# Allowance for Funds Used During Construction (AFUDC)

## Policy

The application base for AFUDC includes the cumulative total of all direct and indirect charges to projects, but excludes all AFUDC related to spending subsequent to January 1 or July 1, whichever is the latest. This exclusion effectively results in semi-annual compounding of AFUDC.

The BHD and MPD have separate transmission AFUDC calculations/rates due to the different allowed return on equity for transmission projects.

## Purpose

The cost-of-capital invested in construction work in progress is included in allowance for funds used during construction[1] ("AFUDC") as an addition to the cost of property constructed using a weighted average cost-of-capital. This cost will be charged to operations through depreciation over the service life of the related assets and recovered through future revenues.

The AFUDC includes a designated cost of equity funds, to be capitalized as part of the acquisition of the related asset. That cost shall be capitalized under those circumstances only if its subsequent inclusion in allowable costs for rate-making purposes is probable.[2]

The cost to acquire or construct a capital asset over time should include the cost of financing that asset until it is placed in service. By including AFUDC in the cost of the capital asset, the associated financing costs will be more equitably recovered from customers, through depreciation, over the service life of the asset.

Versant Power applies two different methods of AFUDC – one for distribution assets and one for transmission assets. The transmission formula follows the methodology prescribed by the (“Federal Energy Regulatory Commission”) FERC.[3] The distribution formula methodology is approved by the Maine Public Utilities Commission (“MPUC”) Docket 81-136.

## Scope

AFUDC application begins in the month in which a project receives charges and continues until the month the project becomes operational plant. On most projects, AFUDC is applied at the full rate to full balance as of the prior month plus half of the charges incurred in the current month. In the case of major capital projects, the actual start date and the operational date will be taken into consideration when applying AFUDC.

## Responsibility(ies)

*Intermediate Accountant* is responsible for running the process to calculate AFUDC monthly.

*Plant Accountant* is responsible for reconciling the calculation.

*Senior Corporate accountant* is responsible for calculating and updating the rates in FIS.

## Pronouncements

FASB ASC 980-360-20

FASB ASC 980-360-25-1

18 CFR PT 101 Chapter 1, section 17

**FERC(s)** 43201 – AFUDC Debt

41911 – AFUDC Equity

## Application

AFUDC is applied to all capital projects with the following exceptions:

a. projects with a construction period less than two months (e.g. routine work orders);
b. projects used to purchase assets that are in-service immediately upon delivery (e.g. office furniture, tools, vehicles, computer hardware, etc.);
c. projects for the purchase of land or land rights that will be held for future use;
d. projects with customer contributions equal to 100% of construction costs and receivable as costs are incurred;
e. projects that are deferred for more than one year; and
f. retirements.
g. contractor payments that are withheld until the completion of the project should not have AFUDC applied.

Allowance for funds used during construction should be capitalized at the effective cost of capital rate, compounded semi-annually, except in the following circumstances:

a. Projects that will be under construction for less than a predetermined time;
b. Projects delayed for more than one year due to extraordinary circumstances; and
c. Projects with an economic value or future benefits that will be exceeded by such capitalization.

## Calculation

The transmission formula includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used, in accordance with this formula:

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

$$Ae=[1-S/W][p(P/D+P+C)+c(C/D+P+C)]$$

Ai = Gross allowance for borrowed funds used during construction rate
Ae = Allowance for other funds used during construction rate
S = Average short-term debt
s = Short-term debt interest rate
D = Long term debt

1 FASB ASC 980-360-20

2 FASB ASC 980-360-25-1

3 18 CFR Pt 101 Chapter 1, section 17

d = Long term debt interest rate
P = Preferred stock
p = Preferred stock cost rate
C = Common equity (excluding Account 216.1 Unappropriated Undistributed Earnings)
c = Common equity cost rate
W = Average balance in construction work in progress less asset retirement costs

The rates are determined annually at the beginning of the year. The balances for long-term debt, preferred stock and common equity are the actual book balances as of the end of the prior year. The cost rates for long-term debt and preferred stock shall be the weighted average cost determined in the manner described below. The cost rate for common equity shall be the rate granted to common equity in the last rate proceeding. The short-term debt balances and related cost and the average balance for construction work in progress shall be estimated for the current year with appropriate adjustments as actual data becomes available.

According to FERC Order 567, FERC requires that public utilities monitor their actual experience and adjust to actual at year-end if a significant deviation from the estimate should occur. A significant deviation exists if the gross AFUDC rate exceeds by more than one-quarter of a percentage point (25 basis points) the rate that is derived from the formula by use of actual 13 monthly balances of construction work in progress and the actual weighted average cost and balances for short-term debt outstanding during the year. Versant Power recomputes the calculations using actual balances each quarter end for evaluation.

The weighted cost is calculated by:

(1) Multiplying the cost of money for each issue of debt by the principal amount outstanding for each issue which yields the annualized cost for each issue; and

*4+Adding the annual cost of each issue to obtain the total for all issues, which is divided by the total principal amount outstanding for all issues to obtain the weighted cost for all issues. For long-term debt, the cost of capital should be the yield to maturity, recognizing any premiums, discounts, or other issuance expenses. #
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The distribution formula is calculated monthly using the prior month-end balances for short-term debt, long-term debt, preferred stock and common equity.

## Distribution vs Transmission Classification

When material is requisitioned it is assigned to a project. Each project is setup with a specific construction class based on the work being done and determines if the material is Distribution or Transmission.