General

Q. Reference: "2024 Capital Budget Application," Newfoundland Power, June 22, 2023, sch. B.

a) Please provide Newfoundland Power's capitalization policy.

b) Please provide Newfoundland Power's position on the capitalization of the Microsoft Enterprise Agreement, the expected useful life of each of the three capital additions, and the corresponding amortization of software.

A. a) Please see Attachment A for a copy of Newfoundland Power's Capitalization Policy.

b) The current Microsoft Enterprise Agreement (the "Agreement") allows Newfoundland Power to install Microsoft solutions, as needed, throughout the three-year contract period.[1] The Agreement also entitles the Company to continuous upgrades which extends the useful life of those solutions.

In accordance with the depreciation rates approved by the Board, supported by the Company's Depreciation Study filed as part of the *2022/2023 Newfoundland Power General Rate Application*, all software solutions are amortized over a 10-year period.[2]

[1] In the absence of this Agreement, the Company would be required to separately purchase all software and software upgrades.

[2] Newfoundland Power's Depreciation Study is completed by Gannett Fleming Valuation and Rate Consultants, LLC. Deprecation calculations are based, in part, by average service lives for each depreciable group of assets. Completing depreciation estimates by asset group, rather than by each individual component, is consistent with standard utility practice.

ATTACHMENT A:

Capitalization Policy

NEWFOUNDLAND POWER
A FORTIS COMPANY

CAPITALIZATION POLICY

This Capitalization Policy provides guidelines for the allocation of costs to either Capital, Retirement or Operating Expense. These principles are intended to conform to accounting principles generally accepted in the United States ("U.S. GAAP"), industry best practices, as well as regulatory accounting matters as approved by the Board of Commissioners of Public Utilities.

Newfoundland Power's capital spending policy provides uniformity and consistency throughout the organization for the accounting of assets that are acquired, built, developed, installed, retired, removed or replaced. This policy should be used to complete both the operating and capital budgets.

Capitalization Principles

1. All expenditures are considered an Operating Expense until it is proven that they meet the capital criteria.

2. In certain cases, US GAAP will not provide definitive rules that apply to every possible situation. In these cases, prior to approval of the expenditure, the Manager/Director of the department initiating the project should confirm with the Director, Finance whether the expenditure is capital or operating.

3. Costs include the amount to acquire, construct, develop or better an asset.

4. Capital assets include but are not limited to land, buildings, property, equipment, machinery, poles, wires, fittings, underground cable, furniture and fixtures, tools and instruments, computers, software, motor vehicles, reservoirs, dams and waterways, water wheels and turbines.

5. All capital assets will be shown at historical cost.

6. Capitalization of all costs will be based on effort (including all support functions) associated with the capital work being performed.

7. Staff will direct charge to projects, where possible.

Capital Expenditures are expenditures in excess of $1,000 and that meet all of the following criteria

1. Provide substantial benefits for a period of more than one year.

2. Extend the useful life of an asset or increase the capacity of an asset or the quality of output efficiency and may reduce operating costs.

3. Are held for use to conduct business/generate income.

* Note that there are individual expenditure items less than $1,000 that can be included in a capital project, such as capital inventory items or timesheet entries. These items contribute to the overall cost of the asset being constructed, and in aggregate would be well in excess of the $1,000 capitalization limit described above.

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Capital Expenditures include the following costs [1]

- internal labour costs directly charged
- contract work directly charged
- materials & supplies directly charged
- overhead recoveries as outlined below
- AFUDC (Allowance for Funds Used During Construction)

Additional Guidelines

Cost of Removal and Retirement

1. When an asset is retired from service, the asset account will be credited with the historical cost of the asset being removed.

2. If the asset being retired is a depreciable asset, the historical cost less any net salvage value and/or any insurance recovered will be charged to accumulated depreciation.

3. If any material is salvaged, the net salvage value is the salvage value less any removal costs.

4. Salvage value is, if the material is sold, the selling price, or if the material is retained for use by the Company, the original cost.

5. The labour charged to retirements should reflect the actual time associated with removal of the plant from service. Percentages have been developed for the following projects:

Project	Percentage of Internal Labour Charged to Retirements
Reconstruction 3rd Party Distribution Distribution Reliability Initiative Rebuild Distribution Lines Upgrades of Distribution Lines Transmission Line Rebuild Transmission Line Maintenance	25%
Replacement of Services Meters Replacement of Street Lights	50%

[1] GEC guidance is detailed in the PP&E process narrative.

Staff Training & Development

1. Initial training to operate or maintain a new plant facility (e.g. substation) being constructed may be capitalized as a part of construction costs.

2. General training, once a plant facility is in service, must be treated as an operating expense.

3. Training and other ongoing support costs related to IT software projects must be treated as an operating expense.

Repairs and Improvements

Ordinary Repairs (Normally Operating Expenses)

Recurring or routine costs for parts, labour etc. that do not extend the useful life of the capital asset but are necessary to keep the asset in normal operating condition (preventative maintenance costs/high wear items) are to be expensed.

Extraordinary Repairs (Normally Capital Expenditures)

Large significant expenditures (relative to the total capital cost of the asset) for major repairs that extend the useful life of the capital asset and are not recurring in nature are generally to be capitalized.

Improvements (Normally Capital Expenditures)

Involves the installation of a new part that is a betterment to the old part and will provide benefit in the form of greater output or lower operating costs.

Overhead Recoveries

1. Vehicle and employee related benefit costs will be charged to capital through a labor overhead rate.

2. The cost of Stores and the purchasing function is charged to materials cost through a loading rate.

Questions

Should you have any questions pertaining to the above policy, please contact the Director, Finance.

Effective Date

This policy is dated and effective as of September 30, 2021.