

1 **Reference: "2023 Capital Budget Application," Newfoundland Power Inc., June 29,**
 2 **2022, Schedule B, pp. 145-150 (System Upgrades).**

3
 4 **Q. The Financial Management System was last upgraded in 2020.**
 5 **Since the last upgrade, the vendor has introduced a new policy**
 6 **that requires upgrades on an annual cycle as opposed to the**
 7 **previous upgrade cycle of every two to three years. An annual**
 8 **upgrade is now required in order to receive vendor support, bug**
 9 **fixes and security updates necessary to keep pace with evolving**
 10 **cybersecurity threats.**

11
 12 **a) Please provide Newfoundland Power's analysis and supporting**
 13 **accounting standards on the capitalization of software upgrades**
 14 **that are required annually;**

15
 16 **b) Please provide descriptions of any enhanced functionality that is**
 17 **completed in the upgrade and if the upgrade is also expected to**
 18 **increase the life of the software; and**

19
 20 **c) Please provide the expected useful life of the upgrade and the**
 21 **treatment of the costs upon the end of the useful life of the**
 22 **software.**

23
 24 **A. a)** Newfoundland Power's capitalization policy conforms to accounting
 25 principles generally accepted in the United States ("US GAAP"), as well as
 26 industry best practices.¹

27
 28 Under the Company's capitalization policy, expenditures greater than
 29 \$1,000 are capitalized if they: (i) provide substantial benefits for a period
 30 of more than one year; (ii) extend the useful life of an asset or increase
 31 the capacity of an asset or the quality of output efficiency and may
 32 reduce operating costs; and (iii) are held for use to conduct
 33 business/generate income.

34
 35 Newfoundland Power's Financial Management System is required to be
 36 upgraded to a version that continues to be fully supported by the
 37 vendor.² Without the system upgrade, the system would have to be
 38 either replaced or retired.³

39
 40 The Company's Financial Management System was implemented in 2002
 41 with an expected service life of 10 years. System upgrades since 2002

¹ Capitalization principles under U.S. GAAP are covered in *Accounting Standard Codification ("ASC") 360 Property, Plant, and Equipment*.

² In Newfoundland Power's experience, the expiration of vendor support is now the primary driver of system upgrades.

³ While it may be possible to continue to run the system unsupported, the impact of system failure on Company operations would be high. Therefore, Newfoundland Power does not see this as a reasonable option.

1 have resulted in the system being in service for 20 years, thus extending
2 its useful life and providing a benefit to the Company for more than one
3 year. Future system upgrades, whether that upgrade occurs annually or
4 at longer intervals, will continue to extend the service life of the system.
5 For example, without the system upgrade proposed in the *2023 Capital*
6 *Budget Application*, the system's life would end.
7

8 All system application and subsequent upgrade costs are depreciated
9 over 10 years, irrespective of the life the specific application, which
10 ultimately could be less, or more, than 10 years.⁴ This approach is
11 consistent with group depreciation methods for software costs.
12

13 This approach, and the service life estimate for software costs, was last
14 reviewed as part of the Company's *2019 Depreciation Study* completed by
15 Gannett Fleming which was filed as part of Newfoundland Power's
16 *2022/2023 General Rate Application*.
17

18 With respect to system upgrades, *ASC 350-40 Internal-Use Software*
19 ("ASC 350-40") is also relevant. ASC 350-40 provides that for upgrades
20 and enhancements to be capitalized, it must be probable that those
21 expenditures will result in additional functionality.
22

23 In addition to bug fixes and security patches, system upgrades also
24 provide increased functionality. Examples of increased functionality from
25 the latest system upgrade to the Company's Financial Management
26 System include:
27

- 28 (i) Credit card transaction import functionality to reduce risk of data entry
29 errors and streamline financial processing;
- 30 (ii) Additional user-defined fields in general ledger transaction entries,
31 allowing users to describe transactions and add comments for review and
32 auditing purposes;
- 33 (iii) Automated financial reconciliation improvements;
- 34 (iv) Currency setup improvements to eliminate problems with different
35 currencies when copying from Excel; and
- 36 (v) Additional fields available for vendors with multiple legal names.
37

38 Details of the 2023 system upgrade for the Financial Management System,
39 including functionality improvements, have not been released by the vendor.
40 However, given Newfoundland Power's past experience with Financial
41 Management System upgrades, it is probable that the project expenditures will
42 result in additional functionality to the system, beyond extending its useful
43 service life.

⁴ For example, while the Financial Management System has been in service for 20 years, the initial costs of implementing that system were depreciated over 10 years. Further, the Company currently does not have any plan to replace or retire its Financial Accounting System, assuming upgrades are completed to continue vendor support.

Requests for Information

- 1 b) See part a).
- 2
- 3 c) See part a).