

1. Policy Summary

| | |
|---------------------------|----------------------------------------------------------------------------------------|
| Title | Capitalization Policy |
| Version / Date | April 9, 2019 |
| Audience | All Employees |
| Risks Addressed | To ensure fixed asset transactions are appropriately designated as capital or expense. |
| Procedure Location | N/A |

2. Purpose

This Policy is effective for periods after August 1, 2019 to establish the requirements for determining whether a fixed asset transaction is capitalized or expensed.

3. Scope

| | |
|----------------------|----------------------|
| In Scope: | Capital projects |
| Out of Scope: | Non-capital projects |

4. Mandatory Requirements

GENERAL:

- All costs associated with Property Plant and Equipment (PP&E) should be reflected in the financial statements when the significant benefits and risks of ownership rest with the company. This includes all costs directly related to the acquisition and construction of an asset including expenditures incurred to place an asset in service.
- The intent of this Policy is to ensure:
 - Additions and retirements of PP&E are properly capitalized and recorded;
 - The Property Unit Catalogs are consistently used and maintained; and
 - Proper accounting for certain costs and activities related to PP&E are disclosed properly to all stakeholders and regulatory bodies. Those costs include expenditures related to PP&E, including acquisition, construction, improvements, replacements, additions, and repairs and maintenance.

CAPITALIZATION GUIDELINES:

- **Code of Federal Regulation (CFR)** – The Code of Federal Regulations (CFR) is a set of rules published in the Federal Register by the executive departments and agencies of the U.S. government. The Federal Energy Regulatory Commission (FERC) CFR defines specific accounting and utility accounts required for utility

companies in quarterly reporting through the standard FERC forms. The accounts defined within the FERC CFR are commonly referred to as FERC utility accounts. The state public service commissions have adopted (and amended for their purposes as necessary) this framework for use with public utilities under their jurisdiction.

- **Property Units** – Specifically identified assets included in the Property Unit Catalog (PUC) are identified as a property unit. The costs directly related to the acquisition and construction of a property unit, including expenditures incurred to place the property unit in service, may be capitalized. If an asset is not identified in the PUC as an identified and trackable property unit, the asset is considered a Minor Item of Property. The property units that are identified and trackable should include the asset description, cost, location and quantity.
- **Minor Item of Property** – Minor Items of property are any part or element of plant, which is not designated as a retirement unit, but is a component part of the property unit, which may be capitalized.
 - The following table provides additional information for the capital versus expense treatment related to costs associated with property units and minor items of property:

| Activity | Property Unit | Minor Item of Property |
|----------------------------------------------------------------|---------------|-----------------------------------------------------------------------------------------------------------------------|
| Additions/Initial Installation (creating a new asset) | Capital | Capital when installed with a property unit. Expense if not installed with a property unit unless allowed in the PUC. |
| Replacement (installing a new asset and retiring an old asset) | Capital | Expense unless allowed in the PUC |
| Removal (cost of removing an old asset – not the retirement) | Capital | Expense unless allowed in the PUC |
| Repair (maintaining an asset) | Expense | Expense |

- **Capitalized Spare Parts** – The cost of large spare parts or auxiliary equipment kept on hand for emergency use are referred to as capitalized spare parts. The capitalized spare parts are considered “in-service” when the company takes delivery of the property unit and are not considered part of inventory (FERC account 154). Capitalized spare parts must meet all of the following criteria:

- Long lead time to procure
- Costly
- Vital to the continued operation of the facility
- Used for emergency replacement only
- Requires customization

It is assumed that such spare parts are stored at or near the property for which they are held rather than in a storeroom. Spare parts that do not meet the criteria above will be considered part of normal inventory.

- **Office Furniture, Equipment, and Tools Capitalization Minimum** – Office furniture and equipment, system shop tools and garage equipment, stores equipment, laboratory equipment, power operated equipment, and miscellaneous equipment will be capitalized if the per unit cost of the item is \$500 or greater for Gas Plant and \$1,000 or greater for Electric Plant per property unit. Equipment noted above should be recorded to the appropriate general plant utility accounts – 389-399. Refer to the Property Unit Catalog for threshold details.
- **Training Costs** – When it is necessary that employees be trained to operate or maintain plant facilities that are being constructed and such facilities are not conventional in nature or are new to the company's operations, these costs may be capitalized as a component of construction cost. Once the plant is placed in service, subsequent training costs shall be expensed. **For Internally Developed Software training please refer to Policy FIN-004: Capitalization of Costs for Software Developed for Internal Use.**
- **Temporary Facilities** – If the temporary facility is expected to be in-service for greater than one-year, the temporary service may be capitalized. Any property unit that is expected/planned to be replaced or removed within one year from the in-service date, the temporary service will be charged to FERC Account 185 as outlined in the CFR 18, Parts 101 and 201.
- **Allowance for Funds Used during Construction (AFUDC) - Refer to the AFUDC policy for guidance for Chesapeake Utilities.**
- **Leasehold Improvements** – Leasehold improvements qualify for capital accounting treatment provided the improvements are property units, and the remaining lease term is greater than one year.
- **Internal Labor, Contracting, and Material Costs** – Costs that are not directly attributable to the construction of an asset may not be capitalized. These costs are expensed as incurred. For the purposes of this policy, local meals are not considered to be directly attributable to the construction of the asset. They should be expensed. Regulated entities may be able to include certain of these costs in their overhead allocable costs. **Refer to the Internal Labor policy for guidance for Chesapeake Utilities.**

- **Overhead Costs** – For regulated entities, overhead costs incurred during construction should be capitalized. Capitalized overheads should include only those costs that are reasonably attributable to the construction. Specific guidance regarding direct and overhead construction costs to be charged to electric and gas plant are included in the Electric and Gas Plant Instructions of the Uniform System of Accounts under FERC-CFR18, Part 101 and the Florida Public Service Commission Rule 25-6.0142 and 25-7.0461.
- **G&A Cost Guideline** – General and administrative support costs and certain allocable costs related to construction of an asset are permissible to capitalize under ASC 980.
- **Contributions in Aid of Construction (CIAC)** - Contributions in the form of money toward the construction of plant shall be credited to accounts charged with the cost of construction. CIAC represents payment received from a third party to reimburse for the cost incurred to perform capital work requested. **Refer to the Capital Project Request and Approval Policy for Chesapeake Utilities procedure on CIAC.**
- **Cost of Removal** – In accordance with Commission or FERC-approved depreciation rates, the company accrues costs of removal expenses with depreciation expenses setting up a liability. When one of these assets is removed, the costs incurred to remove those assets shall be recorded separately in 108S from the costs to replace the asset in 1070. These actual costs of removal incurred will reduce the liability. The same principles outlined in this document apply to cost of removal (i.e. directly attributable costs to remove the asset are capitalized in the reserve through account 108S.)
- **Refurbishments** – Costs incurred to “refurbish, renovate, or remanufacture” pre-existing materials and property units through maintenance or repair activities needed to restore to a “good or like new” Condition, are generally expensed as incurred.
- **Computer Equipment - Computer Equipment** purchased with a cost of greater than \$500 for Gas Plant and \$1,000 for Electric Plant can be capitalized.
- **Capital Approval Policy** – illustrates the requirements for requesting and approving a capital project.
- **Capitalization Thresholds** – Refer to the **Property Unit Catalog and Property Unit Catalog Policy**

5. Policy Governance & Compliance

Any individual found in violation of this Policy could be subject to discipline, up to and including termination. Any exceptions to this Policy must be approved, in writing, by the VP, Controller or Chief Financial Officer.

6. Definitions & Applicability

- Property Unit Catalog (PUC) – lists Chesapeake’s fixed asset property units and describes what can be capitalized. In addition, the PUC provides guidance for the accounting for additions, replacements, removal, and repair of fixed assets.
- Property Unit – specific fixed asset, such as valve, mains, etc. and is factored into the determination of whether to capitalize or expense a fixed asset transaction.
- Fixed asset transaction – addition, retirement or removal of a fixed asset or property unit for Chesapeake’s accounting records.
- Capitalized – fixed asset transaction is reflected on Chesapeake’s balance sheet as an asset rather than expensing the transaction on Chesapeake’s income statement.
- Expense – fixed asset transaction is reflected on Chesapeake’s income statement as an expense rather than capitalizing the transaction on Chesapeake’s balance sheet as an asset.
- FERC – Federal Energy Regulatory Commission which regulates the transmission and wholesale sale of energy in interstate commerce.

7. Supporting Materials

| Materials | Where located |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------|
| <ul style="list-style-type: none"> • Property Unit Catalog Policy • Property Unit Catalog • Internal Capitalization of Labor for General Plant Policy • Project Accounting and Control Policy • Allowance for Funds Used Under Construction (AFUDC) Policy • FERC Classification Policy • Capitalization of Costs of Software Developed for Internal Use • Capital Accruals Policy • General Ledger Account Reconciliation Policy • Physical Inventory Valuation, Count & Reconciliation Policy • Prepaid Expense Policy | SharePoint - TBD or available upon request |

8. Applicable Accounting Standards

None

9. Regulatory Implications

Federal Energy Regulatory Commission (FERC) as detailed in the Code of Federal Regulations – 18 (CFR 18).

Florida Public Service Commission as detailed in FPC rules 25-6.0142 and 25-7.0461.

10. Contacts

| | |
|--------------------|-----------------------------------------------------------------------------------------------------------------------------------|
| P. Rossillo | Senior Director, Assistant Controller Tel: 1-302-736-6718 Email: prossillo@chpk.com |
| M. Petito | Senior Director, Shared Services Tel: 1-302-213-7335 Email: mapetito@chpk.com |
| C. Martin | VP, Regulatory & Rate Affairs Tel: 1-904-530-7051 Email: cheryl_martin@chpk.com |

11. Approval and Signoff

| Name / Title | Signature | Date |
|-----------------------------------------------------------|-----------|------|
| Matthew Petito / Senior Director, Shared Services | | |
| Paige Rossillo / Senior Director, Assistant Controller | | |
| Joe Steinmetz / Vice President, Controller | | |
| Cheryl Martin / Vice President, Regulatory & Rate Affairs | | |

SEE ATTACHED



| | | |
|------------------------------------------------|--------------|--|
| Beth Cooper / Executive Vice President, CFO | SEE ATTACHED | |
|------------------------------------------------|--------------|--|

APPROVALS

This account is cancelled, so you can't create documents.

- DocumentsTemplatesAccount**Capitalization Policy - Final 04 09 19 For Sig**

Sent by Paige Rossillo a month ago.

Download
Original PDF
Created with Sketch.

Date

Pending

Required "Date" field assigned to Cheryl Martin

> see attached email

05/15/2019

Completed

Required "Date" field assigned to Joe Steinmetz

> JOE STEINMETZ

05/15/2019

Completed

Required "Date" field assigned to Paige E. Rossillo

> PAIGE ROSSILLO

05/15/2019

Completed

Required "Date" field assigned to Matthew Petito

> MATI PETITO

Signature

Pending

Required "Signature" field assigned to Cheryl Martin

Completed

Required "Signature" field assigned to Joe Steinmetz

Completed

Required "Signature" field assigned to Paige E. Rossillo

Completed

Required "Signature" field assigned to Matthew Petito

06/11/2019

Completed

Required "Date" field assigned to Beth Cooper

> BETH COOPER

Completed

Required "Signature" field assigned to Beth Cooper

Status

OverviewHistory

•

•

•

•

•

Petito, Matt

From: Martin, Cheryl
Sent: Wednesday, June 05, 2019 3:37 PM
To: Petito, Matt
Subject: Re: Secure link to access your RightSignature Documents

I can see it. Approved Cheryl Martin

> CHERYL MARTIN

Sent from my iPhone

On Jun 5, 2019, at 3:34 PM, Petito, Matt <mapetito@chpk.com> wrote:

Can you see it. If so you can email me your approval

Thanks,

Matt

On Jun 5, 2019, at 3:34 PM, Martin, Cheryl <Cheryl_Martin@chpk.com> wrote:

It's not letting me sign?

Sent from my iPhone

On Jun 5, 2019, at 3:28 PM, Petito, Matt <mapetito@chpk.com> wrote:

Did you get this

Matt Petito, CPA, CIA, CRMA

Senior Director, Financial Shared Services

Chesapeake Utilities Corporation

909 Silver Lake Blvd.

Dover, DE 19904

Office Phone: (302) 213-7335

Cell Phone: (410) 456-5358

mapetito@chpk.com

From: [RightSignature.com](https://www.rightsignature.com) [<mailto:documents@rightsignature.com>]

Sent: Wednesday, June 05, 2019 3:26 PM

To: Petito, Matt <mapetito@chpk.com>

Subject: Secure link to access your RightSignature Documents

<~WRD000.jpg>