EXHIBIT
#3
DE 18-057

Public Service of New Hampshire d/b/a Eversource Energy
Docket No. DE 18-057

Date Request Received: 01/10/2020 **Date of Response: 01/23/2020**
Request No. TS 2-001 **Page 1 of 1**
Request from: New Hampshire Public Utilities Commission Staff

Witness:

Request:
Reference Staff 1-3 (and Eversource's Response). Please identify Eversource's capitalization threshold i.e. the dollar figure at which Eversource will treat a purchased asset or project as a capital project with related AFUDC and burdens. Is this threshold the same for software? Why or why not? How long have the identified thresholds been in place?

Response:
In general, Eversource's capitalization threshold for plant-related assets is $500. There are exceptions to the $500 threshold. Attachment TS 2-001 contains Eversource's capital vs. expense criteria, known as APS #8, on pages 1 through 6. Software has a specific capitalization criteria policy and Eversource's APS #3 is contained in Attachment TS 2-001 on pages 7 through 10. Internal software has a threshold of $100,000. The software capitalization policy is consistent with the accounting guidelines provided in FASB Accounting Standards Codification (ASC) 350-40, "Intangibles - Goodwill and Other - Internal Use Software" (ASC 350-40). The identified thresholds have been in place since at least the 2011 and 2012 timeframes as indicated in the policies.

CAPITAL VERSUS EXPENSE CRITERIA

Note: Terms defined in Appendix A are initially italicized.

Introduction

This policy provides guidelines surrounding the decision to capitalize or expense expenditures for plant. Charging *maintenance* expense and repairs accounts requires the Company to record the expense as incurred, while charging the utility plant accounts (capital) requires the Company to record the cost of the expenditure over the life of the asset through *depreciation*. Questions regarding this determination should be directed to Plant Accounting Manager.

Generally Accepted Accounting Principles (GAAP) provide a framework for determining whether expenditures should be capitalized or expensed. For Eversource's regulated companies, the determination is also impacted by FERC regulation, the rate making process, and the GAAP guidance specific to regulated operations in Accounting Standards Codification (ASC) Section 980. The Plant Accounts and Retirement Units Manual and this policy are established to address the regulated electric and gas businesses.

There are certain expenditures that are capitalized for the regulated businesses that are not permitted to be capitalized for the non-regulated businesses, such as certain overhead costs and the cost of equity. Questions regarding the capitalization of expenditures for the unregulated businesses should be directed to Plant Accounting.

General Information

Plant assets represent capitalized expenditures. Plant assets must meet the definition of an asset in accordance with FASB Statement of Concepts No. 6:

> Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.
>
> *Characteristics of Assets*
> An asset has three essential characteristics:
> (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows,
> (b) a particular entity can obtain the benefit and control others' access to it, and
> (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.

In accordance with FERC guidelines found in Electric Plant Instruction 10 of the Uniform System of Accounts, *retirement units* are the basis for determining whether transactions are capitalized or expensed. Plant Accounting further classifies retirement units into *units of property* and maintains a listing of retirement units and units of property in the Plant Accounts and Retirement Units Manual. When retirement units or units of property are an addition to plant, a replacement, or a retirement, the expenditure is either charged or credited to a utility plant account. Items that comprise a retirement unit or unit of property are called *minor items of property*.

All plant assets, including additions, replacements and improvements, should be analyzed to determine if there is an asset retirement obligation (ARO) associated with them. An ARO is a current legal obligation to remove or retire property, plant or equipment at some point in the future. This obligation may arise as a result of an existing law, statute or ordinance or as a result of a written or oral contract. An ARO may also arise through statements or comments made by management or officials of the Company that someone would or could rely upon. AROs require timely identification and are subject to complex accounting requirements and treatment. Individuals responsible for developing or purchasing property, plant and equipment must consider whether there is a legal retirement obligation associated with the property. Any such potential AROs must be identified and discussed with the Plant Accounting Manager to ensure that they are accounted for on a timely basis using appropriate accounting. New ARO's or changes to existing ARO's are required to be reported to Plant Accounting quarterly.

Expenditures to Be Expensed

The following categories of expenditures shall be expensed:

- Certain Start-up Costs:

The stage of the project when expenditures are incurred influences the decision on whether or not to begin capitalization. A definite plan to perform work on an approved project must be in place prior to capitalization. Plant Accounting should be consulted prior to beginning any major projects to ensure appropriate and timely accounting.

- Repairs and Maintenance:

Repairs and maintenance charges are defined as expenditures that are required to keep existing assets in a condition to adequately and efficiently perform the services for which the unit was designed or assure that the original expected useful life will be attained. These expenditures shall be charged to appropriate expense accounts in the accounting period incurred.

Expenditures to be Capitalized

- Expenditures that meet the definition of a retirement unit or unit of property and are included in the Plant Accounts and Retirement Units Manual shall be capitalized.

- Capital projects (e.g., transmission, distribution and generation)

Once a project has been approved by management, a work order is established by the project management team. Generally, all expenditures directly related to the project incurred after this point are capitalized.

- General Plant

Expenditures associated with the purchase of certain equipment such as office furniture, equipment and tools shall be capitalized if individual units exceed $500. This criterion pertains to equipment included in the following FERC Plant Accounts:

    - 391 - Office Furniture and Equipment
    - 393 - Stores Equipment
    - 394 - Tools, Shop and Garage Equipment

- 395 - Laboratory Equipment
- 398 - Miscellaneous Equipment

Also included are those items identified as Production General Equipment such as office furniture, equipment and tools in the Plant Accounts and Retirement Units Manual for the following Plant Accounts:

- 316 - Misc. Power Plant Equipment - Fossil Production
- 335 - Misc. Power Plant Equipment – Hydro Production
- 346 - Misc. Power Plant Equipment – Other Production

Exceptions to this $500 threshold include items which are purchased “in bulk”, such as office furniture and fixtures used for the initial setup of a facility or department, where although the individual assets may fall below the threshold, in aggregate such assets are significant and shall be capitalized. For this policy, the total cost of the “bulk” equipment must exceed $100,000 to qualify for an exception to the $500 capitalization threshold.

- Replacements and Improvements

When a retirement unit or unit of property is replaced, the cost of the replacement is capitalized and the existing retirement unit or unit of property is retired.

When a retirement unit or unit of property is to be substantially replaced or rebuilt, the cost of the replacement may be capitalized and the existing retirement unit or unit of property retired. The retirement unit must be returned to substantially new condition and the substantial replacement/rebuild must be a minimum of $25,000. If the equipment being rebuilt is being replaced and salvaged to inventory, contact Plant Accounting for accounting guidance.

When a minor item of property <u>that did not previously exist</u> (i.e., it is not a replacement) is added to an existing property unit, the cost of the addition is capitalized if the total cost (installed cost) is greater than $25,000.

When a minor item of property is <u>replaced</u>, the cost of the replacement is expensed, except for “betterments” which are treated as follows.

- Betterment

A replacement of a minor item of property during the life of the property unit is capitalized if it is greater than $500,000 or at least $25,000 and 25% of the book value of the unit of property and it meets one of the following criteria:

  - It increases productive value by raising the capacity or usefulness; ***or***
  - It increases durability or economic life; ***or***
  - It reduces the operating cost or increases efficiency of the existing property.

In FERC terminology, a replacement that meets these criteria is referred to as a betterment. Betterments often involve upgrades through the use of improved materials or updated technology. The amount of the betterment that is to be capitalized is the excess cost of the replacement over the estimated cost at current prices of replacing the asset with no upgrade or improvement in materials, technology, etc. Any remaining costs of the betterment are required to be expensed. The estimated cost at current prices must be documented (e.g., with a third party estimate) and reviewed with Plant Accounting.

Following are examples of betterments:

Example 1:

The cooling fan on a power transformer has failed and must be replaced. The transformer is the unit of property and the fan is a minor item of property. The recorded cost of the transformer is $470,000. Typically, this replacement would be considered maintenance work. In this case, however, a new fan is available at a cost of $175k that has the capability of increasing the kilovolt-amperes (KVA) the transformer can produce. The fan meets the criteria of a betterment because it increases the transformer's productive value by raising the capacity or usefulness of the transformer and the cost is greater than $25,000 and 37% (more than 25%) of the cost of the power transformer. It would cost $100k to replace the old fan with a like unit. The amount to be capitalized as a betterment would be $75k ($175k - $100k). The remaining $100k would be expensed as maintenance.

Example 2:

The supports (minor item of property) for a pier in the waterway at a hydro station must be replaced. The unit of property is the pier, including the supports. Typically, this replacement would be considered maintenance work. In this case, however, there are new supports available at a cost of $520,000 that will extend the useful life of the pier from 30 years to 40 years because of the materials used for these supports. The supports meet the criteria of a betterment because they extend the life of the pier and the cost is greater than $500,000. It would cost $270,000 to replace the old supports without the improved/bettered materials. The amount to be capitalized as a betterment would be $250k ($520k - $270k). The remaining $270k would be expensed as maintenance.

Other substantial improvement costs incurred that do not take the form of a retirement unit, unit of property or minor item of property may occasionally be capitalized if they meet the criteria above related to enhancing the value, life or capacity of an asset. Capitalization in these infrequent situations must be reviewed with Plant Accounting prior to work order approval.

Retirements

Retirement is the removal of property from service due to the end of its productive life. The item may be sold, abandoned or otherwise disposed of. Retirement accounting may also be applied when property is substantially replaced or rebuilt to substantially new condition. When a retirement unit or unit of property is retired from utility plant, the retired property is deducted from the plant account, and the related accumulated provision for depreciation is adjusted, as follows:

- The original cost is subtracted from the appropriate plant account, through the Unit of Property code, found in the company's property records and
- The original cost, *cost of removal*, and *salvage* are recorded to the accumulated provision for depreciation accounts.

Generally, when a minor item of property is retired, no separate accounting entry is required. The item's original cost will be subtracted from utility plant when the retirement unit, of which it is a part, is retired.

Spare Parts

Spare parts kept on hand in a centralized materials and supplies inventory storage location and available for general company use for replacement or maintenance purposes shall not be classified as plant assets prior to being placed in service. For such spare parts, those to be used within one year are classified as materials and supplies and those expected to be used over a longer period are classified as other noncurrent assets.

Under limited circumstances, certain spare parts that are retirement units and are not available for general company use may be capitalized as plant assets. Review with Plant Accounting is required. For a spare part to be capitalized as a plant asset, it must meet all of the following criteria:

1. The part is a retirement unit listed in the Plant Accounts and Retirement Units Manual.
2. The part is unique or of special design, custom manufactured for a specific piece of equipment because it is needed to ensure continuous operation of a facility or to minimize downtime costs that would be caused by lack of an available replacement.
3. The part is vital to the continuous operation of the facility.
4. The part will be used for emergency replacement purposes, not for routine or periodic maintenance or replacement.
5. The part is stored at or near the facility where it will be used for replacement purposes.

Installation costs are capitalized when the capitalized spare part is physically installed.

Exceptions to this capitalization policy must be discussed with and approved by Plant Accounting.

Appendix A

1. ***Cost of Removal***

   The cost of demolishing, dismantling, tearing down or otherwise removing plant, including the cost of incidental transportation and handling. This cost is included in rates and, when collected, is credited to accumulated depreciation.

2. ***Depreciation***

   Depreciation is the loss in service value not restored by current maintenance, incurred in connection with the use of plant and against which the utility is not protected by insurance. Causes of depreciation include wear and tear, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities.

3. ***Maintenance***

   The cost, throughout the life of an asset, required to keep it in efficient operating condition. Among these are, but not limited to, expenditures for painting, lubricating, and adjusting equipment. Characteristically, such expenditures neither add significantly to the value of the property, nor materially prolong its useful life.

4. ***Minor Items of Property***

   The associated parts or items which comprise a retirement unit.

5. ***Retirement Units***

   As defined by FERC and in the *Plant Accounts & Retirement Units* manual, retirement units are the accounting unit for implementing the company's policy for charging the cost of work performed.

7. ***Salvage Value***

   Compensation received for property retired, less any expenses incurred in connection with the sale or in preparing the property for sale; or, if retained, the amount at which the material recovered is chargeable to materials and supplies, or other appropriate account.

8. ***Units of Property***

   An expansion of retirement units into the items which are actually reported and recorded in the company's property records system

Purpose

This policy defines the rules surrounding the purchase and development of internal use computer software applications needed to conduct Eversource operations and to comply with regulatory reporting requirements. Responsibility to assure proper internal controls are in place and a proper audit trail exists for costs charged to development projects rests with the business unit sponsoring the software project.

Questions pertaining to this policy or issues related to a specific potential project to be capitalized should be addressed with the Manager of Plant Accounting.

Background and Scope

Certain internal and external costs associated with developing or obtaining software for internal use are to be capitalized if the project is expected to exceed $100,000. The policy to capitalize such costs is consistent with the accounting guidelines provided in FASB Accounting Standards Codification (ASC) 350-40, "Intangibles – Goodwill and Other – Internal Use Software" (ASC 350-40). This guidance was updated in FASB Accounting Standards Update No. 2015-05 (ASU 2015-05), "Customer's Accounting for Fees Paid in a Cloud Computing Arrangement," which is effective for arrangements entered into or modified beginning January 1, 2016. Specific criteria and guidelines are described below.

Internal use software has the following characteristics:

- The software is acquired, internally developed, or modified solely to meet the Company's internal needs.
- During the software's development or modification, no plan exists to market the software externally.

This policy includes internal use software expenditures for both of the following:

- Software applications new to the company.
- Significant modifications, upgrades or enhancements to existing internal-use software provided it is probable that the expenditures will result in significant additional functionality or will result in a minimum three-year extension of the software's original useful life. The costs of maintaining software, such as routine updates and de-bugging, may not be capitalized.

Costs to be Expensed

Costs that are **not to be capitalized** and must be expensed include:

- Costs incurred during the preliminary stage of a computer software project. Examples of this type of cost are:
    1. Determination of the high-level performance specifications (that is, what the software is intended to do) for the computer software project and related systems requirements.

2. Project viability assessments including identification of potential software solutions, development of cost/benefit analysis and business case preparation to justify a software project.

3. Making strategic decisions to allocate resources between alternative projects at a given point.

4. Exploring alternative means of achieving specified performance requirements, such as the costs associated with making the decision to develop or purchase software.

5. Selecting a vendor if an entity chooses to purchase software and/or a consultant to assist in the development or installation of the software.

- Data conversion from old to new systems. This typically includes tasks such as cleansing of old data, reconciliation or balancing of the data between the old and new systems and conversion of the old data to the new system. However, costs to develop or obtain software that allows for access or conversion of old data may be capitalized.

- Internal and external training costs incurred during any stage of the project.

- Costs incurred after all substantial testing is completed. Capitalization of costs *must cease* when a computer *software project is substantially complete and ready for its intended use*, that is, after all substantial testing is completed.

- Maintenance fees, including those embedded in the purchase price or upgrade price. These costs should be recognized as expense over the maintenance period.

- Costs of maintenance activities undertaken after the software is ready for its intended use to correct errors or keep the software updated with current information. These are routine changes and additions and therefore should be expensed as incurred. If internal costs cannot be separated between maintenance activities and relatively minor upgrades and enhancements, the costs shall be expensed as incurred.

- Cloud hosting arrangement costs to be expensed: Costs of internal-use software to which Eversource obtains access in a Cloud hosting arrangement should be expensed unless they meet both criteria listed below under "Cloud hosting arrangements to be capitalized." Unless they meet these criteria, the costs do not represent purchases of, or convey a license to, software and therefore must be charged to expense as service costs over the period of the arrangement.

Costs to be Capitalized

Once a project is past the preliminary stage (see description of the preliminary stage above), the capitalization of appropriate internal and external costs into a work order may begin. Costs may not be capitalized until both of the following have occurred:

- A project viability assessment has been performed and conceptual formulation, design, and testing of the possible software project alternatives has been completed.

- Management has committed to funding the specific software project and it is probable that the project will be completed.

Development costs to be capitalized: Costs to be capitalized include the internal and external costs necessary to bring the project to substantial completion and make it ready for its intended use, including all substantial testing. The types of costs which are to be capitalized include:

- External costs of materials and services consumed in developing or obtaining computer software for internal use. See below for specific criteria for capitalization of Cloud hosting arrangement costs.

- Payroll and payroll-related costs for employees who are directly associated with and who incur time on the software development project including design of the chosen alternative, development, coding and testing (to the extent the time is spent directly on the project).

- Capitalizable cost of funds, which for the regulated companies is termed Allowance for Funds Used During Construction (AFUDC). The Manager of Plant Accounting should be contacted to discuss the appropriate accounting for capitalizable cost of funds. This cost is calculated on internally developed software as follows:

    1) For regulated companies, debt and equity AFUDC is calculated based on the current AFUDC rates assigned to the particular operating company.

    2) For the unregulated entities, including the service company, capitalizable interest is calculated based on that entity's capital structure. Equity AFUDC is not permitted for the unregulated entities.

- Costs of developing or obtaining software that allows for conversion or access to old data by new systems.

Cloud hosting arrangement costs to be capitalized: Costs of internal-use software to which Eversource obtains access in a Cloud hosting arrangement may be capitalized if they are in effect purchases of, or convey a license to, software, as explained below:

- Costs of Cloud hosting arrangements after the development phase may only be capitalized if they meet **both** of the following criteria and are properly documented and approved in a Project Approval Form (PAF) in accordance with APS 1:

    1) Eversource has the contractual right to take possession of the software at any time during the hosting period without significant penalty (i.e., to take delivery of the software without incurring significant cost and to use the software separately without a significant diminution in its utility or value).

    2) It is feasible for Eversource to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software.

SaaS projects that do not meet the two capitalization criteria above may have internal and external direct costs during the development phase (prior to in service date) that may be capitalized. External direct costs may include the pro-rata portion of an up-front or first year software usage fee applicable to use of the software to develop the project before it is in service. Capitalization for a period in excess of one year is not expected to occur and requires approval by Plant Accounting.

The costs that fall within the guidelines for capitalization must be accumulated in an established work order. Each software project must have its own work order. Costs capitalized in accordance with this policy are subject to audit and must be properly documented.

Revision History

0 Original issue – February 23, 2011

1 Updates for ASU 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement, and miscellaneous clarifications – January 1, 2016