

Capitalization Policy
PEDERNALES ELECTRIC COOPERATIVE, INC.

CAPITALIZATION POLICY
PEDERNALES ELECTRIC COOPERATIVE, INC.
Policy #####

1. Purpose:—

1.1. This ~~policy~~Policy addresses criteria for determining whether expenditures are capital in nature. Capital expenditures result in one of the following:

- The creation of new ~~assets~~Assets
- The replacement of existing ~~assets~~Assets
- The modification of existing ~~assets~~Assets that is a substantial addition or betterment resulting in extension of useful life

1.2. This ~~policy~~Policy conveys Pedernales Electric Cooperative, Inc.'s ~~(“(PEC”) policy)~~ guidelines regarding capitalized expenditures for property, plant, and equipment. ~~It~~ also provides guidelines for consistent and accurate recording of ~~assets~~Assets as required for internal, external ~~(Generally Accepted Accounting Principles (“(GAAP”)~~, Federal), federal, and regulatory reporting.

2. Scope:—

2.1. This ~~policy~~Policy applies to all PEC ~~employees—and—contract~~ personnel~~expenditures~~.

3. Definitions:

3.1. Assembly List - List of Assembly Units that meet the definition of a CPR Unit.

~~3.1.~~**3.2.** Assembly Unit - a group of materials, specifically arranged, that fulfills a specific function in the operation of an electric supply line.

3.3. Asset – things that are resources owned by a company and which have future economic value that can be measured and expressed in dollars.

3.4. Continuing Property Record (CPR) Units – A unit of property which can be readily identified and accounted for by itself. There are two types of CPR Units:

3.4.1. Specifically identifiable units such as land, buildings, pumping equipment, etc., for which one maintains a record showing location and original cost of each item.

3.4.2. Group units such as mains, services, meters, etc. that are recorded in total quantities and at average cost per unit. Group unit property records are a control record and should be supplemented by subsidiary continuing property records subdivided by sizes and recorded in detail from the work orders completed during the year. The total quantities, total cost and average cost per unit should be recorded as part of the continuing property records at the end of each year.

~~3.2.~~**3.5.** Distribution Plant - ~~assets~~Assets with physical substance, including such items as land, buildings, structures, machinery, drawings, and equipment related to electric supply at distribution voltages. FERC GL Accounts 360-~~373~~374.

~~3.3.~~**3.6.** General Plant - ~~asset~~Asset with physical substance, including such items as land, buildings, structures, machinery, and equipment, owned and used by

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the utility but not directly related to the purpose of supplying electricity. FERC GL Accounts 389-399.

3.7. Generally Accepted Accounting Principles (GAAP) - a framework of accounting standards, rules and procedures defined by the professional accounting industry.

3.4.3.8. Intangible Plant - ~~assets~~Assets lacking in physical substance, including such items as trademarks, patents, or copyrights. FERC GL Accounts 301-303.

3.5.3.9. Like-for-Like Replacement - the replacement of an entire Assembly Unit defined as CPR unit or a piece~~the replacement~~ of ~~equipment~~Assets tracked with an asset record in the Cooperative's Asset Management System (exampleExample: substation breaker). ~~Replacement of items that do not comprise an entire Assembly Unit or asset will be expensed as maintenance.~~

3.6. GAAP - a framework of accounting standards, rules and procedures defined by the professional accounting industry.

3.10. Pole Treatment – Various wood pole treatments, such as external ground line, MITC fume treatment, insect & internal treatments, implemented as a program that result in substantial addition or betterment to asset life and reduce long term operating costs of the Asset.

3.11. Refurbishment – Work performed on transformers or other similar CPR Units that generally includes the repair/replacement of missing or badly deteriorated areas of the cabinet that restores the integrity of the transformer housing to its original performance specifications; as opposed to, the treating/painting of surface rust that prevents further rusting and restores the integrity of the paint to its original specification, which is a maintenance expense.

3.7.3.12. Transmission Plant - ~~assets~~Assets with physical substance, including such items as land, buildings, structures, machinery, drawings, easements, and equipment related to electric supply at transmission voltages. FERC GL Accounts 350-359.

4. Policy Statement and Implementation:

Classification of Expenditures. An expenditure that adds to the productive capacity, improves the efficiency, that increases the useful life of an existing ~~asset~~Asset, or that creates a new ~~asset~~Asset may be capitalized. On the other hand, expenditures for routine maintenance and repairs should be expensed in the period incurred. Capital expenditures must meet the guidelines stated below.

4.1. Transmission & Distribution Plant: Expenditures for the following activities are capitalized:

4.1.14.1.1. Installation or construction of new ~~assets~~Assets.

4.1.24.1.2. Upgrades or modifications to existing ~~assets~~Assets that adds to the capacity, improves the efficiency, or increases the useful life.

4.1.2.1. Rebuilding/rewinding of CPR Units such as transformer, regulator or recloser.

4.1.2.2. Refurbishment of CPR Units if refurbishment significantly increases the useful life such as Pole Treatment (10 years) and

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pad mount transformer cabinet restoration.

4.1.3.4.1.3. Like-for-Like Replacement of existing ~~assets~~Assets will be recorded as a capital installation ~~and with a~~ corresponding retirement ~~for such Asset~~. For Distribution Plant this is the Like-for-Like Replacement of Assembly Units defined as CPR Units. The Assembly List includes a listing of acceptable capitalized CPR Units.

4.1.4. Vegetation Management/Tree Trimming/ROW Clearing: Expenditures for the following activities are capitalized:

4.1.4.1. Initial cost of vegetation management, tree trimming, or right-of-way (ROW) clearing including the cost of permits for new ROW/easements for new construction.

4.1.4.2. Vegetation management or other clearing that adapts the property to new use and improvements that "put" property in a better operating condition (betterment) by relocating the ROW, changing the line route.

4.1.4.3. Additional clearing for re-routing a line or the new section of a line that is to be moved.

4.1.4.4. Modifications, additional trimming/clearing or (improvements) to property/ROW width or height to install larger equipment or taller poles.

4.1.4.5. Additional clearing for larger equipment and/or taller poles that are required to provide better service to a member.

4.1.4.5.1. Example: Original 10-foot ROW increasing width to 20-foot.

4.2. General & Intangible Plant: Expenditures for the following activities are capitalized:

4.2.1. Single purchase of a single ~~asset~~Asset with a value of ~~\$2,500~~5,000 or greater AND an expected useful life ~~greater than of~~ two years ~~or greater~~.

•4.2.1.1. Example: ~~single~~Single purchase of an office copy machine with a value of ~~\$2,500~~5,000 or greater.

•4.2.1.2. Example: ~~costs~~Costs for a patent or trademark with a value of ~~\$2,500~~5,000 or greater and will last longer than two years.

4.2.2. Multiple component purchases that create a single ~~asset~~Asset with a total value of ~~\$2,500~~5,000 or greater AND with an expected useful life ~~greater than of~~ two years ~~or greater~~.

•4.2.2.1. Example: ~~multiple~~Multiple purchases of computer hardware/components that make up one asset with total value of ~~\$2,500~~5,000 or greater.

4.2.2.2. Example: ~~multiple~~Example: Set of furniture purchased for a room or area (not individual replacement components).

•4.2.2.3. Example: Multiple expenditures for a single software implementation with total value of ~~\$2,500~~5,000 or greater.

4.2.3. ~~ALL~~All transportation equipment licensed for road use, regardless of value

•4.2.3.1. Example: ~~trailer~~Trailer with a value less than ~~\$2,500~~5,000.

4.2.4. ~~Project and Bulk purchases~~Betterment of an existing Asset to increase

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or extend its useful life where ~~total~~ the value of the Asset is ~~\$40~~ increased by \$5,000 or more.

4.2.4.1. Example: Facilities project to replace plastic siding with fiber cement siding, upgrade of a building's electrical system or security system upgrade. This will not include minor parts replacement or repairs of an existing Asset.

4.2.4.4.2.5. Leasehold Improvements – betterment of leased facilities, land, or offices where the lease term is two years or greater ~~AND expected useful life~~ and the dollar value of the leasehold improvement is greater than ~~two years, even if individual capital items are not valued at \$2,500 or greater each~~ \$5,000.

- ~~Example: Project for office remodel where individual capital items do not meet the \$2,500 threshold, but total project costs are \$40,000 or greater with expected useful life over two years. Items that do not meet capital guidelines per GAAP should be expensed in the period incurred and not included in the capital project.~~
- ~~Example: PEC standardizes computer purchases where an individual computer is less than \$2,500, but the annual purchases of similar computers in aggregate meets or exceeds \$40,000.~~

4.2.5.1. Example: Construction, decking, cabling, security systems, HVAC undertaken for a leasehold property

5. Procedure Responsibilities

5.1. ~~PEC's Chief Financial Officer (“CFO”)~~ has overall responsibility for this ~~policy.~~ Policy. Under the direction of the CFO, PEC's Finance Department is responsible for enforcing this ~~policy~~ Policy, establishing operational procedures, reporting mechanisms, and training to ensure work results conform to this ~~policy~~ Policy. PEC employees and any contract personnel are responsible for following this ~~policy.~~ Policy.

5.2. The Assembly List will be modified from time to time as new Assembly Units are approved or existing Assembly Units are inactivated by the PEC Standards Committee. The PEC Standards Committee generally keeps PEC construction standards up to date and in compliance with the National Electric Safety Code and other applicable regulations and standards.

6. Enforcement

6.1. Violations of this Policy may result in disciplinary action, up to and including, termination.

7. Superseding Effect

7.1. This Policy supersedes all previous policies and memoranda concerning the subject matter. Only the Approver may authorize exceptions to this ~~policy.~~ Policy.

8. References and Related Documents:

8.1. Generally Accepted Accounting Procedures

8.2. Federal Energy Regulatory Commission List of Accounts

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8.3. Budget Policy

8.4. Assembly List

Policy Title:	Capitalization Policy
Policy Number:	
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Effective Date:	January 1, 2015; XX,XX,XXXX
Amendment Dates:	July 21, 2014; July 18, 2016; XX,XX,XXXX
Approver:	Board of Directors
Applies to:	All <u>PEC</u> employees and contract personnel
Administrator:	Finance
Superseding Effect:	This Policy supersedes all previous policies and memoranda concerning the subject matter. Only the Approver may authorize exceptions to this policy- <u>Policy</u> .