

# Black Hills Service Company

## Cost Allocation Manual

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## Table of Contents

Introduction.....	3
Service Company Organization .....	3
Direct Costs versus Indirect Costs .....	4
Transaction Coding.....	5
General Ledger Business Unit (GLBU):.....	6
Operating Unit (OpUnit):.....	6
Department (Dept): .....	7
Account (Acct).....	7
Resource:.....	8
Product: .....	8
Work Order: .....	8
Timekeeping .....	9
Loadings.....	9
Allocation Factors.....	10
Changing Allocation Factors .....	11
Subsidiary Payment for Direct and Indirect Charges .....	11
Allocating Fixed Assets .....	12
Appendix 1 – BHSC Departments.....	13
Appendix 2 – Allocation Factors .....	21

## **Introduction**

The purpose of this cost allocation manual is to document the allocation processes of Black Hills Service Company, from recording the original transaction through the allocation of costs to Black Hills Corporation subsidiaries. Various topics to be addressed include the organization of the Service Company, the recording of transactions, calculating and assigning allocation factors, and recording allocation transactions.

Black Hills Service Company (the Service Company) was formed on December 30, 2004, and was fully implemented and operational as of January 1, 2006. The Service Company was formed as required by the Public Utility Holding Company Act of 1935, which was administered by the Securities and Exchange Commission (SEC). Service companies were required of all registered holding companies under this law. Service companies coordinate corporate support functions and distribute costs to registered holding company subsidiaries using pre-defined allocation methodologies that had to be approved by the SEC.

Black Hills Corporation became a registered holding company at the end of 2004, and through a transition period and various amendments to the registered holding company filings, established the date of January 1, 2006 to fully implement the Service Company. In August of 2005, this law was repealed and replaced by the Public Utility Holding Company Act of 2005, which is administered by the Federal Energy Regulatory Commission (FERC). This new law was effective in February of 2006. Although certain administrative and reporting requirements changed as a result of the repeal, Black Hills Corporation did not change its implementation plan.

The Service Company is a wholly owned subsidiary of Black Hills Corporation (the Holding Company), and is a separate legal entity. The majority of operations and all employees were transferred out of the Holding Company on the effective date of implementation. The only transactions that remain at the Holding Company are transactions pertaining to long-term debt and related deferred finance costs, corporate credit facility and related deferred finance costs, and the administration of money pool transactions for both the utility money pool and the non-utility money pool. In addition, as will be discussed in greater detail later, certain corporate costs are charged directly to the Holding Company. The most notable of these types of costs are corporate development project costs.

## **Service Company Organization**

The Service Company is organized into operating departments based upon the services that those departments provide to Black Hills Corporation subsidiaries. A list of each

department, as well as a brief description of the services they provide, is attached as Appendix 1.

### **Direct Costs versus Indirect Costs**

A key issue in distributing Service Company costs is distinguishing between direct costs and indirect costs. The account coding will change depending on whether the cost is a direct or indirect cost. Below is a summary of each of these types of costs and examples of these costs.

**Direct costs** are those costs that are specifically associated with an identified subsidiary. This means that it is known exactly to which subsidiary these costs relate. Here are some examples:

- A Payroll Processor is processing the payroll for Black Hills Power. The labor costs incurred in processing payroll are specifically associated with an identified subsidiary. Therefore, this would be a direct cost.
- An Internal Auditor travels to Denver to complete audits for Colorado Independent Power Production and Black Hills Exploration and Production. The time associated with completing the audits would be charged to each company based on the time worked for each specific company project. The travel expenses should be split equally or on a pro rata share based on days worked. The Human Resources department incurs costs to bring an employment candidate on-site to Gillette for an interview with Wyodak Resources. These travel costs incurred in bringing the employee in for the interview are specifically associated with an identified subsidiary. Therefore, this would be a direct cost.
- A Help Desk technician orders a replacement computer monitor for an employee at Black Hills Power. This hardware cost incurred is specifically associated with an identified subsidiary. Therefore, this would be a direct cost.

**Indirect costs** are those costs that are not associated with an identified subsidiary. This means that the costs indirectly support all companies or directly support the operation of the Service Company. In other words, costs that would be directly charged to the Service Company using the definition and examples above would be classified as indirect costs. Here are some examples:

- The Internal Audit department is completing a BHC consolidated financial statement audit. Since all entities indirectly affect the financial statements of BHC consolidated, this charge would be considered an indirect cost.
- An Environmental representative attends an industry training event). This charge cannot be directly attributable to any specifically identified company; therefore, this charge would be considered an indirect cost

- A Help Desk technician orders a replacement computer monitor for an employee of the Service Company. This hardware cost incurred is specifically associated with the Service Company. Therefore, this would be an indirect cost.

It is important to consider two things when determining if a cost is a direct cost or an indirect cost: (1) Can the costs that are coded to a specific company or group of companies be substantiated; and (2) Can it be substantiated that a utility-based entity is not subsidizing the operations of non-utility based company with the time and expenses that have been charged to them. A certain level of judgment will be involved when deciding whether a particular cost should be directly charged or indirectly allocated.

There are certain costs that will always be considered either direct or indirect costs. Below is a list of significant Service Company expenses that follow these rules:

Always considered direct costs:

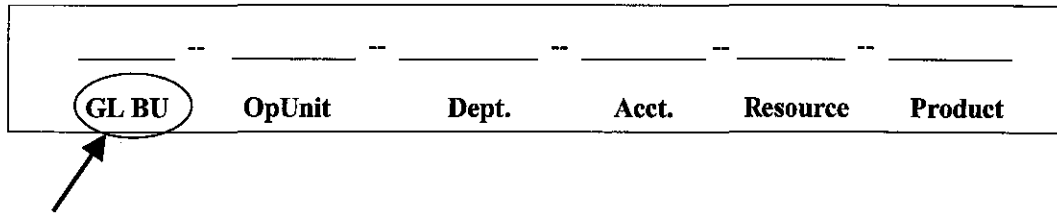
- Capitalized costs for non-BHSC projects (including capitalized labor)
- Corporate development project costs
- Retiree healthcare costs

Always considered indirect costs:

- Board of Directors' fees and expenses
- General Office rent
- Depreciation of BHSC assets
- Directors' and officers' insurance
- Investor relations expenses
- Shareholder expenses
- Intercompany interest expense and income

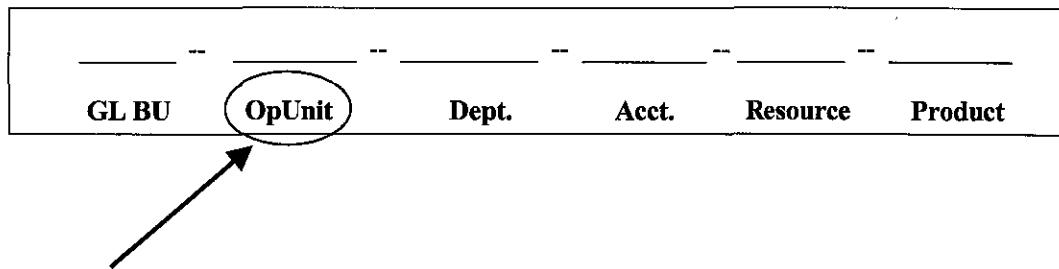
### **Transaction Coding**

The Service Company uses an accounting software system to accumulate and distribute both direct costs and indirect costs. It is important to have costs properly classified as direct or indirect. Direct costs will be directly charged to the subsidiaries, while indirect costs will be allocated to the subsidiaries using pre-defined allocation factors. Below is a description of the coding.



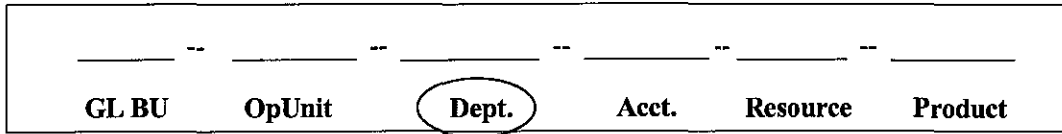
**General Ledger Business Unit (GLBU):**

- Five (5) character numeric field.
- The GLBU field is used to identify the company that will be receiving the charges.
- The GLBU field is required on all accounting transactions.
- The GLBU field will default when the Operating Unit (OpUnit) is entered.



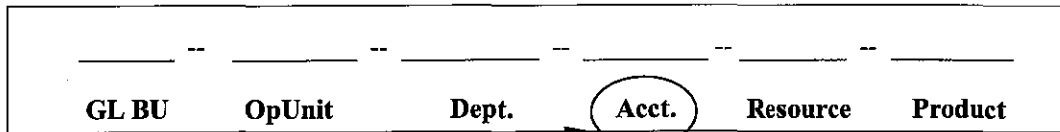
**Operating Unit (OpUnit):**

- Six (6) character numeric field.
- The OpUnit field is used to identify the account code block as either a direct cost or an indirect cost.
- If the cost is a direct cost, the OpUnit field will be populated using the OpUnit code for the company being directly charged.
- If the cost is an indirect cost, the OpUnit field will be populated using one of the BHSC OpUnit's. Indirect costs also include costs directly related to the Service Company.



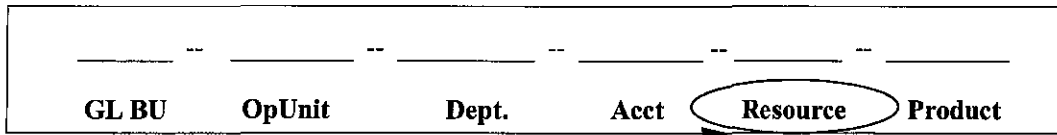
**Department (Dept):**

- Four (4) character numeric field.
- The Dept field is used to identify where the cost(s) originated.
- The Dept field is required on all income statement and capital transactions.
- Every department is assigned to a GLBU.



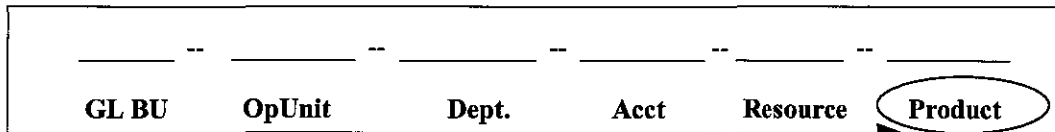
**Account (Acct)**

- Six (6) character numeric field.
- The Account field is required on all accounting transactions.
- All companies will generally use the same Chart of Accounts although some values will be specific to certain companies.



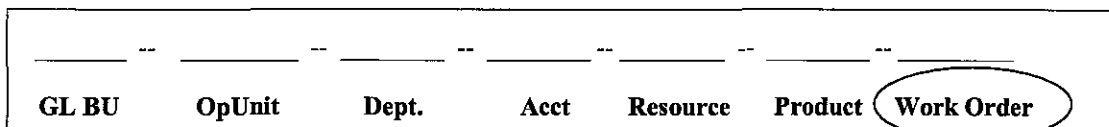
**Resource:**

- Four (4) character numeric field.
- A Resource is used to identify types of costs.
- The Resource field is required on all income statement and capital accounting transactions.



**Product:**

- Three (3) character numeric field.
- A Product code is used to identify business lines.



**Work Order:**

- Eight (8) character numeric field.



- Represents the collection of costs to allow the monitoring of a job or group of costs.
- The Work Order field is required on all construction work in progress transactions

### **Timekeeping**

All Service Company employees are required to complete a timesheet for each two week pay period. Timesheets of appropriate employees must be approved by a supervisor.

Employees must complete the code block, as previously discussed, for each time record. The timesheet will default the department and resource. However, the employee is responsible for providing the remainder of the code block. Employees are encouraged to enter their time in one half hour increments, although they may use smaller increments if they so choose.

### **Loadings**

Certain benefits that are provided to employees become an inherent cost of labor. To account for these benefits and allow for them to be charged to the appropriate subsidiary, they become part of a loading rate that is added on to each payroll dollar.

The loading rates are calculated at the beginning of the year based on budgeted benefit expenses and budgeted labor. Benefit costs and loading rates are reviewed, and updated as needed. Below is a list of components of the loading rates:

#### **General labor loadings:**

- **Compensated Absences:** including but not limited to PTO, Holiday, Jury duty, Funeral pay, United Way day, Short-term Disability and Annual Physical appointment.
- **Payroll Taxes:** including but not limited to FICA, FUTA SUTA and city taxes
- **Employee Benefits:** including but not limited to health and medical, 401K match and fees, Pension, Retiree healthcare and associated fees and Pension audit fees
- **Incentives:** including but not limited to Non-officer incentive plans, Restricted Stock and Stock Option expense

#### **Supplemental loadings:**

- Officer short term incentive plans
- Officer supplemental retirement
- Officer performance plan

Loadings calculated on payroll are based on estimated benefit costs, therefore, differences between actual benefits will be inherent to this process. After the difference is calculated and reviewed for reasonableness, it is recorded to a separate department, and indirectly allocated to Black Hills Corporation subsidiaries.

### **Allocation Factors**

As previously stated, Service Company costs are either directly charged to a subsidiary, or indirectly allocated when the cost is not associated with a specific subsidiary. Indirect costs are allocated using one of several pre-defined allocation factors. Each department has been assigned one of these allocation factors. All indirect costs of that department are then allocated using that factor. When determining which allocation factor should be assigned to each department, a factor is selected based on the specific cost driver of that department. For instance, the expenses incurred by a Human Resources department are primarily related to their support of all company employees. In this example, the cost driver for the Human Resources department indirect costs is employees. Therefore, their indirect costs will be allocated based upon the Employee Ratio.

For certain departments, a specific cost driver may not be clearly identifiable or the driver may not be cost effective to compute on a continuing basis. In these instances, a three-pronged general allocation factor is used, which is referred to as the Blended Ratio. This ratio equally weights three different general ratios: Gross Margin, Asset Cost (limited to gross PP&E), and Payroll Dollars. These factors were chosen to be included in the Blended Ratio because they best allocate costs based on the diverse nature of BHC operations.

In addition, some departments utilize a Holding Company Blended Ratio. The difference between the Blended Ratio and the Holding Company Blended Ratio is that the Holding Company Blended Ratio allocates a percentage of costs to BHC Holding Company. For example, the Corporate Governance department will allocate indirect costs using the Holding Company Blended Ratio because certain costs incurred, such as New York Stock Exchange fees and Board of Directors costs, relate to both the Holding Company and the subsidiary companies.

One additional item to note is that pooled benefits, primarily health care costs, are allocated differently due to the pooling method for benefits such as self-insured health care. Black Hills Corporation has chosen to pool certain benefit costs and spread the risk amongst all subsidiaries equally. All pooled benefit costs of BHC are paid by the Service Company and allocated to subsidiaries based on employee counts.

Appendix 2 includes a list of all allocation factors, including a brief description of the factor, the basis for the calculation of the factor, and the departments to which that

factor has been assigned. Asset factors and employee count factors are calculated as of period-end dates, while revenue and expense factors are calculated for twelve months ended as of period-end dates.

### **Changing Allocation Factors**

Allocation factors are set at the first of the year, based upon financial information from the prior year ending December 31<sup>st</sup>. Assets, utility assets, employee counts, and power generation capacity are based on values as of the previous period ending December 31<sup>st</sup>. Gross margin, utility gross margin, payroll dollars, and utility payroll dollars are based on values for the 12 months ended December 31<sup>st</sup>.

Certain events may occur during the year that are deemed to be significant to Black Hills Corporation that will require corresponding adjustments be made to the allocation factors. Examples of these types of events include acquisitions, divestitures, new generation, significant change in asset base, significant staffing changes or new, significant revenue streams.

When these events occur, indirect allocation factors will be adjusted. When adjusting allocation factors, it is the policy of the Service Company to not recalculate all allocation factors. Rather, allocation factors will be adjusted with pro forma adjustments for the subsidiary with a significant change in a specific allocation factor base. For example, if an acquisition occurs during the middle of the year, pro forma values will be loaded. Asset values at the time of the acquisition would be used, as well as pro forma gross margin and payroll dollars for a 12 month period. It should be noted that estimations may be required, especially when significant additions or changes are expected as a result of the acquisition.

It should also be noted that asset values, gross margin, and payroll dollars for the other companies will not be changed. However, the ratios will change because the base against which the ratios are calculated will change. Subsidiary companies would see decreased ratio values with acquisitions, and increased ratio values with divestitures. Changes will be effective as of the beginning of the month following the significant event, and will apply to all transactions for the month.

### **Subsidiary Payment for Direct and Indirect Charges**

It is the policy of the Service Company to insure payments are made by the subsidiary companies for direct and indirect charges. All payments for direct and indirect charges must be remitted to the Service Company by the end of the following month. The

Service Company will monitor payments received during the month to insure that all subsidiary companies make payment in a timely manner.

### **Allocating Fixed Assets**

The Service Company maintains certain fixed assets that are used by and benefit multiple Black Hills Corporation subsidiaries. These fixed assets primarily consist of computer hardware and software that form the corporate-wide information technology network. Because these fixed assets support multiple Black Hills Corporation subsidiaries, they are allocated to the appropriate subsidiaries monthly as part of the month-end close process, along with the allocation of these assets' accumulated depreciation. Construction Work in Process balances are not allocated.

Allocated assets and accumulated depreciation are maintained in separate general ledger accounts at the subsidiary level so that they are not intermingled with regular subsidiary fixed assets, and for ease of reconciliation.

The allocation factor used for fixed assets and accumulated depreciation is the Blended Ratio, except as otherwise noted. Depreciation expense is also allocated using the Blended Ratio.

## **Appendix 1 – BHSC Departments**

**The following departments are included in BHSC as of 01/01/2013 and are subject to changes as required to support evolving business requirements.**

### **SC-ACCOUNTING SYSTEMS (4700)**

Description: Maintains the corporate- wide accounting systems of Black Hills Corporation, most notably the general ledger and financial statement preparation systems. (Blended)

### **SC-DISBURSEMENTS (4701)**

Description: Processes payments to vendors and prepares 1099s and applicable documentation for the majority of Black Hills Corporation subsidiaries. Also, processes payroll including but not limited to time reporting, calculation of salaries and wages, payroll tax reporting and compliance reports for Black Hills Corporation and its subsidiaries. (Blended)

### **SC-CORP DEVELOPMENT (4702)**

Description: Facilitates the development of the corporate strategy, prepares strategic plans, and evaluates potential business opportunities. Department also assists various subsidiaries with financial analysis and special projects. (HoldCo Blended)

### **SC-CORP GOV AND SHAREHOLDER SERV (4703)**

Description: Develops and enforces corporate governance policies and procedures in accordance with applicable laws and regulations. Provides oversight of compliance with Securities and Exchange Commission rules and regulations. Oversees the administrative duties to the Board of Directors. Provides various recordkeeping and administrative services related to shareholder services. Assists in the administration of equity-based compensation plans. (HoldCo Blended)

### **SC-TAX (4704)**

Description: Prepares quarterly and annual tax provisions of all Black Hills Corporation subsidiaries. Maintains and reconciles all current and deferred income tax general ledger accounts. Prepares tax filings and ensures compliance with applicable laws and regulations. Oversees various tax planning projects. (Blended)

### **SC-CREDIT AND RISK (4705)**

Description: Provides risk management, risk evaluation, and risk analysis services. Provides support to the Executive Risk Committee. Evaluates contract risks. (Blended)

#### SC-LEGAL - CORPORATE (4706)

Description: Provides legal counsel and services related to general business operations, including labor and employment law, finance, litigation, contracts, utility rates and regulation, financial reporting, Securities and Exchange Commission, Federal Energy Regulatory Commission and other state and federal compliance, environmental matters, real estate and other legal matters. Oversees the hiring and administration of external counsel. Provides legal support to various corporate development projects. (Blended)

#### SC-CORPORATE AFFAIRS (4708)

Description: Provides oversight to Public Relations, Marketing, Governmental Affairs, Regulatory Affairs and Regulatory Services/Resource Planning for all Black Hills Corporation and its subsidiaries. (Blended)

#### SC-ENVIRONMENTAL SERVICES (4709)

Description: Establishes policies and procedures for compliance with environmental laws and regulations. Researches emerging environmental issues and monitors compliance with environmental requirements. Oversees environmental clean-up projects. Obtains permits to support the business operations of Black Hills Corporation and its subsidiaries. (Asset)

#### SC-EXECUTIVE MGMT (4710)

Description: Provides overall oversight of Black Hills Corporation and its subsidiaries. Provides the Board of Directors information for decision making purposes. (HoldCo Blended)

#### SC-SAFETY (4711)

Description: Develops and implements safety planning activities and provides employee safety education. Administers the corporate safety program. Assists with compliance with DOT, OSHA, and MSHA regulations. (Employee)

#### SC-FINANCE AND TREASURY (4712)

Description: Coordinates activities related to securities issuance, including maintaining relationships with financial institutions, debt holders, rating agencies, equity analysts and equity investors. Performs accounting, cash management, debt compliance, and

investing activities. Monitors capital markets to support financial planning for all subsidiaries. Oversees the administration of corporate pension and 401(k) plans. (HoldCo Blended)

#### **SC-FINANCIAL REPORTING (4713)**

Description: Oversees the corporate consolidation of subsidiary financial statements. Prepares monthly internal financial reports for management. Prepares quarterly and annual financial reports to the Securities and Exchange Commission, financial statements to banks and quarterly and annual financial statements filed with FERC. Researches emerging accounting issues and assists with the compliance of new accounting rules and regulations. (HoldCo Blended)

#### **SC-BUDGET AND FORECAST (4714)**

Description: Oversees the accumulation of subsidiary financial budgets and forecasts. Provides the consolidation of the corporate wide- budget and forecast. Guides the preparation of strategic plans. (Blended)

#### **SC-GENERAL ACCOUNTING (4715)**

Description: Provides management and administrative support for accounting and finance functions of the Company's regulated and non-regulated businesses including external audit coordination. (Blended)

#### **SC-ACCOUNTING-CENTRAL SERVICES (4716)**

Description: Maintains the accounting records for Black Hills Service Company and Black Hills Corporation. Provides oversight of Accounts Payable, Payroll, and Property Accounting departments. (Blended)

#### **SC-ACCOUNTING-GENERATION SERV (4717)**

Description: Provides general ledger accounting to non-regulated generation facilities and accounting support to all generation facilities. (Generation Capacity)

#### **SC-HUMAN RESOURCES CORP (4718)**

Description: Provides general Human Resources support services through the administration of policies for all facets of Human Resources, including employee relations, labor relations, talent management, recruiting and employment staffing, compensation and benefits administration and state/federal regulation compliance. (Employee)

#### **SC-HUMAN RESOURCES REGULATED (4720)**

**Description:** Provides general Human Resources support services to the subsidiaries through the administration of policies and labor contracts for all facets of Human Resources, including employee relations, labor relations, talent management, recruiting and employment staffing, compensation and benefits administration. (Employee)

#### **SC-COMPENSATION AND BENEFITS (4721)**

**Description:** Administers policies related to compensation and benefits. Oversees the self-insured medical benefits plans and other pooled benefits and provides support to the third party administrators of the plans. (Employee)

#### **SC-ORGANIZATIONAL DEVELOPMENT AND TRAINING (4722)**

**Description:** Provides for employee and leadership development, succession planning, performance management, goal alignment, employee engagement, strategic workforce planning, talent assessment and general HR support for Black Hills Corporation and its subsidiaries. (Employee)

#### **SC-ENGINEERING ROTATION PROGRAM (4723)**

**Description:** Provides a rotation program to develop staff for critical need areas within Black Hills Corporation and its subsidiaries. (Blended)

#### **SC-INSURANCE (4724)**

**Description:** Facilitates physical risk management strategies through the purchase and evaluation of various types of insurance coverage. Provides claims management services. (Blended)

#### **SC-INTERNAL AUDIT (4725)**

**Description:** Reviews internal controls and procedures to ensure assets are safeguarded and transactions are properly authorized and recorded. Oversees the Sarbanes Oxley compliance efforts. (Blended)

#### **SC-IN-HOUSE CREATIVE SOLUTIONS (4726)**



Description: Provides program for effective, measured, and coordinated advertising. Manages, develops and implements communication channels to maintain effective communications with stakeholders. Designs and develops communication materials. (Blended)

#### SC-POWER DELIVERY MGMT (4728)

Description: Performs resource planning, power delivery management, strategic planning, and construction management for the corporation's power generation assets. (Generation Capacity)

#### SC-PROPERTY ACCOUNTING (4729)

Description: Maintains the accounting records for property, plant and equipment for the majority of subsidiaries of the corporation. Assists in compliance with regulatory accounting requirements as it relates to property. Prepares various operating and financial reports for management. (Asset)

#### SC-RECORDS MGMT (4730)

Description: Administers and maintains the records retention policies and procedures of the corporation. Manages and maintains the content management software. (Blended)

#### SC-SUPPLY CHAIN MGMT (4731)

Description: Develops strategies and provides general oversight to Facilities, Contract Management, Strategic Sourcing, Procurement, Fleet Services, Materials Management and Supplier Diversity departments. (Blended)

#### SC-CONTRACTS MGMT (4732)

Description: Manages contracts, including drafting, negotiating, reviewing and interpreting contracts. (Blended)

#### SC-STRATEGIC SOURCING (4733)

Description: Executes the procurement process including, purchasing activities, managing vendor relationships, and issue resolution and tracking and expediting orders. (Blended)

#### SC-FLEET SERV (4734)

Description: Manages fleet expense cards, fleet contracts, vehicle purchasing, replacement, disposal, licensing/registration and titling. Advises on vehicle maintenance and repairs, alternative fuel selections and implementations. (Blended)

#### SC-FACILITIES (4736)

Description: Provides facility, construction, and real estate management services for corporate-wide facilities. Supports disaster recovery and business continuation planning. (Blended)

#### SC-GOVERNMENTAL AFFAIRS (4741)

Description: Advances corporate objectives by initiating, influencing, monitoring, and researching government legislation and policies. Acts as a liaison with legislators and other governmental officials. Maintains relationships with federal, state and other governmental bodies. (Blended)

#### SC-IT ADMINISTRATION (4742)

Description: Provides guidance, governance, and strategic planning to the overall information technology operations. (Blended)

#### SC-IT BUSINESS APPLICATIONS-FIN AND HR SYSTMS (4743)

Description: Manages, maintains, and enhances the financial and human resource related business applications of the company. (Blended)

#### SC-IT BUSINESS APPLICATIONS-REGULATED (4744)

Description: Manages, maintains, and enhances business applications within the utility companies. (Utility Blended)

#### SC-IT BUSINESS APPLICATIONS-WEB SERV SUPP (4745)

Description: Manages, maintains, and enhances the web-based service business applications of the company. (Blended)

#### SC-IT BUSINESS APPLICATIONS-WHOLESALE AND ENTERPRISE (4746)

Description: Manages, maintains, and enhances the wholesale and enterprise-wide business applications of the company. (Blended)

#### SC-IT INFRASTRUCTURE SERV (4747)

Description: Manages, maintains, and enhances data center operations, infrastructure servers, storage, system software, enterprise architecture, and corporate databases. (Blended)

#### SC-IT COMMUNICATIONS (4748)

Description: Manages and supports the data and voice communication needs for the company. Provides telecommunication expense management services. (Blended)

#### SC-IT USER SERVICES (4749)

Description: Provides technology support services for the company, including field services. (Blended)

#### SC-IT COMPLIANCE (4751)

Description: Responsible for internal and external audit compliance, disaster recovery, change management and legal compliance related to technology. (Blended)

#### SC-MATERIALS MGMT (4752)

Description: Manages inventory, obsolescence and scrap. Ensure availability of proper materials. Pull, restock and stage materials. (Blended)

#### SC-CONTINUOUS IMPROVEMENT (4753)

Description: Helps identify solutions to improve work processes, maximize business performance and add value for customers and stakeholders. (Blended)

#### SC-GENERATION PLANT OPERATIONS (4754)

Description: Operates and manages the generation for BHCOE and BHCIPP. (NamePlate Generation Capacity)

#### SC-IT HELPDESK / TECHNOLOGY INTEGRATION (4755)

Description: Provides IT telephone support, technology training and technology integration services. (Blended Ratio)

#### SC-CPGS PLANT OPERATIONS (4756)

Description: Operates and manages the new generation for the Cheyenne Prairie Generation Station. (NamePlate Generation Capacity)

#### SC-PROCUREMENT (4760)

Description: Executes the procurement process including, purchasing activities, managing vendor relationships, and issue resolution and tracking and expediting orders. (Blended)

#### SC – ASSET BLENDED (4793)

Description: Records depreciation for the Service Company assets. (Blended)

**SC-BENEFIT POOLED (4794)**

Description: Records pooled benefit costs, primarily related to health and welfare for Black Hills Corporation and its subsidiaries. (Employee)

**SC-ACCOUNTING ACCRUAL ENTRIES (4795)**

Description: Records accrual of certain charges not related to specific departments or not significant enough to allocate to each department. (Blended)

**SC-BENEFITS LOADING (4796)**

Description: Records overhead benefit costs loaded to labor costs (Blended)

## **Appendix 2 – Allocation Factors**

*Asset Cost Ratio* – Based on the total cost of assets as of December 31 for the prior year, the numerator of which is for an applicable BHC subsidiary and the denominator of which is for all applicable BHC subsidiaries. Assets are limited to property, plant, and equipment, and include construction or work in process. Assets are also reported at their FERC value, meaning that assets for the utility subsidiaries will not include any adjustments that are required to bring their FERC financial statements into compliance with GAAP. FERC requires that acquired fixed assets be recorded at their gross value with accumulated depreciation, while GAAP requires that acquired fixed assets be recorded at their net book value. An adjustment journal entry is used to eliminate the gross-up of cost and accumulated depreciation for preparation of GAAP financial statements, but this adjustment is not factored into the calculation of the Asset Cost Ratio.

The Environmental Services and Property Accounting departments utilize this ratio, and it is a component in the Blended Ratio and the Holding Company Blended Ratio.

*Gross Margin Ratio* – Based on the total gross margin for the prior year ending December 31, the numerator of which is for an applicable BHC subsidiary and the denominator of which is for all applicable BHC subsidiaries. Gross margin is defined as revenue less cost of sales. Certain intercompany transactions may be excluded from gross margin if they would not have occurred if the revenue relationship was with a third party instead of a related party.

No departments utilize this ratio, but it is a component in the Blended Ratio and the Holding Company Blended Ratio.

*Payroll Dollars Ratio* – Based on the total payroll dollars for the prior year ending December 31, the numerator of which is for an applicable BHC subsidiary and the denominator of which is for all applicable BHC subsidiaries. Payroll dollars include all bonuses and compensation paid to employees, but do not include items that are only included on an employee's W-2 for gross-up and income tax purposes, such as life insurance premiums over \$50,000.

No departments utilize this ratio, but it is a component in the Blended Ratio and the Holding Company Blended Ratio.

*Blended Ratio* – A composite ratio comprised of an average of the Asset Cost Ratio, the Payroll Dollars Ratio, and the Gross Margin Ratio. These factors are equally weighted. This factor is sometimes referred to as the general allocation factor.

Departments that utilize this ratio include Accounting Systems, Accounts Payable, Tax, Credit and Risk, General Accounting, Insurance, Internal Audit, Legal, Corporate Affairs, Budget and Forecast, General Accounting, Accounting-Central Services, Engineering

Rotation Program, Insurance, Internal Audit, In-House Creative Solutions, Records Management, Supply Chain Management, Contract Management, Strategic Sourcing, Fleet Services, Facilities, Governmental Affairs, Information Technology Administration, Information Technology Business Applications Wholesale and Enterprise, Information Technology Business Applications Web Service Support, Information Technology Business Applications Financial and HR Systems, Information Technology Infrastructure Services, Information Technology Communications, Information Technology User Services, Corporate Security, Information Technology Compliance, Materials Management, Continuous Improvement, Information Technology Helpdesk / Technology Integration, Procurement, Assets Blended, Accounting Accruals, Benefits and BHSC portion of the Rapid City Plant Street Facility, Midlands Data Facility and Bellevue Data Center Facility.

*Holding Company Blended Ratio* – 5% of costs allocated to the Holding Company, with the remaining 95% of costs allocated using a composite ratio comprised of an average of the Asset Cost Ratio, the Payroll Dollars Ratio, and the Gross Margin Ratio. These factors are equally weighted.

Departments that utilize this ratio include Corporate Development, Corporate Governance and Shareholder Services, Executive Management, Finance and Treasury and Financial Reporting.

*Employee Ratio* – Based on the number of employees at the end of the prior year ending December 31, the numerator of which is for an applicable BHC subsidiary and the denominator of which is for all applicable BHC subsidiaries.

Departments that utilize this ratio include Safety, Human Resources Corp., Human Resources Regulated, Compensation and Benefits, Organizational Development and Training, and Payroll. Health and welfare costs for BHC will be in a pool and allocated to subsidiaries based on the Employee Ratio.

*Power Generation Capacity Ratio* – Based on the total power generation capacity at the end of the prior year ending December 31, the numerator of which is for an applicable BHC subsidiary and the denominator of which is for all applicable BHC subsidiaries. Power generation includes capacity in service and capacity under construction.

Departments that use this ratio include Power Delivery Management and Accounting-Generation Services.

*Utility Asset Cost Ratio* – Based on the total cost of utility assets as of December 31 for the prior year, the numerator of which is for an applicable BHC utility subsidiary and the denominator of which is for all applicable BHC utility subsidiaries. Utility assets are limited to property, plant, and equipment, and include construction or work in process. Assets are also reported at their FERC value, meaning that assets for the utility subsidiaries will not include any adjustments that are required to bring their FERC

financial statements into compliance with GAAP. FERC requires that acquired fixed assets be recorded at their gross value with accumulated depreciation, while GAAP requires that acquired fixed assets be recorded at their net book value. An adjustment journal entry is used to eliminate the gross-up of cost and accumulated depreciation for preparation of GAAP financial statements, but this adjustment is not factored into the calculation of the Utility Asset Cost Ratio.

No departments utilize this ratio, but it is a component in the Utility Blended Ratio

*Utility Employee Ratio* – Based on the number of utility employees at the end of the prior year ending December 31, the numerator of which is for an applicable BHC utility subsidiary and the denominator of which is for all applicable BHC utility subsidiaries.

No departments currently utilize this ratio.

*Utility Gross Margin Ratio* – Based on the total utility gross margin for the prior year ending December 31, the numerator of which is for an applicable BHC utility subsidiary and the denominator of which is for all applicable BHC utility subsidiaries. Utility gross margin is defined as revenue less cost of sales. Certain intercompany transaction may be excluded from utility gross margin if they would not have occurred if the revenue relationship was with a third party instead of a related party.

No departments utilize this ratio, but it is a component in the Utility Blended Ratio.

*Utility Payroll Dollars Ratio* – Based on the total utility payroll dollars for the prior year ending December 31, the numerator of which is for an applicable BHC utility subsidiary and the denominator of which is for all applicable BHC utility subsidiaries. Utility payroll dollars include all bonuses and compensation paid to employees, but do not include items that are only included on an employee's W-2 for gross-up and income tax purposes, such as life insurance premiums over \$50,000.

No departments utilize this ratio, but it is a component in the Utility Blended Ratio.

*Utility Blended Ratio* – A composite ratio comprised of an average of the Utility Asset Cost Ratio, the Utility Payroll Dollars Ratio, and the Utility Gross Margin Ratio. These factors are equally weighted.

The IT Business Applications Regulated department utilizes this ratio.

*Nameplate Generation Capacity Ratio* – Based on the total facility's power generation capacity at the end of the prior year ending December 31, the numerator of which is for an applicable BHC subsidiary and the denominator of which is for all applicable BHC subsidiaries. Nameplate generation includes capacity in service and capacity under construction at the facility.

The Generation Plant Operations and CPGS Plant Operations departments utilize this ratio. (should the Generation Plant Operations department be re-named to PAGES Plant Operations? If so, this will need to be updated in multiple places.

*Square Footage Ratio* – The total square footage of a given facility, the numerator of which is for an applicable BHC subsidiary and the denominator of which is for all applicable BHC subsidiaries.

The Rapid City Plant Street Facility and the Denver Office Facility utilize this ratio.