

## Northern States Power Company, a Minnesota corporation

### Description of Allowance for Funds Used during Construction (AFUDC) Statement of Methods, Procedures and Calculations, and Construction Overhead Procedure

The Company currently uses three overhead mechanisms for assigning costs to construction projects. The most common overhead is the Allowance for Funds Used during Construction (AFUDC). The other two are for charging Engineering & Supervision (E&S) and Administrative & General (A&G) costs. Property taxes that accrue and are properly chargeable to construction are direct assigned to the work order and an overhead is no longer used. Each of the three overheads is discussed below.

#### Allowance for Funds Used during Construction (AFUDC)

AFUDC allows the capitalization of the cost of borrowed funds and a reasonable rate on other funds to be charged to projects that are capital in nature until the project is placed in-service. This overhead is excluded from any project that is de minimis or is comprised of an asset that was purchased (i.e. can be placed in-service immediately). Non-de minimis construction is when the total charges exceed the minimum dollar amount of \$25,000. The following excerpt from the Uniform System of Accounts for Electric Utilities defines the method employed at NSPM.

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(17) *Allowance for funds used during construction* (Major and Non-major Utilities) 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, not to exceed, without prior approval of the Commission, allowances computed in accordance with the formula prescribed in paragraph (a) of this subparagraph. No allowance for funds used during construction charges shall be included in these accounts upon expenditures for construction projects, which have been abandoned.

(a) The formula and elements for the computation of the allowance for funds used during construction shall be:

$$Ai = s \cdot (S/W) + d \cdot (D/D + P + C) \cdot (1 - S/W) = \text{Gross allowance for borrowed funds used during construction rate}$$

$$Ae = [1 - S/W] \cdot [p \cdot (P/D + P + C) + c \cdot (C/D + P + C)] = \text{Allowance for other funds used during construction rate}$$

$S$  = Average short-term debt

$s$  = Short-term debt interest rate

$D$  = Long-term debt

$d$  = Long-term debt interest rate

$P$  = Preferred stock

$p$  = Preferred stock cost rate

$C$  = Common equity

$c$  = Common equity cost rate

$W$  = Average balance in construction work in progress, less asset retirement costs related to plant under construction

(b) The rates shall be determined annually. The balances for long-term debt, preferred stock, and common equity shall be 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 indicated in §35.13 of the Commission's Regulations under the Federal Power Act. The cost rate for common equity shall be the rate granted common equity in the last rate proceeding before the ratemaking body having primary rate jurisdictions. If such cost rate is not available, the average rate actually earned during the preceding three years shall be used. The short-term debt balances, 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.

The AFUDC rate, a simple rate, is calculated using the above formula (effective with the issuance of Federal Power Commission Order No. 561 on February 2, 1977), and it uses the various components of capital, including the cost of short and long-term debt (including restricted-use debt, as required by Accounting Release No. 13, effective May 1, 1983), and preferred and common stock. The rate is applied against the current month's AFUDC base (prior month's life-to-date construction charges plus one-half of the current month's charges, less one-half of the current month's classifications, and the prior month's AFUDC) for eligible jobs to determine the amount of the monthly AFUDC. The FERC allows for semi-annual compounding and this is maintained through the determination of an effective monthly rate using monthly compounding that effectuates the semi-annual compounding effect of the simple rate.

Accounts "419.1 – Allowance for Other (Equity) Funds Used during Construction" and "432 – Allowance for Borrowed Funds Used during Construction" are credited, in accordance with the ratio derived in the AFUDC formula, with the concurrent debit to the construction account 107, Construction Work in Progress by work order. The rate is calculated as amounts in CWIP change, the financing arrangements warrant an updated rate, and adjustments are made to reallocate total AFUDC between the debt and equity components. AFUDC is directly calculated and charged to each work order; no clearing account is used.

AFUDC as defined by the FERC includes the net cost (during the period of construction) of borrowed funds used for construction purposes and a reasonable rate on other funds when so used. The following is a list of capitalization rates for the five years ending with the test year.

<u>Period</u>	<u>Rate</u>
<u>Last 5 Calendar Years:</u>	
Jan 2013 – Dec 2013	6.735%
Jan 2012 – Dec 2012	7.327%
Jan 2011 – Dec 2011	8.455%
Jan 2010 – Dec 2010	8.543%
Jan 2009 – Dec 2009	8.031%

The rate provided is the rate in effect as of December 31 of each year.

#### Engineering & Supervision (E&S)

Engineering and Supervision costs are capitalized as construction overheads. Where it is not practicable to direct charge the pay and expenses of the engineers, surveyors, draftsmen, inspectors, first line management, and their assistants to construction, the Company uses an overhead to achieve this task. These costs are gathered in a general overhead pool and first split between capital, operating, and maintenance based on the direct charges for each of these categories. The capital construction amount then is allocated to each work order appropriately based on current month charges. The E&S charges are gathered separately by functional class (production, transmission, and distribution) to further define the allocation.

<b>Period Total</b>	<b>Distribution</b>			<b>Transmission</b>		
	<b>Avg. Rate</b>	<b>Amount Capitalized (Generated)</b>	<b>Amount Allocated (Cleared)</b>	<b>Avg. Rate</b>	<b>Amount Capitalized (Generated)</b>	<b>Amount Allocated (Cleared)</b>
<u>Last 5 Calendar Years:</u>						
Jan 2013 – Dec 2013	16.56%	\$26,551,948.39	\$26,608,004.56	3.06%	\$12,269,296.71	\$12,462,418.24
Jan 2012 – Dec 2012	22.44%	\$23,582,869.00	\$23,928,351.49	4.99%	\$12,511,591.81	\$11,808,298.84
Jan 2011 – Dec 2011	23.63%	\$23,898,374.88	\$23,485,903.54	5.72%	\$9,416,612.40	\$9,974,223.28
Jan 2010 – Dec 2010	26.21%	\$22,746,246.93	\$22,563,400.58	6.85%	\$9,487,897.30	\$9,429,005.92
Jan 2009 – Dec 2009	30.99%	\$22,063,607.59	\$22,498,612.87	6.45%	\$6,926,085.12	\$7,006,151.95

<b>Period Total</b>	<b>Production</b>		
	<b>Avg. Rate</b>	<b>Amount Capitalized (Generated)</b>	<b>Amount Allocated (Cleared)</b>
<u>Last 5 Calendar Years:</u>			
Jan 2013 – Dec 2013	1.45%	\$1,685,639.36	\$1,672,848.47
Jan 2012 – Dec 2012	0.97%	\$1,136,216.79	\$1,194,304.49
Jan 2011 – Dec 2011	0.12%	\$1,063,120.60	\$1,058,258.04
Jan 2010 – Dec 2010	0.20%	\$984,765.12	\$1,018,347.25
Jan 2009 – Dec 2009	0.53%	\$1,017,310.54	\$871,435.28

Administrative & General (A&G)

Administrative and General Costs are capitalized as construction overheads. The overhead relates to all the personnel in the administrative office that work on construction to assure its continued operation, but are not direct to any one project. A prime example is the payroll analyst to assure the construction labor receives its payroll checks. It is inefficient for these employees to direct charge all the work orders and thus an overhead is used.

Every two years, the Company performs an A&G study that reviews the time employees in certain administrative departments spend on capital work. The percent of payroll for these employees is charged to an overhead pool, one-twelfth each month. The overhead pool is allocated to electric, gas, or common utility work orders based on current month charges.

<b>Period</b>	<b>Avg. Rate</b>	<b>Amount Capitalized (Generated)</b>	<b>Amount Allocated (Cleared)</b>
<u>Last 5 Calendar Years:</u>			
Jan 2013 – Dec 2013	0.10%	\$1,402,782.80	\$1,481,879.96
Jan 2012 – Dec 2012	0.14%	\$1,310,407.87	\$1,259,212.45
Jan 2011 – Dec 2011	0.10%	\$950,252.74	\$887,202.51
Jan 2010 – Dec 2010	0.13%	\$1,169,494.20	\$1,286,555.09
Jan 2009 – Dec 2009	0.16%	\$1,200,474.40	\$1,129,249.97