



Preliminary 2011 Revenue Requirements

Appendix E

Capitalized Power Purchases

1 **Issue**

2 FortisBC performs several types of capital work on generation facilities that may
3 require the procurement of power to replace lost generation. This can occur during
4 major refurbishments such as Upgrade and Life Extension (“ULE”) projects or
5 occasionally as generation capacity is also lost as a result of taking turbines or
6 generators out of service due to unplanned events. In certain circumstances, excess
7 power purchase costs that result from the lost generation capacity are included in
8 the capital cost of the project. As part of the 2010 NSA, the BCUC has requested an
9 “accounting opinion that capitalization of outage costs is consistent with CICA HB
10 3061”.

11 **Analysis**

12 FortisBC’s analysis is organized as follows:

- 13 1) Overview of relevant paragraphs from CICA 3061 – *Property, Plant &*
14 *Equipment*;
- 15 2) Analysis of relevant paragraphs in accordance with capitalization process for
16 outage costs;
- 17 3) Assessment of other CICA HB sections that might be used as analogy;
- 18 4) Overview of FortisBC Capitalization Policy; and
- 19 5) Historical precedent.

20 **1) Overview of relevant paragraphs from CICA 3061 – *Property, Plant &*** 21 ***Equipment***

22 Upon review of CICA 3061, it was noted that there is no direct reference to
23 specific issues such as idle equipment, reconditioning programs that require
24 dismantling facilities, or capitalization of costs incurred as a result of initiating
25 a project. Therefore, the cost definition per CICA 3061 was taken as the
26 relevant accounting literature.

27 *CICA 3061 – Property, Plant & Equipment (par. 5, emphasis added)*

1 “Cost is the amount of consideration given up to acquire, construct,
2 develop, or better an item of property, plant and equipment and includes
3 all costs directly attributable to the acquisition, construction, development
4 or betterment of the asset including installing it at the location and in the
5 condition necessary for its intended use.”

6 Paragraph 3(g) of CICA 3061 also acknowledges property, plant and
7 equipment subject to rate regulation with its own definition:

8 ***Rate-regulated property, plant and equipment*** are items of property, plant
9 and equipment held for use in operations meeting all of the following criteria:

- 10 (i) *The rates for regulated services or products provided to*
11 *customers are established by or are subject to approval by a*
12 *regulator or a governing body empowered by statute or contract*
13 *to establish rates to be charged for services or products.*
- 14 (ii) *The regulated rates are designed to recover the cost of*
15 *providing the services or products.*
- 16 (iii) *It is reasonable to assume that rates set at levels that will*
17 *recover the cost can be charged to and collected from*
18 *customers in view of the demand for the services or products*
19 *and the level of direct and indirect competition. This criterion*
20 *requires consideration of expected changes in levels of demand*
21 *or competition during the recovery period for any capitalized*
22 *costs.*

23 It should also be noted that outside of CICA 3061, amounts approved by a
24 regulator are eligible to be capitalized in the context of a rate regulated
25 environment under the current Canadian GAAP framework provided that
26 adequate disclosure is made.

1 **2) Analysis of relevant paragraphs in accordance with capitalization**
2 **process for outage costs**

3 With respect to CICA 3061 par. 5 above, the amount of consideration given
4 up by FortisBC in carrying out capital work on generation facilities includes
5 the opportunity cost of excess power purchases. In other words, if the capital
6 work was not performed and the turbines or generators were not taken out of
7 service, these excess power purchases would not be made. As a result,
8 power purchases over and above the average capacity requirements are
9 tangible, valid costs that will be incurred as a result of performing the
10 refurbishment or other capital work. It is management's view that these
11 excess power purchase costs can be considered directly attributable to the
12 capital activity.

13 Further, CICA 3061 should not be considered independent of the Canadian
14 GAAP framework. If the regulator approves an amount, such as power
15 purchase costs, for inclusion in an item of rate-regulated property, plant and
16 equipment as defined in item 1 above, then that item of property, plant and
17 equipment is compliant with CICA 3061.

18 **3) Assessment of other CICA HB sections that might be used as analogy**

19 As noted in item 1 above, the lack of direct reference to this specific
20 accounting issue indicates that professional judgment is required. In applying
21 professional judgment, analogous accounting guidance may be referenced.

22 Included in CICA 3061 is specific literature related to capitalizing interest (or a
23 regulator approved allowance) for the costs of financing capital construction
24 activity.

25 *CICA 3061 – Property, Plant & Equipment (par. 23, emphasis added)*

26 *“The cost of an item of property, plant and equipment that is acquired,*
27 *constructed, or developed over time includes carrying costs directly*
28 *attributable to the acquisition, construction, or development activity such*

1 *as interest costs when the enterprise's accounting policy is to capitalize*
2 *interest costs. For an item of rate-regulated property, plant and*
3 *equipment, the cost includes the directly attributable allowance for funds*
4 *used during construction allowed by the regulator.”*

5 In accordance with regulatory order, FortisBC capitalizes an allowance for
6 funds used during construction (“AFUDC”) in lieu of interest costs. The nature
7 of capitalizing interest (or AFUDC) is similar to incurring excess power
8 purchase costs in that they are both types of “carrying costs”. In the case of
9 capital work on generation facilities, when a turbine or generator is shut down
10 to perform the refurbishment or other capital work, a necessary cost is
11 purchasing power. This is due to reduced generation capacity that must be
12 replaced in order to meet customer demand commitments. Therefore, the
13 excess power purchases resemble a financing cost for lost power.

14 **4) Overview of FortisBC Capitalization Policy**

15 FortisBC's Capitalization Policy is attached as Appendix E-1. While no direct
16 reference to capitalizing power purchases is mentioned, this situation does
17 not appear to be inconsistent with the FortisBC Capitalization Policy
18 according to the following Capitalization Principles:

- 19 *2. In certain cases neither GAAP nor regulatory requirements provide*
20 *definitive rules that apply to every possible situation.*
- 21 *3. Costs include the amount to acquire, construct, develop or better an asset.*
- 22 *6. Capitalization of all costs will be based on effort (including all support*
23 *functions) associated with the capital work being performed.*

24 **5) Historical precedent**

25 Previous ULEs performed at FortisBC have included excess power purchases
26 as part of the project costs. For each ULE, the project costs have been
27 approved by the BCUC. The capitalization of incremental power purchase

1 expenses arising from the ULE projects have also been approved in annual
2 Revenue Requirement applications. The most recent ULE project approval,
3 the Corra Linn Unit 2 Upgrade and Life Extension project, was approved by
4 BCUC Order C-5-09. Included in the quantitative analysis of this ULE was a
5 capitalized power purchase expense. Attached as Appendix E-2 is Table 8.1b
6 of the CPCN Application identifying the incremental power purchase expense
7 to be capitalized.

8 **Conclusion**

9 Upon review of CICA 3061, it was noted that there is no direct reference to this
10 specific issue, therefore it is necessary to apply the principles of the relevant
11 guidance.

12 Based on our analysis of the eligible capital cost definition in CICA 3061, it is
13 management's view that excess power purchase costs can be considered directly
14 attributable to the refurbishment or other capital work on a generation facility since
15 the power purchase costs are actual consideration given up to better the item of
16 property, plant and equipment. In addition, if the regulator approves the power
17 purchase costs for inclusion in an item of rate-regulated property, plant and
18 equipment, it is compliant with CICA 3061.

19 This accounting treatment is also not inconsistent with FortisBC's Capitalization
20 Policy.

21 FortisBC believes the accounting treatment proposed is appropriate and consistent
22 with management policy and the Canadian GAAP framework.

Appendix E - 1
FortisBC Capitalization Policy



Capitalization Policy

This Capitalization Policy provides guidelines for the allocation of costs to either Capital or Operating Expense. These principles are intended to conform to Generally Accepted Accounting Principles as outlined in the CICA Handbook (GAAP), regulatory requirements as well as industry best practices. Where differences exist between this policy and BCUC Orders, the regulatory Order will prevail.

FortisBC'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 Operating Expense until it is proven that they meet the capital criteria.
2. In certain cases neither GAAP nor regulatory requirements provide definitive rules that apply to every possible situation. In these cases, prior to approval of the expenditure, the Manager of the department initiating the project should confirm with the Manager, Budgets and Forecasts whether the project is capital or expense.
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, insulators, 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.
8. Where there is a regulatory GAAP variance, a copy of the variance will be filed with the finance department.

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 (non-recurring expenditures) Note: this does not include routine maintenance.
3. Are held for use to conduct business/generate income.

Capital Expenditures include the following costs:

- Internal Labour costs directly charged
- Contract Work directly charged
- Vehicle Hours directly charged
- Materials & Supplies directly charged
- Overhead recoveries as outlined below
- AFUDC (Allowance for Funds Used During Construction)



Capitalization Policy

Additional Guidelines

Investigative Spending Projects

1. Investigative projects are defined as projects requiring investigation work to be completed before a proper scope and budget estimate can be submitted.
2. Investigative projects require an order to be set up to capture dollars while investigation is under way and will be reported as a deferred charge.
3. Once a capital project is set up the dollars will transfer to this approved project.
4. If a project is not approved the dollars in this project will be charged to Operating Expense.

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.

Staff Training & Development

1. Training to operate or maintain a new plant facility (e.g. substation) being constructed may be capitalized as a part of construction costs.
2. Training and other ongoing support costs related to IT software projects must be treated as an operating expense.
3. General training, once a plant facility is in service must be treated as an operating expense.

Repairs and Improvements

1. **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.
2. **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.
3. **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 for many years

Questions:

Should you have any questions pertaining to the above policy please contact the Manager, Budgets and Forecasts or the Controller.

Appendix E - 2
Corra Linn Unit 2 Life Extension
CPCN Application Cost Summary

Table 8.1b
Cost Comparison – 2009/2010 CEP Original Budget vs. CPCN Submission

Item	Task	Original Cost	Revised Cost	Variance	Reason
1	Generator				
	Generator Rewind & Rotor Pole Refurbishmen	3,448	3,459	11	
	Excitation System	563	605	42	
	Unit Protection & Controls	929	831	(98)	Price based on new quote from supplier
	Generator MV Switchgear Generator Bus	628	316	(312)	Price based on new quote from supplier
	Generation Main Leads	683	551	(132)	Efficiency gained through quantity order
	Generator Component Refurbishment	522	445	(77)	
	Generator Neutral Grounding Cubicle	46	53	7	
	AC and DC Auxiliary Systems	41	43	2	
	Subtotal	6,860	6,303	(556)	
2	Mechanical				
	Mobilization	123	427	304	Scope change for site security & truck access improvements
	Turbine Replacement	2,498	2,478	(20)	Price based on new quote from suppliers
	Turbine Component Refurbishment	1,374	1,149	(225)	Price based on new quote from suppliers
	HP Gov & HP Oil Lift System	535	454	(80)	
	Trash rack, Penstock, & Draft Tube	205	110	(94)	Scope change, draft tube modifications are not required.
	Unit Auxiliary Equipment	169	130	(39)	
	Subtotal	4,903	4,749	(154)	
3	Transformer				
	Unit Transformer	1,438	1,116	(321)	Price based on new quote from supplier
	Switchyard Improvements	388	346	(42)	
	Subtotal	1,826	1,463	(363)	
4	Auxiliary & Miscellaneous				
	Capitalized Power Purchase Expense	429	450	21	
	Commissioning & Testing	251	282	31	
	Acceptance Testing, demob, & project close	671	1,015	344	Scope change for site remediation
	Generator, turbine assembly & alignment	309	316	6	
	Subtotal	1,661	2,063	402	
5	Administration				
	Engineering, project management & safety	2,132	2,242	110	
	Construction Support	15	15	1	
	AFUDC	1,835	492	(1,343)	AFUDC recalculated due to updated timing and amount of capital expenditures and timing of completion of project tasks
	Subtotal	3,982	2,750	(1,232)	
6	Balance of Plant				
	P4 U2 ULE Total	3,448	1,456	(1,992)	Scope change
7	Spillway Gate Isolation Study	46	47	1	
8	East Wingdam Handrail Upgrade	78	79	1	
9	Power House Crane Upgrade	174	176	2	
10	Salvage	1,005	879	(126)	
	Project Total	23,983	19,964	(4,018)	