



# Capitalization and Unit of Property Integration

## BACKGROUND

Upon completing its merger with another utility, a large, multi-jurisdictional IOU needed to integrate its capitalization policies and unit of property (UoP) catalogues for its expanded generation fleet, transmission, distribution and general utility property. The existing UoPs were overly cumbersome and a perennial source of disputes in project capital/expenditure classification decisions. As one senior accounting manager at the company described, the UoP catalogues had grown “out of control.”

The merger presented an opportunity to align the capitalization practices of both companies, incorporate industry best practices, address key upcoming projects and resolve previous organizational disputes. Senior management also wanted to ensure any new levels of capitalization would be defensible to the public service commissions overseeing the company’s numerous jurisdictions. MCR had previously worked with the company on a UoP catalogue integration for its merger with a former utility and was asked to assist again.

## APPROACH

MCR reviewed the separate legacy catalogues for each company to identify differences and highlight challenges to the integration. The review produced the following:

- A gap analysis, documenting differences in the level of detail and data structure between the two catalogues
- An analysis comparing the two companies’ capitalization policies and thresholds against a comprehensive industry benchmark of peer utilities
- A listing of components found in multiple accounts and functional areas, which became candidates for uniform application of capitalization guidance

Informed by the review, MCR developed a plan to integrate the two catalogues, simplify the resulting catalogue, provide more consistent capitalization guidance and assess the resulting dollar impact to capitalization levels.

The plan was implemented in the following steps:

- *Create a Uniform UoP catalogue* — In order to eliminate repetition, enhance user friendliness and ensure consistent guidance, MCR consolidated UoPs common to many accounts and functional areas, and applied uniform capitalization thresholds. For UoPs identified as unique to specific accounts and functional areas, a hierarchical catalogue was created, utilizing both FERC guidance and a refined data structure, enabling quick reference by both accounting and site organizations.

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## APPROACH *(continued)*

- *Create a Supporting UoP Database* — In order to maintain data integrity, ensure traceability to legacy catalogues and facilitate downstream records integration, MCR leveraged its supporting UoP database. This product mapped the current UoPs to those of each legacy company, and also provided the capability for customized catalogue reporting based on parameters such as FERC account, asset class and functional area.
- *Evaluate the Subsequent Impact of Implementation* — Senior management was concerned about maintaining a defensible level of capitalization, particularly in the face of aggressive public service commissions in some jurisdictions. The impact assessment was a critical step to addressing their concerns. We worked closely with engineering and functional area management to develop estimates of projected spending for key UoPs that could potentially create a shift between capital and O&M expense. We performed scenario analysis using a Monte Carlo technique to measure the impact and quantify uncertainties associated with the new UoP catalogue.

## RESULTS

The newly integrated UoP catalogue resulted in an 80% reduction in the number of UoPs, a significant improvement from the level of repetition and detail in the legacy catalogues. The impact assessment results showed a conservative shift from O&M to capital spending, alleviating management concerns about the level of capitalization in the newly merged company. Other key outcomes were:

- The catalogue reviews, facilitated by MCR with the accounting and site organizations, identified valuable insights on upcoming operational issues facing the functional areas. This proactive approach and MCR's independent perspective guided both groups to mutually beneficial definitions for key asset classes.
- In addition to the catalogue integration effort, MCR also developed new units of property to support the company's renewables assets. Through an exhaustive review of engineering drawings and vendor documentation, and operational experience, MCR identified new UoPs unique to these technologies, which were not captured in the legacy catalogues.
- By consolidating units of property, establishing well-defined capitalization thresholds and creating a user-friendly catalogue structure, the new catalogue clarified guidance for site organizations and reduced the number of resources required by asset accounting to analyze capital funding requests. This new structure reduced much of the "churn" characterizing previous capital/expense decisions.

**MCR can help you with your Unit of Property needs**

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