BPA Policy 212-9

Allowance for Funds Used During Construction (AFUDC)

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1. Purpose & Background

The purpose of this policy is to provide guidance on the proper accounting treatment for capitalized interest and to describe the formula utilized to calculate the annual AFUDC rate.

2. Policy Owner

BPA's Chief Financial Officer is the owner of this policy, and assigns responsibility for its implementation to BPA's Accounting Officer (AO).

3. Applicability

BPA employees

4. Terms & Definitions

A. **Allowance for Funds Used During Construction (AFUDC):** A generally accepted accounting principle whereby the cost of financing capital construction projects is added to the cost of the asset.

B. **AFUDC FERC Rate Formula:** BPA uses the FERC formula for AFUDC as defined in Title 18 CFR Part 101 Electric Plant Instruction 3(A)(17). The portion of the formula and elements applicable to BPA for calculating the annual AFUDC rate are:

$Ai = s\ (S/W) + d\ (D/D+P+C)\ (1-S/W)$

Ai	= Gross allowance for borrowed funds used during construction rate
S	= Average short-term debt (estimated forecast)
s	= Short-term debt interest rate (estimated forecast)
D	= Long-term debt
d	= Long-term debt interest rate
P	= Preferred stock
p	= Preferred stock cost rate
W	= Average balance in Construction Work-in-Progress (CWIP)
C	= Common equity
c	= Common equity cost rate

Per FERC guidance in Accounting Release 13 (AR-13), no single borrowing rate will be project specific. The formula includes a component for the weighted average cost of long-term debt which is to include both use-restricted and unrestricted borrowings.

According to FERC guidance, short-term borrowings should be included in the AFUDC rate calculation even if they are not used to fund construction. In recent years, BPA has entered into a short-term borrowing agreement with Treasury and, to comply with the

FERC requirements, BPA will consider the short-term debt and interest rates forecasts when updating the AFUDC rate each year using the following simplified formula:

Ai = s (S/W) + d(1-S/W)

C. **Trust fund AFUDC:** In situations where debt proceeds borrowed to fund capital construction projects are placed in a restricted trust or special fund, AFUDC assigned to the construction project should include a provision for the cost of borrowing the unspent trust funds. Per AR-13, AFUDC assigned to the project should be determined by applying BPA's annual AFUDC rate to the balances in the trust fund.

Trust fund investment earnings during construction should be credited against the cost of construction (to reduce the overall project cost).

5. Policy

A. **Assets Qualifying for Interest Capitalization**

AFUDC will be applied to assets that require a period of time to bring them to the condition and location necessary for their intended use.

B. **Capitalization Period**

Except as provided in Section 5.C., the AFUDC capitalization period shall begin and continue as long as the two conditions below are present:[1]

1. Capital expenditures for the project have been incurred, and
2. Activities that are necessary to get the construction project ready for its intended use are in progress. The term "activities" is to be construed broadly.

Brief interruptions in activities, delays that are inherent in the asset acquisition process and interruptions in activities that are imposed by external forces are unavoidable in acquiring the asset and as such do not call for a cessation of interest capitalization.

The capitalization of AFUDC will stop when the asset has been tested,[2] is substantially complete[3] and is placed in service or ready for its intended use.

When assets are completed in parts and each part is capable of being used independently while work continues on other parts, interest capitalization stops when each part is substantially complete and ready for use.[4]

[1] FERC Accounting Release (AR-5)
[2] AR-5
[3] ASC 835-20-25
[4] ASC 835-20-25-5

C. **Halting of AFUDC for Construction Delays**

Interest is not to be capitalized during periods when BPA intentionally defers or suspends activities related to the asset. Similarly, if management has the ability to cure externally imposed delays but chooses not to do so then interest capitalization should cease.[5] Interest cost incurred during such periods is a holding cost, not an acquisition cost.[6] No AFUDC should be accrued during periods of interrupted construction, unless BPA can justify the interruption as being reasonable (i.e. not controllable by management) under the circumstances.[7]

The project may be placed in a hold status during which time it will not receive monthly AFUDC if:

1. Management intentionally defers or suspends substantially all activities necessary to get the asset ready for its intended use,
2. The project is expected to be completed in the future,
3. The existing project costs are expected to benefit the future asset, and
4. The delay is expected to last longer than one year (project delays of less than one year will be evaluated if the AFUDC accrued during the delay would be material to the financial statements).

When activities resume, the project will be placed back in an active status and AFUDC charges will resume.

D. **AFUDC Application for Software Projects**

AFUDC on software projects is capitalized only during the application development stage. If BPA suspends substantially all activities related to the software being developed or obtained for internal use, interest capitalization shall cease until activities resume.

E. **Corps of Engineers and Bureau of Reclamation**

The Corps of Engineers and Bureau of Reclamation calculate AFUDC on capital projects based on funding source and in accordance with their own policies. They use BPA's rate for direct funded projects and the one-year U.S. Treasury rate for appropriation funded projects.

6. Policy Exceptions

AFUDC will not be applied to inventory, land, assets that are ready for their intended use upon receipt or assets that are customer funded.

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[5] PwC Accounting and Reporting Manual 4740 – Capitalization of Interest Cost
[6] ASC 835-20-25-6
[7] AR-5

7. Responsibilities

A. The authority for making accounting policy is vested in the **Administrator** and is delegated to the **Executive Vice President and Chief Financial Officer (CFO)**.

B. **BPA's CFO** is delegated the authority by the Administrator to provide, on a BPA-wide basis, those financial management systems, policies, and procedures deemed necessary to keep complete and accurate accounts of operations, including all funds expended and received in connection with acquisition, transmission, and sale of electric energy and other BPA services.

C. The **Accounting Officer** is responsible for establishing policy, operational procedures and practices that implement reporting and accounting guidance and relevant training, ensuring that the work results conform to the established policies.

D. **Accounting and Reporting Managers** provide functional guidance and oversight to BPA's financial management systems and establish BPA and FCRPS requirements and reporting mechanisms, ensuring adequacy of internal controls and compliance with applicable laws, regulations, and internal directives.

E. **BPA Staff** are responsible for following this policy.

8. Standards & Procedures

<u>Standard AFUDC</u>

The equation for calculating monthly AFUDC is:

((Prior month charges + (current month charges * .50)) * AFUDC rate) / 12

Interest is compounded annually.

For projects financed by funds held in a special trust, additional AFUDC will be calculated as follows:

<u>Trust Fund AFUDC</u>

Project cash balance in trust * AFUDC rate / 12

<u>Negative Trust AFUDC (allocation of trust fund earnings)</u>

(Project cash balance in trust / Total project cash in trust receiving an allocation) * monthly net trust investment earnings

Note: Trust fund AFUDC and negative AFUDC are only applied to active projects with a positive cash balance in the trust fund.

9. Performance & Monitoring

Compliance with this policy is through A-123 internal controls 3.C.1.a Work Order Review and Project Analysis.

10. Authorities & References

A. ASC Topic 835 "Interest"

B. Title 18 CFR Part 101 Electric Plant Instructions 3(A)(17) – FERC Uniform System of Accounts

C. FERC Accounting Release 5 (AR-5) Capitalization of Allowance for Funds Used During Construction

D. FERC Accounting Release 13 (AR-13) Allowance for Funds Used During Construction

E. PwC Accounting and Reporting Manual 4740 – Capitalization of Interest Cost

11. Review

This policy is scheduled for review in January 2022.

12. Revision History

Version Number	Issue Date	Brief Description of Change or Review
1.0	6/20/2017	First publication in BPA Policy set. This is a revision of BPA Accounting Manual, Ch. 3.05, *BPA's Allowance for Funds Used During Construction (AFUDC) Policy*, reviewed Jan. 2012.
1.1	11/27/2017	Appendix A updated to include FY 2018 AFUDC rate. This was an administrative update not subject to formal review. Previous effective date of 6/20/2017 retained.
1.2	6/19/2018	Appendix B added.

Appendix A

AFUDC RATES BY FISCAL YEAR

Rates for current and prior fiscal years are as follows:

- FY 2020 – 3.00%
- FY 2019 – 3.18%
- FY 2018 – 3.09%
- FY 2017 – 3.05%
- FY 2016 – 2.97%
- FY 2015 – 3.09%
- FY 2014 – 3.72%
- FY 2013 – 3.59%
- FY 2012 - 4.08%
- FY 2011 - 4.35%
- FY 2010 - 4.81%
- FY 2009 - 5.23%
- FY 2008 - 5.44%
- FY 2007 - 5.09%
- FY 2006 - 4.78%
- FY 2005 - 4.89%
- FY 2004 - 5.32%
- FY 2003 - 6.31%
- FY 2002 - 6.49%
- FY 2001 - 6.61%
- FY 2000 - 6.66%
- FY 1999 - 6.82%
- FY 1998 - 7.39%

AFUDC APPLICATION CRITERIA

The following project types and statuses are used to identify the projects that will receive AFUDC each month:

Capital Project Types

CL	BPA Capital
CS	Capital Spares
C3	3rd Party Financial Capital
IC	Information Technology Capital
CJ	Capital Jointly Funded (BPA funded share)
TC	Interconnection Trans Credits

ML Master Lease Financed
MS Master Lease Spare
MD Master Lease Financed Spacer Dampers (trust fund AFUDC only)

AND

Project Status

A Approved
B Labor Hold for Tolerance Analysis (used by TBL)
J Hold for Tolerance Analysis (used by TBL)
T Completion in Process (used by TBL)

Examples of substantial delays in starting construction, or substantial delays during construction due to external forces (i.e. uncontrollable by management) under which AFUDC may still be applied:

- Court-ordered work stoppage
- Bankrupt customer
- Natural disaster
- Worksite inaccessible due to severe weather

CESSATION OF AFUDC

Due to the large number of capital projects and the administrative costs of placing projects on and off hold as well as monitoring those projects, BPA has set a one year delay or more threshold requirement in order for projects to be placed on hold in the accounting system. The one year threshold will be applied as long as the resulting impacts are not material to the financial statements. Asset Accounting will evaluate the appropriateness of applying the threshold on a case by case basis.

Examples of substantial delays in starting construction, or substantial delays during construction imposed by internal forces (i.e. controllable by management) that may result in the cessation of AFUDC are:

- Management defers delivery of materials
- Management defers design
- Intentional budget reduction efforts
- Projects put "on the shelf"

Project Status:

H Hold
O Labor Hold
N Plant Accounting Hold

Capital Project Types that Do Not Receive AFUDC:

CQ Capital Acquisition
CV Conservation
FC Fish & Wildlife – Capital
CF Capital Funded in Advance
CI Capital Indirects
LA Land & Land Rights
SD Spacer Damper Replacement FAS 71
RS Radio Spectrum
LS Land Relating to Radio Spectrum
LC LGIA- Land

Additional Information on CF Project Types:

Project type CF is the traditional capital project funded in advance. Type CF is part of Transmission Business Line's reimbursable program. The accounting treatment is based on the contract terms and financial arrangements. Accumulated expenditures eligible for interest capitalization should be determined on a cash basis and expenditures on discrete projects should be reduced by progress payments from customers[8]. BPA owns the asset, but is not financially responsible for funding it. BPA does not "borrow" for CF work since the customer's deposit is on hand to accomplish construction. BPA does not borrow any funds or pay interest on them, so CF project types are excluded from AFUDC calculation.

[8] PwC Accounting and Reporting Manual 4740 – Capitalization of Interest Cost

Appendix B

FERC Formula Practical Application at BPA

The items listed below are derived from the notes to the audited financial statements and are considered when determining which debt to include in the AFUDC calculation.

Note	Item	Formula use
Debt and Appropriations	Columbia Generating Station (CGS)	Excluded
Debt and Appropriations	Cowlitz Falls Hydro Project	Excluded
Debt and Appropriations	Nuclear Project 1 (WNP1)	Excluded
Debt and Appropriations	Nuclear Project 3 (WNP3)	Excluded
Debt and Appropriations	Northern Wasco Hydro Project	Excluded
Debt and Appropriations	Capital Lease Obligations	Included
Debt and Appropriations	NIFC Debt	Included
Debt and Appropriations	Other Capital Lease Obligations	Included
Debt and Appropriations	Customer Prepaid Power Purchases	Included
Debt and Appropriations	Borrowings From Treasury	Included
Debt and Appropriations	Federal Appropriations	Excluded
Debt and Appropriations	Federal Appropriations (Not Scheduled For Payment)	Excluded
Deferred Credits and Other	Customer Reimbursable Projects	Excluded
Deferred Credits and Other	Generation Interconnection Agreements	Included
Deferred Credits and Other	Third AC Intertie Capacity Agreements	Excluded
Deferred Credits and Other	Legal Claims and Settlements	Excluded
Deferred Credits and Other	Federal Employees' Compensation Act	Excluded
Deferred Credits and Other	Fiber Optic Leasing Fees	Excluded
Deferred Credits and Other	Derivative Instruments	Excluded
Deferred Credits and Other	Other	Excluded