Accounting Policy Statement No. 3
Capitalization of Costs Related to Computer Software Purchased or Developed for Internal Use or Incurred in a Cloud Hosting Arrangement

Purpose

This policy defines the rules surrounding the purchase and development of internal use computer software applications and Cloud hosting arrangements needed to conduct Eversource operations and to comply with regulatory reporting requirements. Responsibility to assure proper internal controls are in place and a proper audit trail exists for costs charged to development projects rests with the business unit sponsoring the software project.

Questions pertaining to this policy or issues related to a specific potential project to be capitalized should be addressed with the Manager of Plant Accounting.

Background and Scope

Certain internal and external costs associated with developing or obtaining software for internal use are to be capitalized if the project is expected to exceed $100,000. The policy to capitalize such costs is consistent with the accounting guidelines provided in FASB Accounting Standards Codification (ASC) 350-40, “Intangibles – Goodwill and Other – Internal Use Software” (ASC 350-40). Specific criteria and guidelines are described below.

Internal use software has the following characteristics:

- The software is acquired, internally developed, or modified or obtained in a Cloud hosting arrangement solely to meet the Company’s internal needs.
- During the software’s development or modification, no plan exists to market the software externally.

This policy includes internal use software expenditures for both of the following:

- Software applications new to the company.
- Significant modifications, upgrades or enhancements to existing internal-use software provided it is probable that the expenditures will result in significant additional functionality or will result in a minimum three-year extension of the software’s original useful life. The costs of maintaining software, such as routine updates and de-bugging, may not be capitalized.

Costs to be Expensed

Costs that are **not to be capitalized** and must be expensed include:

- Costs incurred during the preliminary stage of a computer software project. Examples of this type of cost are:
    1. Determination of the high-level performance specifications (that is, what the software is intended to do) for the computer software project and related systems requirements.
    2. Project viability assessments including identification of potential software solutions, development of cost/benefit analysis and business case preparation to justify a software project.

3. Making strategic decisions to allocate resources between alternative projects at a given point.

4. Exploring alternative means of achieving specified performance requirements, such as the costs associated with making the decision to develop or purchase software.

5. Selecting a vendor if an entity chooses to purchase software and/or a consultant to assist in the development or installation of the software.

- Data conversion from old to new systems. This typically includes tasks such as cleansing of old data, reconciliation or balancing of the data between the old and new systems and conversion of the old data to the new system. However, costs to develop or obtain software that allows for access or conversion of old data may be capitalized.

- Internal and external training costs incurred during any stage of the project.

- Costs incurred after all substantial testing is completed. Capitalization of costs *must cease* when a computer *software project is substantially complete and ready for its intended use*, that is, after all substantial testing is completed.

- Maintenance fees, including those embedded in the purchase price or upgrade price. These costs should be recognized as expense over the maintenance period.

- Costs of maintenance activities undertaken after the software is ready for its intended use to correct errors or keep the software updated with current information. These are routine changes and additions and therefore should be expensed as incurred. If internal costs cannot be separated between maintenance activities and relatively minor upgrades and enhancements, the costs shall be expensed as incurred.

Costs to be Capitalized or Deferred

Once a project is past the preliminary stage (see description of the preliminary stage above), the capitalization of appropriate internal and external costs into a work order may begin. Costs may not be capitalized until both of the following have occurred:

- A project viability assessment has been performed and conceptual formulation, design, and testing of the possible software project alternatives has been completed.

- Management has committed to funding the specific software project and it is probable that the project will be completed.

Development costs to be capitalized: Costs to be capitalized include the internal and external costs necessary to bring the project to substantial completion and make it ready for its intended use, including all substantial testing. The types of costs which are to be capitalized include:

- External costs of materials and services consumed in developing or obtaining computer software for internal use. See below for specific criteria for capitalization of Cloud hosting arrangement costs.

- Payroll and payroll-related costs for employees who are directly associated with and who incur time on the software development project including design of the chosen alternative, development, coding and testing (to the extent the time is spent directly on the project).

- Capitalizable cost of funds, which for the regulated companies is termed Allowance for Funds Used During Construction (AFUDC). The Manager of Plant Accounting should be contacted to discuss the appropriate accounting for capitalizable cost of funds. This cost is calculated on internally developed software as follows:

  1) For regulated companies, debt and equity AFUDC is calculated based on the current AFUDC rates assigned to the particular operating company.

  2) For the unregulated entities, including the service company, capitalizable interest is calculated based on that entity's capital structure. Equity AFUDC is not permitted for the unregulated entities.

- Costs of developing or obtaining software that allows for conversion or access to old data by new systems.

Cloud hosting arrangement costs to be capitalized to Plant Account 303 (Intangible Plant): Costs of internal-use software to which Eversource obtains access in a Cloud hosting arrangement may be capitalized to Plant Account 303 (Intangible Plant) if they are in effect purchases of, or convey a license to, software, as explained below:

- Costs of Cloud hosting arrangements after the development phase may only be capitalized to Plant Account 303 (Intangible Plant) if they meet **both** of the following criteria and are properly documented and approved in a Project Approval Form (PAF) in accordance with APS 1:

  1) Eversource has the contractual right to take possession of the software at any time during the hosting period without significant penalty (i.e., to take delivery of the software without incurring significant cost and to use the software separately without a significant diminution in its utility or value).

  2) It is feasible for Eversource to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software.

Costs of Cloud hosting arrangements that do not meet the two capitalization criteria above are not considered purchases of licenses. Rather, they are hosting arrangements that are service contracts. However, hosting arrangements that do not meet the two capitalization criteria above may have implementation costs – internal and external direct costs during the development phase (prior to in service date) – that may be deferred to Prepaid Expenses. Examples of direct development costs may include software integration, customization, configuration, installation, design and coding. Cost of funds (or AFUDC) may not be capitalized on these projects. External direct costs may include the pro-rata portion of an up-front or first year software usage fee applicable to use of the software to develop the project before it is in service. Capitalization for a period in excess of one year is not expected to occur and requires approval by Plant Accounting. The deferred costs of hosting arrangements that are service contracts must be presented as Prepaid Expenses, and the related amortization in Operating Expenses within the same account to which any ongoing fees paid to the cloud provider are charged.

The determination of whether or not to capitalize implementation costs is based on the internal-use software guidance discussed above.

Situations in which Eversource places its own software application onto the cloud infrastructure of a provider; that is, Infrastructure as a Service or Platform as a Service contracts:

Costs of implementation on a cloud platform of a software application which Eversource already owns a license to independent of its relationship with the cloud provider should be accounted for comparably to situations in which the provider is conferring a license and Eversource could take the application and run the application on its own or with another third-party provider. That is, the capitalizable costs as noted above should be capitalized to Plant Account 303 (Intangible Plant). However, this is only if Eversource has the contractual right to retake the software and if it would be feasible to run it on its own hardware or that of another third-party provider. If not, the capitalizable costs should be recorded to Prepaid Expenses, and the associated amortization should be charged to the same account to which any ongoing fees paid to the cloud provider are charged.

Multiple-element software arrangements - Eversource may enter into a contract with a third party that includes multiple elements, such as a software license, implementation services, hosting services, and training. The consideration paid to the third party should be allocated to each element based on the relative standalone price of the elements in the contract, not necessarily separate prices stated within the contract for each element. After allocation, the determination of whether or not the costs should be capitalized or expensed will depend on the nature of the cost incurred, as discussed above.

The costs that fall within the guidelines for capitalization must be accumulated in an established work order. Each software project must have its own work order. Costs capitalized in accordance with this policy are subject to audit and must be properly documented.

Revision History

0 Original issue – February 23, 2011

1 Updates for ASU 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement, and miscellaneous clarifications – January 1, 2016

2 Updates for ASU 2018-15, Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract – April 23, 2020

3 Update to change reference to FASB Accounting Standards Codification – February 24, 2023

4 Updates to clarify accounting for software placed on the Cloud – June 27, 2023