

Capitalization Policy

PEDERNALES ELECTRIC COOPERATIVE, INC.

1. Purpose:

- 1.1. This Policy addresses criteria for determining whether costs are capital in nature. Capital costs result in one of the following:
 - The creation of new long lived Assets either by acquisition or construction;
 - The replacement of existing Assets; or
 - The modification of existing Assets that is a substantial addition or betterment resulting in extension of useful life.
- 1.2. This Policy conveys Pedernales Electric Cooperative, Inc.'s ("PEC" or "Cooperative") guidelines regarding capitalized costs for property, plant, and equipment. It also provides guidelines for consistent and accurate recording of Assets as required for internal, external Generally Accepted Accounting Principles ("GAAP"), federal, debt compliance, and regulatory reporting.

2. Scope:

- 2.1. This Policy applies to all PEC costs. In general, the ongoing activities at the Cooperative are accounted for as Operations and Maintenance expenses and expensed in the period incurred. However, if a cost adds to the productive capacity, improves the efficiency, increases the useful life of an existing Asset, or if the cost creates a new Asset, then it may be capitalized.

3. Definitions:

- 3.1. Asset – Any resources owned by the Cooperative and which have future economic value that may be measured and expressed in dollars.
- 3.2. Continuing Property Record ("CPR") Units – A unit of property which can be readily identified and accounted for by itself. There are two types of CPR Units:
 - 3.2.1. Specifically identifiable units such as land, buildings, and equipment, etc., for which one maintains a record showing location and original cost of each item.
 - 3.2.2. Group units such as poles, transformers, meters, etc. that are recorded in total quantities and at a total grouped asset value. Group assets are referred to at an average cost per unit. Group unit property records are a control record and should be supplemented by subsidiary continuing property records subdivided by sizes and recorded in detail from the work orders completed during the year. The total quantities, total cost and average cost per unit should be recorded as part of the continuing property records at the end of each year.
- 3.3. Distribution Plant – Assets with physical substance, including such items as land, buildings, structures, machinery, drawings, and equipment related to electric supply at distribution voltages. FERC Accounts 360-374.
- 3.4. Federal Energy Regulatory Commission ("FERC") Account – The Cooperative's system of accounts is based on the Code of Federal Regulations, Title 7, Chapter XVII, Rural Utilities Service, Department of Agriculture, Part 1767, Subpart B –

Capitalization Policy

PEDERNALES ELECTRIC COOPERATIVE, INC.

Uniform System of Accounts, and is generally referred to as the FERC system of accounts.

- 3.5. General Plant – Assets with physical substance, including such items as land, buildings, structures, machinery, and equipment, owned and used by the Cooperative but not directly related to the purpose of supplying electricity. FERC Accounts 389-399.
 - 3.6. Generally Accepted Accounting Principles (“GAAP”) – A framework of accounting standards, rules, and procedures defined by the professional accounting industry.
 - 3.7. Intangible Plant – Assets lacking in physical substance, including such items as trademarks, patents, or copyrights. FERC Accounts 301-303.
 - 3.8. Transmission Plant – Assets with physical substance, including such items as land, buildings, structures, machinery, drawings, easements, and equipment related to electric supply at transmission voltages. FERC Accounts 350-359.
4. **Policy Statement and Implementation:** Capital costs must meet the guidelines stated below.
- 4.1. **Transmission and Distribution Utility Plant.** Costs for the following activities are capitalized:
 - 4.1.1. Installation or construction of a new Asset.
 - 4.1.2. Upgrades or modifications to existing Assets that adds to the capacity, improves the efficiency, or increases the useful life.
 - 4.1.3. Replacement of existing Assets will be recorded as a capital installation with a corresponding retirement for such Asset.
 - 4.2. **General and Intangible Plant.** Costs for the following activities are capitalized:
 - 4.2.1. Single purchase of a single Asset with a value of \$7,500 or greater and an expected useful life of two years or greater.
 - 4.2.2. Multiple component purchases that create a single Asset with a total value of \$7,500 or greater and with an expected useful life of two years or greater.
 - 4.2.3. Substantial addition or betterment of existing Asset to increase the value or extend the useful life where the value of the Asset is increased by \$7,500 or more.
 - 4.2.4. All transportation equipment licensed for road use, regardless of value.
5. **Procedure Responsibilities:**
- 5.1. PEC’s Chief Financial Officer (“CFO”) has overall responsibility for this Policy. Under the direction of the CFO, PEC’s Finance Department is responsible for enforcing this Policy, establishing operational procedures, reporting mechanisms, and training to ensure work results conform to this Policy. PEC employees and any contract personnel are responsible for following this Policy.
6. **Enforcement:**
- 6.1. Violations of this Policy may result in disciplinary action, up to and including, termination.

Capitalization Policy

PEDERNALES ELECTRIC COOPERATIVE, INC.

7. Superseding Effect:

7.1. This Policy supersedes all previous policies and memoranda concerning the subject matter. Only the Approver may authorize exceptions to this Policy.

8. References and Related Documents:

- 8.1. Generally Accepted Accounting Principles
- 8.2. Rural Utilities Services Uniform System of Accounts
- 8.3. Federal Energy Regulatory Commission Uniform System of Accounts
- 8.4. PEC Budget Policy
- 8.5. PEC Assembly Unit List
- 8.6. PEC Capitalization Handbook

| | |
|---------------------|--|
| Policy Title: | Capitalization Policy |
| Review Frequency: | Every 2 years |
| Last Reviewed: | December 13, 2019 |
| Date Adopted: | January 1, 2015 |
| Effective Date: | December 13, 2019 |
| Amendment Dates: | July 21, 2014; July 18, 2016; December 13, 2019 |
| Approver: | Board of Directors |
| Applies to: | All PEC employees and contract personnel |
| Administrator: | Finance |
| Superseding Effect: | This Policy supersedes all previous policies and memoranda concerning the subject matter. Only the Approver may authorize exceptions to this Policy. |