

SECTION: Finance
SUBJECT: Capitalization Policy
Issue / Revise Date: January 1, 2011 Effective Date: January 1, 2011

POLICY STATEMENT

This policy provides guidelines for determining whether an expenditure is capital or operating in nature. This policy is not intended to cover every potential situation that may exist at SaskPower. Professional accounting judgment should be exercised when applying these policies. For assistance in the application of this policy, please contact Corporate & Financial Services.

MEASUREMENT

Property, plant and equipment is initially recognized at cost. Subsequently, International Accounting Standard (IAS) 16 permits entities to use either the "cost model" or the "revaluation model" to value its assets on an on-going basis. SaskPower has elected to use the cost model to value all of its property, plant and equipment on an on-going basis.

PROCEDURES

For each planned expenditure, a determination must be made as to whether it is capital or operating in nature. Any decision is guided by generally accepted accounting principles as defined according to the International Financial Reporting Standards (IFRS) and other relevant accounting literature. All expenditures are eventually recovered through a charge to income. However, the classification as capital or operating determines the timing of the charge. An operating expense is charged against current income while the cost of a capital asset is charged to income over the useful life of the asset.

NEW ASSETS

As per paragraph 7 of IAS 16 - Property, Plant & Equipment - the cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

- a) It is probable that future economic benefits associated with the item will flow to SaskPower; and
- b) The cost of the item can be measured reliably.

An expenditure on a new asset is considered to meet the capitalization criteria if all of the following conditions are met:

1. The expenditure will result in identifiable future economic benefits, improved environmental performance or is associated with the obligation to serve.

Future economic benefits are defined as those benefits that directly or indirectly result in a reduction of operating expenses or an increase in revenues by a substantial and quantifiable amount. This includes, but is not limited, to one or a combination of:

- a) reliability improvements;
 - b) capacity improvements;
 - c) efficiency improvements;
 - d) life extension;
 - e) improved quality;
 - f) compliance with regulatory requirements; or
 - g) other supportable reasons, including business policy and engineering standards (specific policy or standard must be stated)
2. The identifiable benefits to SaskPower are for a service life of three or more years; and
 3. Ownership or a right to utilize the asset is assured.

SUBSEQUENT COSTS OR BETTERMENTS

Expenditures that relate to the replacement or refurbishment of an existing capital asset / component must meet the above criteria plus at least one of the following:

- a) increases the service life of the existing component by at least 25% of the original estimated useful life;
- b) results in an increase in the previously assessed physical output, service capacity, or quality of output by a significant and quantifiable amount;
- c) reduces operating costs of the existing component by a substantial and quantifiable amount over a period of at least three years; or
- d) improves the quality of output (this includes specific tangible assets that result in improved environmental performance).

When an existing asset is replaced or refurbished, the remaining net book value of the asset or component being replaced must be retired (see Asset Disposals and Retirements). Please contact C&FS for the process to retire an existing asset.

The costs incurred in the maintenance of the service potential of an existing asset are considered to be a repair and should be expensed. The reason these costs are expensed rather than capitalized is that they do not add to the future economic benefits of the asset. Rather, they maintain the asset's potential to deliver the level of future economic benefits that it was expected to provide when it was originally acquired.

REGULAR MAJOR INSPECTION COSTS

Labour costs are incurred to regularly inspect the condition / quality of the Corporation's generating assets and make assessments regarding their remaining useful life. The inspections normally take place as part of a scheduled major overhaul. In addition to the inspection activities, the scheduled major overhauls normally include both repair and maintenance activities as well as certain capital activities.

Under IFRS, the inspection costs can be capitalized if they are considered to be a condition of continuing to operate the facility (i.e. there is no legal or regulatory requirement to complete the inspection). In addition, the inspection activities must provide future economic benefits and the cost can be measured reliably.

It was determined that the inspection activities that normally take place during SaskPower's generation overhauls should not be classified as capital. The inspections are not considered to be a condition of continuing to operate the facility. In addition, the inspection activities are not expected to provide future economic benefits. Instead, the inspection activities are considered to permit SaskPower to maintain the service potential expected when the asset was originally acquired.

CAPITAL RELATED ACTIVITIES

Self constructed capital asset projects can take place in a number of stages over a number of years. The following identifies the typical stages that a project goes through and identifies how the costs incurred in each stage should be treated. However, costs may not necessarily be incurred in the sequence below. In these situations, capitalization should be applied based on the nature of the costs rather than on the timing of their occurrence.

Preliminary Project Stage

This stage involves need, concept and scope identification, preliminary design, budget estimation, and preliminary ranking. This includes the cost of all studies prior to project approval. This stage typically begins with the initial investigation and ends once the appropriate level of approval has been received to proceed with the project.

During the preliminary project stage, there is a high level of uncertainty that the project will proceed and future benefits are not assured. Accordingly, prior to such approval being obtained, all costs should be expensed as incurred.

Implementation / Development Stage

At this stage, detailed design, manufacturing, purchasing, construction, and commissioning occur. This stage typically begins once the appropriate level of approval to proceed with the project has been obtained and ends once the asset is substantially complete and ready for productive use.

Once the project proceeds to the implementation / development stage, uncertainty as to future benefits no longer exists. Therefore, costs incurred during this stage can be capitalized. Project costs which were previously expensed in prior periods will not be reversed and capitalized in subsequent reporting periods.

Costs should cease to be capitalized once the asset is in the location and condition necessary for it to be capable of operating in the manner intended by management.

Post-Implementation / Operation Stage

This stage includes ongoing maintenance and training as well as an appraisal and audit comparing original objectives and costs to actual results. This stage typically begins once the asset is substantially complete and ready for productive use.

The costs incurred in the post-implementation / operation stages are not capital since they are not required to bring the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Since the asset is already in use, any support provided is an operating / maintenance activity and should be expensed as incurred unless it is part of a larger project that meets the criteria for a betterment.

COSTS ELIGIBLE FOR CAPITALIZATION

All capital activities at SaskPower are recorded at cost. However, only certain activities related to a capital project can be considered cost for accounting purposes. General guidance as to what should be considered a valid cost is given in paragraphs 16, 17 and 19 of IAS 16 - Property, Plant & Equipment:

“The cost of an item of property, plant and equipment comprises:

- a) Its purchase price, including import duties and non-refundable taxes, after deducting trade discounts and rebates.
- b) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

Examples of directly attributable costs are:

- a) Salaries and benefits of employees working directly on the construction or acquisition of the item of property, plant and equipment;
- b) Costs of site preparation;
- c) Initial delivery and handling costs;
- d) Installation and assembly costs;
- e) Costs of testing whether the asset is functioning properly...; and
- f) Professional fees.

Examples of costs that are not costs of an item of property, plant and equipment are:

- a) Costs of opening a new facility;
- b) Costs of introducing a new product or service (including costs of advertising and promotional activities);
- c) Costs of conducting business in a new location or with a new class of customer (including costs of staff training); and
- d) Administration and other general overhead costs.”

The costs directly attributable to getting the asset ready for its intended use include SaskPower’s internal staff costs (including travel, accommodation, and sustenance) only if the individual is directly associated with and devotes time to the project. This would include a Project Sponsor, Project Manager, or member of the Project Team. Incidental or indirect internal costs should be expensed as incurred.

Internal salary and benefit costs and certain contractor costs are charged to the project using standard rates. The standard labour and contractor rates are reviewed and updated annually by Corporate & Financial Services and the Business Units to ensure

the rates reflect actual costs. The rates are stored in a table in SAP and are also posted on the EIN for reference. Please refer to the EIN posting for more details on standard rates.

Training costs should be expensed as incurred. Training involves uncertain future benefit and is not necessary to get the asset ready for its intended use. These costs are employee related, not capital asset related.

Capital Allocation Charge

Internal costs directly attributable to a capital project may be applied to SaskPower's capital projects using a capital allocation charge (formerly known as "overhead costs"). The capital allocation charge is intended to capture the cost of individuals who work on capital projects but do not charge their time directly to the project. The capital allocation charge is used by those individuals who make small contributions to a large number of capital projects. Since they work on so many projects, it would be unreasonable to have the individuals track and charge their time to each project. As a result, a capital allocation rate has been developed and is used in place of direct charging.

The capital allocation rates are reviewed and updated annually by Corporate & Financial Services and the Business Units to ensure that the rates reflect actual costs. The capital allocation rates are stored in a table in SAP and are posted on the EIN for reference.

INTEREST CAPITALIZED

Where construction or development of a capital project is ongoing for a period of time, the asset is not of any productive use to the Corporation, but funds that could be used elsewhere are being tied up by the construction process. To recognize this inherent carrying cost, interest must be capitalized on projects that are anticipated to be under construction or development for a period of 6 months or longer. Interest is not capitalized on projects that are under construction or development for less than 6 months.

The following provides a guideline for the different types of self constructed assets at SaskPower and the general time frame for construction of these assets

Less Than 6 Months (No Interest)	Greater than 6 Months (Interest)
Distribution	Generation
Vehicles	Transmission
Building Renovations	New Buildings
	Computer Application Projects

Costs Eligible for Interest

Interest is applied monthly on the ending asset under construction balance – excluding previously accumulated interest charges. Generally, accrued costs and holdbacks are included in the asset under construction balance. These costs do not represent an outflow of cash. However, in most cases, the time between accrual / holdback and payment is generally insignificant. In these cases, the Corporation will apply interest on the entire asset under construction balance as the impact is not considered material.

Where accrued costs / holdbacks are significant or the funds are not expected to be released for an extended period of time, then interest should not be recorded on the accrual / holdback. In these instances, please contact Corporate & Financial Services to discuss the procedures to accomplish this.

Interest Rate

The annual interest capitalized during construction is calculated at a simple interest rate based on the previous year’s weighted average cost of long-term debt and short-term borrowings.

The interest expense associated with capital leases are considered to be specific to the leased asset and are not included in the general interest rate calculation.

Timing of the Application of Interest to Capital Projects

Capitalization of interest commences in the month when the project begins or when activities necessary for the preparation of the asset for its use are under way.

Capitalization of interest is discontinued at the end of the month prior to the project going in-service. This is consistent with the depreciation policy, which recognizes a whole month's depreciation in the month the project goes in-service. Thus there is a smooth transition from interest capitalization to depreciation.

ASSET IMPAIRMENTS

IAS 36 establishes standards for the recognition and measurement of impairment of long-lived assets.

Economic Impairment

Assets should be tested separately for impairment. Where the recoverable amount cannot be estimated for individual assets, it should be estimated as part of a Cash Generating Unit (CGU). CGUs are the smallest identifiable group of assets, including the asset under review, that generates cash flows and are largely independent of the cash flows from other assets or groups of assets.

SaskPower relies on a total cost of service methodology to set its domestic (Saskatchewan) rates. This total cost of service methodology is based upon the full recovery of both fixed and variable costs (rate base) plus a return/margin on rate base. SaskPower sets rates to achieve an appropriate rate of return on the total rate base. It is not based on earning specific returns on individual assets. This methodology results in higher returns from certain assets (e.g. hydro plants) offsetting weaker returns from other assets (natural gas plants).

As SaskPower's rates are based on providing a return on total rate base, the Corporation does not identify cash flows from specific assets. Therefore, SaskPower has one CGU for impairment testing purposes. The impairment test is applied against the total carrying value of all of SaskPower's long-lived assets.

An analytical review of SaskPower's cost of service methodology (return on rate base); business plan and the assumption of going concern demonstrate that there is no impairment of SaskPower's assets.

The exception to this is SaskPower's equity investment in the MRM Cogeneration Station. This asset has an independently identifiable revenue source. As per the IFRS guidance, this asset is assessed at the end of each reporting period as to whether there is any indication that an asset may be impaired. If any such indication exists, the recoverable amount of the asset needs to be estimated.

Impairment losses are recognized when the carrying value of the asset exceeds the recoverable amount, which is the higher of:

- a) Value in use; and
- b) Fair value less costs to sell.

An impairment loss recognized in prior periods shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized.

Damaged Assets

When an asset is impaired as a result of damage to the asset, the Corporation has an impaired asset. If the asset is not insured, SaskPower will normally repair or replace the asset at its own cost.

If SaskPower repairs the damaged asset or component, the cost of the repair is expensed in the current period. However, if the Corporation replaces the damaged components, the cost of the replacement component is capitalized. In this situation, the Corporation must also identify and retire the damaged component.

If the asset is insured, the funds from insurance are to be recorded against the gain / loss account when the receipt of the insurance proceeds is virtually certain. This is normally considered to take place once the insurance company accepts the claim and makes payment to SaskPower.

DECOMMISSIONING LIABILITIES

IAS 37 establishes standards for the recognition and measurement of decommissioning liabilities. IFRS requires decommissioning liabilities to be recognized for legal and constructive obligations to retire or decommission an existing asset and remediate the facilities.

A constructive obligation arises from an entity's actions based on an established pattern of past practice, published policies or a sufficiently specific current statement, indicating to other parties that it will accept certain responsibilities. As a result, a valid expectation has been created that those responsibilities will be discharged.

Decommissioning activities are considered to occur in situations where SaskPower has completely discontinued an activity in a particular area or region. However, when the asset is replaced with a similar asset in the same area or region and the activity continues, no decommissioning activities are considered to have occurred.

Decommissioning liabilities are established at the time original asset is commissioned. In accordance with IAS 16 - Property, Plant & Equipment, paragraph 16 - the offsetting entry to the liability at the time of commissioning is an increase in the value of the associated asset.

A provision for the cost of decommissioning activities has been established for SaskPower's coal, gas, cogeneration and wind generation facilities; former northern and southern diesel sites and for assets containing polychlorinated biphenyls (PCBs) in excess of existing federal regulations. These represent obligations for which the Corporation has an obligation as a result of past events, it is probable the company will complete the decommissioning activities and the cost to remediate the facilities can be reliably estimated.

However, a provision has not been established for SaskPower's transmission, distribution and hydro generation assets, as these assets are expected to be maintained and operated indefinitely. Therefore, it is not probable that the Corporation will complete decommissioning activities on these facilities and a reliable estimate of the provision is not possible.

Initial Recognition and Measurement

The decommissioning liability is recognized at fair value in the period in which the liability is incurred. This is normally the period that the asset is commissioned.

Upon initial recognition of the decommissioning liability, an asset retirement asset is also recorded. The asset retirement asset is recorded at the same value as the decommissioning liability.

The decommissioning liability is subsequently increased annually to recognize an increase in the value of the liability due to the passage of time (accretion expense). The accretion expense is classified as part of finance charges. The asset retirement asset is amortized on a straight line basis over the remaining estimated period to the decommissioning date. The amortization cost is included as part of depreciation expense.

The decommissioning liability and asset retirement asset are calculated in accordance with the guidance provided in IAS 37 and IAS 16 and documented within the Decommissioning Liability study. The accretion and depreciation expense are calculated in excel and posted by journal voucher into SAP.

Subsequent Recognition and Measurement

The decommissioning liability estimates are reviewed annually for completeness and appropriateness. A detailed decommissioning cost study is completed every 5 years with the intent of updating decommissioning cost estimates.

The decommissioning liability is revised if there are any changes in assumptions used to estimate the cash flows required to settle the obligation, including changes in discount rates, estimated probabilities, amounts and timing of settlement, as well as changes in the legal requirements of the obligation.

The revisions to the decommissioning liability are calculated in accordance with the guidance provided in IFRIC Interpretation 1, Changes in Existing Decommissioning, Restoration and Similar Liabilities.

ASSET DISPOSALS AND RETIREMENTS

Retirements Covered by Decommissioning Liabilities

Charges against the decommissioning liability can be made only when the entire asset is taken out of service and decommissioned. The provision is not to be used for partial rebuilds (i.e. the cost of removing and replacing a boiler at a power plant).

At the time of decommissioning, all direct costs of removal are charged against the provision and the provision is credited with all salvage proceeds. The amount charged to the provision is limited by the value of the liability set up for the specific asset. Any difference between the actual removal costs and the decommissioning liability for a given asset will be charged directly to the gain/loss account at the time of disposal.

The undepreciated costs are also charged to the gain/loss account at the time of retirement.

Retirements not covered by Decommissioning Liabilities

Upon retirement of assets not covered by a decommissioning liability, the net cost of removal (direct costs of removal less proceeds) is charged directly to the gain/loss account at the time of disposal. The carrying amount of an item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected from its use. The remaining net book value of the asset (undepreciated cost) upon retirement is also charged to the gain/loss account.

For most assets, retirement from plant-in-service only occurs upon confirmation from the appropriate business unit that the asset is no longer in use by the Corporation. In the meantime, even fully depreciated assets continue to be carried at a net book value of zero.

The exception to this rule is tools. Tools are automatically retired after 7 years of service (once fully depreciated – estimated service life is 7 years).

Replacement of Assets upon Retirement

When an asset being retired is being simultaneously replaced, the cost of removal of the old asset is considered to be a cost incurred to prepare the site for the new asset and should be capitalized as part of the new asset.

The net book value (undepreciated cost) of the replaced asset is derecognized (retired). If the cost of the item being replaced is not known, the cost of the new asset can be used to determine the cost of the old asset at the time it was acquired or constructed.

The difference between the proceeds on disposal, if any, and the remaining net book value of the replaced asset is charged to the gain/loss account.

Retirement of Transformers

Transformers are removed from service due to burnouts, salvages, capacity change, and voltage changes. Transformers may be defective or may still be usable.

Whenever transformers are removed from service, the costs of removal are expensed. Otherwise, transformer retirements are generally treated the same as other asset retirements not covered by decommissioning liabilities. However, while defective transformers are retired permanently, usable transformers are retired to inventory.

Transformer inventories are maintained on an average cost basis. Retired usable transformers are added to inventory at the existing unit average price.

CUSTOMER CONTRIBUTIONS

Customer contributions are funds received from customers to partially cover the construction costs for new service connects or upgrades and system improvements. The Customer Services Policy Manual details the corporation's policy regarding the customer's share of the service connection costs. This manual should be referenced for further details regarding the Corporation's customer contribution policy.

The cost of the service and the customer contribution are recorded separately. The total cost of the service is charged directly to the capital asset while the total customer contribution receipt is recognized as revenue (other revenue).

Refunds of Customer Contributions:

A customer contribution may be refunded if there is a further service extension branching off the line for which the original contribution was received, and if this extension occurs within a five year period after the initial construction. In this case, for purposes of calculating the contribution, the original project and new extension will be treated as a single project, and the total contribution required will be prorated between the original customer and the new customer.

DEPRECIATION

Depreciation is calculated on all SaskPower capital assets, with the exception of land. The depreciation method, residual values and estimated useful lives are reviewed annually for reasonableness and continued appropriateness. A formal depreciation study is completed every 5 years. The depreciation rates are updated in SAP based on the results of the study.

SaskPower's policy is to calculate depreciation on a straight-line basis over the estimated service life of the related asset.

When an asset is brought into service, a full month's depreciation is recognized in the month it comes in service. This is consistent with the treatment of interest in that no interest is applied on projects in the month they come in service. Thus there is a smooth transition from interest capitalization to depreciation.

CAPITAL LEASES

Rather than purchase all of its capital assets, SaskPower leases a number of assets from other parties. Leases may be classified as either capital or operating leases.

As per IAS 17, Leases, a lease is considered to be a finance (capital) lease when substantially all of the benefits and risks associated with ownership of the leased asset are transferred to SaskPower. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

1. The lease transfers ownership of the asset to the lessee (SaskPower) at the end of the lease term. This would occur when the terms of the lease result in ownership being transferred to SaskPower or when the lease provides for a bargain purchase option.
2. The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised.
3. The lease term is for the major part of the economic life of the asset even if title is not transferred.
4. At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.
5. The leased assets are of such a specialized nature that only the lessee can use them without major modifications.

Assets under capital leases are recognized at the fair value of the leased property or, if lower, the present value of the minimum lease payments at inception of the lease. The discount rate used in calculating the present value of the minimum lease payments is the interest rate implicit in the lease, if this is practicable to determine; if not, the Corporation's rate for incremental borrowing should be used. The capitalized value of the leased asset will be depreciated using the same methods as for similar owned assets. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its useful life.

The obligation under the capital lease is recorded as a long-term liability at the same value as the asset under the lease. Lease payments will then be treated as a reduction in the liability, with a principal component and an interest component. Interest is calculated at the same rate as used for discounting the lease payments.

Assets under capital lease will be disclosed separately from owned assets if the capital lease is material.

Leasehold Improvements

From time to time, the Corporation may incur costs to improve a leased asset. If the asset is under an operating lease, the costs should be expensed in the period incurred. However, if the asset is under a capital lease, and if the expenditures meet the criteria for “betterments” as described earlier in this policy, the costs may be capitalized as part of the leased capital asset and depreciated accordingly.

Determining Whether an Arrangement Contains a Lease

IFRIC 4 provides guidance to determine whether an arrangement contains a lease within the scope of IAS 17. Specifically it requires the evaluation of the substance of the arrangement and assessment of whether:

- (a) fulfillment of the arrangement is dependent on the use of a specific asset or assets; and
- (b) the arrangement conveys a right to use the asset. This right is conveyed if any one of the following conditions is met:
 - (i) The purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset; or
 - (ii) The purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset; or
 - (iii) Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the arrangement, and the price that the purchaser will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output.

If the agreement meets both tests (a) and (b) it is then necessary to look to the guidance in IAS 17 to determine if the lease should be treated as a capital or operating lease.

ADDITIONAL INFORMATION (i.e. Benefits, Exceptions, Terminology, etc.):

INQUIRIES: Contact: Corporate Accounting & Reporting
SaskPower: Corporate & Financial Services

APPENDICES:

APPENDIX I - COMPUTER APPLICATION DEVELOPMENT COSTS

**APPENDIX II – LINE & SWITCHING STATION REPLACEMENTS OR
BETTERMENTS**

APPENDIX III – ENVIRONMENTAL COSTS

APPENDIX IV – ADDITIONAL ITEMS

RELATED POLICIES:

REFERENCE/AUTHORITY:

- IAS 16 “Property, Plant & Equipment”;
- IAS 38 “Intangible Assets”;
- IAS 36 “Impairment of Assets”;
- IAS 23 “Borrowing Costs”;
- IAS 17 “Leases”;
- IFRIC Interpretation 4 “Determining Whether an Arrangement Contains a Lease”;
- IAS 37 “Provisions, Contingent Liabilities and Contingent Assets”;
- IFRIC Interpretation 1 “Changes in Existing Decommissioning, Restoration and Similar Liabilities”;

- Emerging Issues Committee (EIC) Abstract – EIC 86 “Accounting for the Costs of a Business Reengineering Project”;
- AICPA – Statement of Position 98-1 – “Accounting for the Costs of Computer Software Developed or Obtained for Internal Use”.

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Approved by: SaskPower Executive

APPENDIX I – COMPUTER APPLICATION DEVELOPMENT COSTS

SaskPower periodically undertakes computer application development projects. These projects can include developing internal applications, purchasing applications from external parties with subsequent modification to meet SaskPower's specific needs, or developing SaskPower systems to meet the needs of purchased software. General guidance for the treatment of costs related to computer software development projects is provided below.

Software applications or programs that are less than \$15,000 should be expensed. The mass purchase or upgrade of multiple software programs that exceed the above dollar limit can be capitalized if they meet the criteria described below.

Capitalization of Computer Application Development Projects

The general guidance for capitalization of new assets and betterments described earlier in this policy apply to software development projects. However, in addition to those guidelines, the following specific guidelines have been developed with respect to application development projects.

Computer application development projects typically involve three distinct stages. The three stages are the preliminary project stage, the application development stage and the post implementation stage. Certain qualifying costs incurred during the application development stage can be capitalized. All other costs incurred should be expensed.

Costs may not necessarily be incurred in the sequence outlined below. The capitalization rules should be applied based on the nature of the costs incurred rather than the timing of their occurrence. The following is a description of the typical activities that are performed in each stage.

Preliminary Project Stage

The activities incurred during the preliminary project stage should be expensed when incurred as there is a high level of uncertainty that the project will proceed. As a result, future benefits are not assured. Activities that are normally performed in this stage include:

- Making strategic decisions regarding the allocation of resources;
- Determining the performance requirements of the software;
- Exploring and evaluating alternative means of achieving the performance requirements;
- Determining the technology requirements necessary to achieve the performance requirements of the software;
- Inviting vendors to demonstrate their software;and
- Business process re-engineering activities, whether performed by employees of SaskPower or by third parties. Business process re-engineering activities generally include the following activities:

- Preparation of request for proposal.
- Current state assessment - the process of documenting the entity's current business process, except as it relates to current software structure.
- Process reengineering - the effort to reengineer the entity's business processes to increase efficiency and effectiveness.
- Restructuring the work force - the effort to determine what employee makeup is necessary to operate the reengineered business processes.

All of the above costs should be expensed as incurred.

Application Development Stage

The activities performed during the application development stage create probable future benefits. Therefore, certain costs incurred during this stage can be capitalized. After the preliminary project phase is completed, an alternative selected, and proper approvals are obtained, uncertainty as to future benefits no longer exists. The activities / costs incurred during the application development stage generally include:

- The purchase of all equipment related to the application including hardware, installation of telephone lines, installation of cables, and software.
- External consulting costs (excluding process re-engineering);
- Designing the application including software configuration and software interfaces;
- Coding – generating detailed instructions in a computer language to carry out the requirements of the software;
- Installing the software; and
- Testing the software including parallel processing.

Internal staff costs (including travel, accommodation, sustenance, and labour) can be charged to a project only if the individual is directly associated with the project (i.e.- designated as an Executive Sponsor, Project Sponsor, Project Manager, or member of the Project Technical Team or the Project User Team). Incidental/indirect internal costs should be expensed as incurred (i.e. if a non-project business unit employee is asked to attend a particular meeting or to obtain certain information for the technical team).

Internal staff's salary and benefit costs and certain contractor costs are charged to the project using standard rates. The standard labour and contractor rates are reviewed and updated annually by Corporate & Financial Services and the Business Units. The rates are stored in a table in SAP and are also posted on the EIN for reference. Please refer to the EIN posting for more details on standard rates.

Testing of computer applications development is necessary to ensure that the applications are operating effectively and are meeting the original project specifications. Since these costs are necessary to get the application ready for its intended use, these costs may be capitalized. These activities include internal staff costs for the designated team members involved in testing.

Data conversion costs necessary to allow for access of existing data by a new system can be capitalized. This would include creating interfaces to access existing data. All other detailed data conversion activities and processes should be expensed as incurred. Typical data conversion activities that should be expensed include reconciling or balancing the new data with the data extracted from the old system, purging existing data and creating or inputting new data required by the system.

Interest costs are not capitalized on computer application development projects as they are not considered material given the relatively short time frame in which most projects are completed.

The corporate overhead rate is applied to computer application development projects.

Post-Implementation / Operation Stage

The post implementation / operation stage costs are not capital since they are not required to get the application ready for its intended use. Since the asset is already in use, any support provided is an operating / maintenance activity and should be expensed as incurred. These activities include:

- Training costs including costs to train employees to develop, configure or implement software.
- Performance of maintenance activities. Maintenance activities are considered those activities performed after the software is put into use. Maintenance activities include:
 - Creation / modification of reports;
 - Updating / maintaining / creating tables or master data;
 - Minor modifications to the configuration of the system;
 - Applying regularly scheduled patches; and
 - Correcting coding errors or other problems;

These costs are more routine and more comparable to maintenance activity rather than a capital activity. Therefore, all costs incurred during this stage should be expensed as incurred.

Software Upgrades & Enhancements

SaskPower regularly upgrades and or makes enhancements to its software systems. An upgrade or enhancement is a modification to existing software that results in additional functionality. Additional functionality is considered to be modifications that enable the software to perform tasks it was previously not capable of performing. This can include the implementation of a new or previously unused module in SAP or the creation of new code that results in a new or enhanced function or application. The result of the upgrade or enhancement should be an identifiable asset or “artifact” that never existed before.

Upgrades and enhancements as defined above can be capitalized only if it meets the “Betterment” criteria outlined on page 2 of SaskPower’s Capitalization Policy. The previously identified “capitalization of computer software development costs” guidelines should be applied when determining which costs are eligible for capitalization.

A modification that is required in order to comply with a maintenance or licensing agreement but does not add additional functionality is considered a maintenance activity, the costs of which should be expensed.

Other activities that would be considered to be maintenance would be those identified in the “post-implementation / operation stage”. These activities should be expensed in the period that they occur.

If an upgrade consists of both enhancements and maintenance, the costs related to the enhancement and maintenance activities need to be identified and tracked separately. The enhancement costs can then be capitalized and the maintenance activities expensed. If a reasonable separation of the costs is not possible, then all of the costs should be expensed as incurred.

APPENDIX II – LINE & SWITCHING STATION REPLACEMENTS OR BETTERMENTS

SaskPower undertakes projects to repair, replace or improve switching stations and line facilities on a continuous basis which ultimately increase the life of the line or switching station. These projects can take the form of planned repair/replacement or emergency maintenance necessitated by a storm or an accident. This policy outlines the criteria for determining which costs may be capitalized.

Capitalization of Switching Station and Line Betterment Project Costs

The general guidance under “capitalization criteria-betterment” described earlier in this policy applies to continuous repair and replacement projects. In the case of large assets like switching stations and transmission / distribution lines, the definition of an asset becomes very important when assessing the 25% extended life criteria. For example, the replacement of one pole will extend the life of the pole by 25%; however, it may not extend the life of the whole line by 25%. The overall life of SaskPower line and switching station facilities is extended through planned and budgeted projects to replace specific poles, conductor or switching station equipment. This piece by piece asset replacement ultimately extends the total life of the facility. These planned activities include pole replacements, pole stubbing, pole treating, conductor replacements and switching station improvements.

All line and switching station repairs, replacements and improvements on a pre-planned basis should be capital.

Unplanned repairs, replacements and improvements necessitated on an emergency basis due to unusual circumstances such as storm damage should be expensed immediately.

APPENDIX III – ENVIRONMENTAL COSTS

Environmental expenditures can be classified as one of three types:

1. Those which will be of use to the Corporation during the useful life of a related asset (for example, emissions control regulators at a thermal power plant);

Environmental costs undertaken as part of an acquisition of a capital asset are capitalized as part of the entire expenditure.

In addition, environmental expenditures incurred subsequent to the construction or acquisition of capital assets are capitalized if they improve the asset's safety or efficiency or if they mitigate or prevent environmental contamination that has yet to occur and that would otherwise result from future operations or activities.

2. Those which are incurred in the current period that are not part of normal operations (for example, clean-up of a toxic spill). This can relate to assets that SaskPower owns or to past activities that occurred on an asset (land or building) that SaskPower purchases.

These costs will be expensed in the period that the liability can be reasonably estimated.

3. Environmental or decommissioning activities for which a provision has been established are discussed in the Decommissioning Liabilities section.

APPENDIX IV – ADDITIONAL ITEMS:

Expenditures on Assets Not Owned by SaskPower:

SaskPower may incur costs on assets not owned by the Corporation. An improvement to a road or bridge providing access to a construction site is an example. These expenditures will provide benefits over future periods by allowing the Corporation access to its own assets. In such cases, it is appropriate to capitalize the expenditures provided that there is assurance that SaskPower will be allowed to use the asset to realize benefits. The assurance may take the form of a lease, a written agreement or a recognized right.

Capital Spares:

Capital spares are spare parts and equipment that are kept in stock for emergency use, but in normal circumstances may not be used during the life of the asset. As they are designed for specific facilities, they have limited use outside that facility. They include items such as spare turbo-generator bearings, spare motors and spare generator coils. In general, these items require a large lead time to purchase and are often acquired when a project is first constructed.

The original cost of a capital spare is capitalized and depreciated as part of the asset that it supports.

Coal Mining:

In the course of its coal exploration and development program, the Corporation incurs costs for the acquisition of land, mineral rights, and lease rentals to maintain these rights, surface rentals, licenses and other fees necessary to gain access to the properties. The following are the guidelines used to determine when these expenditures should be classified as capital items and when they should be considered operating items.

a) Land Acquisition Costs

All costs of land acquisition are considered to be capital costs.

b) Lease Fees (if for a period greater than 1 year)

Lease fees and other costs to maintain control of coal reserves will be capitalized if the properties are not being actively mined but are part of the long-term mining plan. Costs associated with actively mined coal properties will be expensed as incurred.