AVISTA

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Avista Corp.
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VIA OVERNIGHT MAIL

State of Idaho
Idaho Public Utilities Commission
11331 W. Chinden Blvd
Bldg 8 Suite 201-A
Boise, ID 83714

Attention: Ms. Jan Noriyuki, Secretary

RE: Case Nos. AVU-E-20-09 & AVU-G-20-06
In the Matter of the Application of Avista Utilities, for an Accounting Order for Approval of Depreciation and Amortization Rates for Investment in Software

Dear Ms. Noriyuki:

In accordance with Case No. GNR-U-20-01, Order No. 34602, which suspends the requirement to file physical copies, the Company has attached for electronic filing with the Commission an Application for an Accounting Order for Approval of Depreciation and Amortization Rates for Investment in Software.

Please direct any questions regarding this filing to Liz Andrews at (509) 495-8601 or liz.andrews@avistacorp.com.

Sincerely,

/s/ Paul Kimball

Paul Kimball
Manager of Compliance & Discovery

Enclosures

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UTILITIES COMMISSION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF	)	
AVISTA CORPORATION, D/B/A AVISTA	)	CASE NO. AVU-E-20-09
UTILITIES, FOR AN ACCOUNTING ORDER	)	
FOR APPROVAL OF DEPRECIATION AND	)	CASE NO. AVU-G-20-06
AMORTIZATION RATES FOR INVESTMENT	)	
IN SOFTWARE	)	

APPLICATION OF AVISTA CORPORATION

I. INTRODUCTION

Avista Corporation, doing business as Avista Utilities (hereinafter "Avista" or "Company"), at 1411 East Mission Avenue, Spokane, Washington, pursuant to Section 61-524 Idaho Code and Rule 52 of the Idaho Public Utilities Commission ("Commission Rules of Procedure"), hereby applies to the Commission authorizing Avista to use an amortization period for its capitalized software license costs and its capitalized software implementation costs that aligns with the life of the underlying contract for Information Technology (IT) services. As described more fully below, Avista is currently authorized to amortize software over a five-year period. Accounting guidelines require Avista to amortize capitalized costs over its useful period, which can be different than a standard five-year period. With this application, the Company is not requesting to impact customers' rates, or a prudence review of any related assets at this time.

Avista is a utility that provides service to approximately 395,000 electric customers and 259,000 natural gas customers in a 26,000 square-mile area in eastern Washington and northern Idaho. Avista Utilities also serves approximately 105,000 natural gas customers in Oregon. The largest community served by Avista is Spokane, Washington, which is the location of its main office.

Communications in reference to this Application should be addressed to:

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II. BACKGROUND

The purpose of depreciation and amortization expense is to provide for recovery of the original cost of plant (less estimated net salvage) over the used and useful life of the property by means of an equitable plan of charges to operating expense. Tangible assets, usually referred to as plant, property and equipment, are depreciated. Intangible assets, such as software, land rights and rights-of-way, are amortized.

The Commission is empowered to ascertain and determine the proper and adequate rates of depreciation of the Company's property used in the rendering of retail electric and natural gas service under the provisions of Idaho Code Section 61-525. Each utility under the Commission's jurisdiction is required to conform its depreciation accounts to the rates so ascertained and determined by the Commission. The Commission may make changes in such rates of depreciation from time to time as the Commission may find necessary.

Avista updated its depreciation rates in Idaho in Case Nos. AVU-E-18-03 and AVU-G-18-02, with depreciation rates effective April 1, 2019 (See Order No. 34276 issued March 19, 2019). In that depreciation study, for capitalized software (recorded in FERC Account No. 303100 – Intangibles Software) Avista had not proposed to change the amortization period for software, so the five-year life that Avista had been using remained in effect.

III. REASON FOR PROPOSAL

There are four basic methods of acquiring software applications, including: 1) buy and use off-the-shelf software, 2) buy and customize software, 3) self-develop software, and 4) lease software. Historically, Avista has primarily either bought the software or self-developed the software. In both of these cases, the costs were capitalized and amortized over the useful life of the property. Avista has been approved to amortize most software over a five-year life. For large IT projects that the Company has recently installed, including our Customer Information System (Oracle CC&B) in 2015 and the Meter Data Management System in 2017, the Company has requested and received approval for longer amortization periods.

A summary of the software costs that Avista has in service at December 31, 2019 follows:

Software at December 31, 2019

Type		Amount	Life
Software	$	160,158,184	5 years
CC&B Software		100,831,203	15 years
MDM Software		30,329,509	12.5 years
	$	291,318,896	

Due to changes in technology over the last several decades, leasing[1] of IT solutions, including hardware and software has gained prominence for businesses. The leasing of the products can be done several ways, including acquiring the applications to run on Avista-owned equipment with a term license, or by acquiring the applications to run on a hosted service or the "cloud". Avista has acquired software applications using these methods and because of the contract terms, an amortization life of other than five years is necessary in both types of arrangements.

Cloud computing services can provide a utility with access to vendors who operate specialized technology, while providing a way to address technological obsolescence as the contracts with these companies allow for renewals that use the latest technologies.

[1] The term leasing is used to describe the right to use IT services which can be in the form of a service level agreement, a subscription agreement, a user contract or agreement, etc.

Fee structures for cloud computing arrangements (hosting arrangements) can vary, but generally reflect ongoing monthly, quarterly, or annual payments. In addition, similar to a traditional Company-owned IT solution, an upfront payment may be made in return for a reduced monthly fee, or no ongoing fee at all, over the course of the contract period. The contract period can also vary. Based on current accounting guidelines[2], if the cloud computing arrangement includes a license to internal-use software, then the software license is capitalized. In addition, if the arrangement does not include a software license, the Company is allowed to capitalize the integration costs of these arrangements as software while recording the ongoing service portion of the contract as an operating expense. Because these contract periods can vary, the useful life of the capitalized license and integration costs will vary. Therefore, the Company is requesting that the amortization period for the capitalized license and the capitalized integration costs be set to reflect the useful life or term of the arrangement.

The term of the hosting arrangement includes the noncancelable period of the arrangement plus periods covered by (1) an option to extend the arrangement if the customer is reasonably certain to exercise that option, (2) an option to terminate the arrangement if the customer is reasonably certain not to exercise the termination option, and (3) an option to extend (or not to terminate) the arrangement in which exercise of the option is in control of the vendor.

[2] In August 2018, the FASB issued ASU 2018-15, "Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract". These amendments align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by these amendments.

Avista is not requesting to impact customers' rates at this time. Avista will begin utilizing the new amortization period on projects that become used and useful after obtaining commission approval in this proceeding when the project becomes used and useful. Once approved, the impact on amortization expense would be included in a future general rate case.

IV. DESCRIPTION OF PROJECTS

Leasing Arrangement Using Avista Owned Equipment

Avista has recently implemented leasing IT solutions that are term licensing arrangements. For products acquired that are licensed with a perpetual license, a five-year life is appropriate. If the term of the license is other than five years, a term other than five-years is necessary. An example of this type of project and the reason for use of an amortization period other than five years is as follows.

AppDynamics Pro is an application performance monitoring (APM) and IT operations analytics (ITOA) solution that monitors application and infrastructure performance. Avista purchased a three-year term license for on-premises deployment of the AppDynamics platform in January 2020 (1/11/2020 – 1/10/2023) for $733,000. AppDynamics is used by operations teams to reduce downtime, identify potential performance issues, and speed time to resolution among Avista's business critical infrastructure and applications. This tool quickly pinpoints issues when they arise to assist in the quick identification of the root cause in application or system performance degradation. Based on the complexity and number of disparate systems our business and customer transactions traverse, it would not be feasible to maintain industry standard service levels by continuing to rely on a manual approach to system support without incurring significant cost increases.

In accordance with GAAP, the portion of the cost attributable to the licenses for AppDynamics Pro was fully capitalized, which was approximately $590,000. The remaining cost of $143,000 has been recorded as a prepaid IT contract (FERC Account No. 165150) and is being amortized over the life of the contract, three years.

Because Avista has only been authorized by the Commission to amortize software costs over 5 years, this asset is currently being amortized over a longer period than its useful life. At the end of the three-year term, the renewal cost will create a situation where costs are fluctuating annually, as depicted below:

		Amortization (Currently Authorized)							
5-Year Amortization Period	**Cost**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**
Original License	$590,000	$118,000	$118,000	$118,000	$118,000	$118,000			
First Renewal License	$590,000				$118,000	$118,000	$118,000	$118,000	$118,000
Second Renewal License	$590,000							$118,000	$118,000
Annual Total		$118,000	$118,000	$118,000	$236,000	$236,000	$118,000	$236,000	$236,000
		Amortization (Requested)							
3-Year Amortization Period	**Cost**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**
Original License	$590,000	$196,667	$196,667	$196,667					
First Renewal License	$590,000				$196,667	$196,667	$196,667		
Second Renewal License	$590,000							$196,667	$196,667
Annual Total		$196,667	$196,667	$196,667	$196,667	$196,667	$196,667	$196,667	$196,667

As shown above, the actual annual cost, if the original cost was amortized over three years would be a consistent $196,667 per year. By amortizing over five years, the annual expense fluctuates between $118,000 and $236,000. This highlights the need for Avista to be able to amortize software over its useful life (i.e. term), as opposed to a set five-year life, that is currently authorized. AppDynamics Pro is one example of software that is leased by Avista with a term license.

"Cloud" or Hosting Arrangement

Avista plans on implementing IT solutions that are hosting arrangements. An example of this type of project that was recently implemented in July 2020 and the reason for an amortization life other than a five-year period follows.

Avista is building a Customer Experience Platform (CXP) and as a base to the software suite, Salesforce software is being utilized. The initial implementations became operational in July 2020. The CXP tool will give customer service reps the ability to see the full scope of a customer's services, billing information and interactions with customers in a single pane by integrating with foundational systems, including customer information and information from the billing system, work and asset management system, etc. This tool will improve the customer experience while improving the efficiency of the customer service reps.

The Salesforce platform was acquired in February 2019 for a 5-year term with an option for an additional one-year extension, which ends in February 2025. During implementation, costs have been capitalized. When the software became operational, the costs incurred between February 2019 and July 2020 (18-month implementation period) were recorded as plant-in-service as software implementation costs. The remaining life will be approximately 54 months of the six-year term. The remaining contract costs will be recorded as a prepaid expense when annual payments are made, and will be amortized over the remaining contract life as operations and maintenance expense. The total costs of the 2020 project is estimated to be approximately $13.5 million. The capitalized portion will be approximately $10 million and will be amortized over a five-year life as currently allowed. In addition, the Company plans on investing in additional products to support the CXP beyond 2020. Those software packages will have contracts that are planned to be co-termed, so the end of life will sync up with the life of the Salesforce contract. Therefore, depending on the date that these additional products are purchased and placed in service, the life may be between one to four years. Approval of this application would allow Avista to use the shorter life on the new software packages.

Avista has only been authorized by the Commission to amortize software costs over five years but the costs of this product should be amortized over a shorter life than what is currently authorized. Salesforce is one example of software acquired using a hosting arrangement by Avista.

V. <u>PROPOSED ACCOUNTING TREATMENT</u>

Under Section 61-525 Idaho Code, which authorizes the Commission to determine the proper and adequate rates of depreciation of property used by a public service company, the Commission may ascertain and by order fix the proper and adequate rates of depreciation of utility property. Each utility must conform its depreciation accounts to the rates ordered by the Commission. Currently, the Commission has approved a depreciable life of five years for software, with a depreciation rate of 20.0 percent.

The Company is requesting the Commission approve a depreciable life for the license to internal-use software and implementation costs of hosting arrangements to reflect its useful life. Avista anticipates using additional lives between 2-10 years at this time that will coincide with the terms of the various arrangements, and expected extensions to contracts. If the Commissions were to not approve the use of lives other than 5 years for software, Avista would be required to maintain two separate sets of books, with different depreciable lives for GAAP reporting and for regulatory reporting. Two sets of books would be an administrative burden and cost to the utility and its customers. Parties in general rate cases will have the opportunity to review all of the software projects and the lives that have been assigned.

For administrative and economic efficiencies, the Company prefers to maintain uniform utility accounts, including depreciation rates, across its three state service territories, including Idaho, Washington and Oregon. To maintain consistent depreciation rates across all states, the Company has also requested to use a life that reflects the useful life of the software in its Washington and Oregon jurisdictions. Avista anticipates receiving approval for using a rate that agrees with the useful life from these states for term license products and software integration costs that are capitalized. Maintaining consistent depreciation rates across all states is critical to avoid multiple sets of depreciation accounts and records that would impose a costly administrative burden on the Company and unnecessary expense for the Company's customers.

VI. <u>MODIFIED PROCEDURE</u>

Avista believes that a hearing is not necessary to consider the issues presented herein, and respectfully requests that this Application be processed under Modified Procedure; i.e., by written submissions rather than by hearing. RP 201, et seq.

VII. <u>REQUEST FOR RELIEF</u>

WHEREFORE, Avista respectfully requests that the Commission issue an Order approving Avista to use an amortization period for its software licenses and its capitalized software integration costs that aligns with the life of the underlying contract and expected extensions for Information Technology services. Avista is not requesting to impact customers' rates at this time. Avista will begin utilizing the new amortization period when the project becomes used and useful. Once approved, the impact on amortization expense would be included in a future general rate case.

DATED at Spokane, Washington, this 9th day of October, 2020.

AVISTA CORPORATION

By ______________________

Patrick Ehrbar
Director of Regulatory Affairs
Avista Corp

VERIFICATION

STATE OF WASHINGTON)
)
County of Spokane)

Patrick Ehrbar, being duly sworn, on oath deposes and says:

That he is the Director of Regulatory Affairs of Avista Corporation;

That he has read the foregoing Application, knows the contents thereof, and believes the same to be true.

Patrick Ehrbar

Subscribed and sworn to before me this 9th day of October, 2020.

PATTY L HANSON
COMMISSION EXPIRES
NOTARY
PUBLIC
11-23-21
STATE OF WASHINGTON

Patty L. Hanson

Notary Public in and for the State
Washington, residing in Spokane