity of derivative instruments, it is unlikely that all situations have been adequately covered in this Policy. Employees should endeavour to follow the spirit of the Policy and consult with Corporate Accounting as required to ensure a particular derivative instrument is accounted for correctly.

TRANSITIONAL PROVISIONS

34 This policy is effective January 1, 2011 and should be applied retroactively with restatement of prior periods except as outlined below.

35 Any item of property, plant and equipment, construction work-in-progress and intangibles recognized prior to January 1, 2011 should be translated at the foreign exchange rate used prior to January 1, 2011.

36 Any required transitional adjustment as a result of the change in foreign exchange rates applied to regulatory assets and liabilities as compared to accumulated other comprehensive income should be deferred and recognized in foreign exchange expense as the related derivative settles beginning January 1, 2011.

37 Any other required transitional adjustment as a result of implementing the policy (most likely due to ineffectiveness recognized prior to January 1, 2011) should be deferred and expensed over the weighted average life of the related derivatives beginning January 1, 2011.

38 All transitional adjustments should be to the balance sheet only. Net earnings of years prior to 2011 will not be restated.

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24 The timing of a hedged item may only move forward or back by a maximum of three months. Should the hedged item move forward or back by an amount of time greater than three months, the Company should assume the hedged item no longer exists and there exists a new risk exposure. The movement or extinction of a hedged item should be evidenced by current forecasts. Any gains and losses on settling the initial transaction should therefore be deferred until recognition and measurement of the hedged item.¶

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