BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

In the Matter of the Application of HAWAIIAN ELECTRIC COMPANY, INC., HAWAII ELECTRIC LIGHT COMPANY, INC., and MAUI ELECTRIC COMPANY, LIMITED For approval to defer certain computer software development costs and to commit funds in excess of $2,500,000 (excluding customer contributions) for Item P0001010, Human Resources Suite System, to accumulate an allowance for funds used during construction during the deferral period, to amortize the deferred costs, and to include the unamortized costs in rate base	DOCKET NO. 2006-0003

DECISION AND ORDER NO. 23413

RECEIVED
2007 MAY -4 A 9:05
DIV. OF CONSUMER ADVOCACY
DEPT. OF COMMERCE AND
CONSUMER AFFAIRS
STATE OF HAWAII

Filed May 3, 2007

At 12 o'clock P .M.

Karen Higashi
Chief Clerk of the Commission

ATTEST: A True Copy
KAREN HIGASHI
Chief Clerk, Public Utilities
Commission, State of Hawaii.
Karen Higashi

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DECISION AND ORDER

By this Order, the commission approves the proposed accounting treatment requested by HAWAIIAN ELECTRIC COMPANY, INC. ("HECO"), HAWAII ELECTRIC LIGHT COMPANY, INC. ("HELCO"), and MAUI ELECTRIC COMPANY, LIMITED ("MECO") (collectively, "Applicants"), for the purchase and installation of Project P0001010, Human Resources Suite System, described herein.

I.

Background

A.

Application

On January 3, 2006, Applicants filed their application, requesting approval to: commit funds in excess of $2,500,000 for the purchase and installation of Project P0001010, Human Resources Suite System; to defer certain computer software development costs (e.g., the costs of acquiring, designing, installing, and testing the computer software); to apply an allowance for funds used during construction ("AFUDC") during the deferral period; to amortize the deferred costs (including AFUDC) over a twelve-year period (or such other period as the commission finds to be reasonable); and to include the unamortized deferred costs (including AFUDC) in rate base (collectively, the "HR Suite Project" or the "Project").[1]

Applicants filed the Application pursuant to Decision and Order No. 18365, filed on February 8, 2001, in Docket No. 99-0207 (HELCO's 2000 Test Year rate case), which ordered that commission approval is required prior to incurring software development costs to be deferred and amortized for ratemaking purposes. Applicants also filed the Application pursuant to Paragraph 2.3.g.2 of the commission's General Order No. 7, Standards for Electric Utility Service in the State of Hawaii, ("G.O. No. 7"), which states, in part, that: "[p]roposed capital expenditures for any single project related to plant replacement,

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[1]See Application, Exhibits A-N, Verification, and Certificate of Service, filed on January 3, 2006 ("Application"). Applicants served copies of the Application on the DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS, DIVISION OF CONSUMER ADVOCACY ("Consumer Advocate"), an *ex officio* party to this docket pursuant to Hawaii Revised Statutes ("HRS") § 269-51 and Hawaii Administrative Rules ("HAR") § 6-61-62. Applicants and the Consumer Advocate are collectively referred to as the "Parties."

expansion or modernization, in excess of [$2,500,000][2] . . . shall be submitted to the Commission for review at least 60 days prior to the commencement of construction or commitment for expenditure, whichever is earlier."[3]

1.

Description of the HR Suite Project

As described in the Application, the HR Suite Project consists of: (1) the purchase, installation, and configuration of a new human resources management system ("HRMS") and associated hardware and supporting operating systems; (2) data conversion and cleansing; (3) interface development and testing; (4) user training; and (5) post-implementation support.

Applicants assert that the HR Suite Project will support their respective human resource or "HR" processes, including workforce staffing and development, compensation administration, performance management, benefits administration, and leave management through one central database. Specifically,

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[2]In Docket No. 03-0257, the commission increased the monetary threshold governing the filing of capital expenditure applications, from $500,000 to $2.5 million, exclusive of customer contributions, effective July 1, 2004. See Decision and Order No. 21002, filed on May 27, 2004, in Docket No. 03-0257.

[3]Applicants maintain their position (as raised in Docket Nos. 04-0131 and 04-0268, discussed below) that "paragraph 2.3g.2 only applies to 'proposed capital expenditures for any single project related to plant replacement, expansion or modernization.'" Application, at 8. However, Applicants explained that they also filed the Application pursuant to G.O. No. 7, Paragraph 2.3.g.2, "in the abundance of caution and to avoid controversy," for the capital expenditures and deferred expense amounts that they propose to include in rate base.

Applicants claim that the HR Suite Project will improve the delivery of human resource services by providing the following capabilities:

- Replace multiple disparate systems and applications with an integrated system with expanded human resource functionality;
- Automate manual processes (currently handled on non-integrated Excel spreadsheets and Microsoft Access databases) such as compensation administration, leave management, tracking of safety equipment/apparel and transportation-type benefits;
- Replace outdated systems or manual processes and provide immediate access to information with online employee and management self-service;
- Improve efficiencies and accuracy in data maintenance and management;
- Reduce costs related to system changes as a result of new or changing legislation; and
- Improve system security and tracking.[4]

The estimated completion date for the HR Suite Project is twelve months from the commencement of the Project.

According to Applicants, the management and administration of their workforce is handled by HECO's Corporate Excellence ("CE") departments and the respective human resources departments of HELCO and MECO. CE, with its counterparts at HELCO and MECO, support approximately 2,000 employees and administer benefits for 1,500 retirees for HECO, HELCO, MECO and Hawaiian Electric Industries, Inc. ("HEI").[5]

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[4]Application, at 10.

[5]See Application, at 15. The HR Suite Project will be used by HECO, HELCO, MECO, and HEI. All of these companies, according

Currently, Applicants' human resource functions are handled by the human resource module of Ellipse (HECO's Enterprise Resource Planning or "ERP"), Tesseract (the benefits administration system), "and an array of off-the-shelf and in-house constructed mini-systems and spreadsheets developed over the years (such as People-Trak© for EEO/AAP reporting, PDS Pro for performance management, SALAD for salary administration, JVN_EOL for internal job vacancies, DARS for accessing legacy and current HR data in prepared reports, and more)."[6] The various systems and spreadsheets are manipulated to collect, record, process, store, analyze, manage, disseminate, and communicate the data used and created by CE. According to Applicants, "[t]he outdated systems are increasingly difficult and costly to maintain, and cannot meet the current and/or future business needs of the Companies."[7]

Applicants state that they began to evaluate the long-term viability of the current benefits administration and HR management systems as early as 1998. In January 2003, a cross-functional team of employees from HECO's CE and Information Technology and Services Departments commenced a Human Resources Management System Replacement Assessment ("HRMS Assessment").[8]

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to Applicants, are covered under the same benefit plans, policies, and procedures.

[6]Application, at 16. Exhibit F, attached to the Application, lists the systems that are currently used by CE to manage Applicants' workforce.

[7]Application, at 3.

[8]The HRMS Assessment is attached as Exhibit E to the Application.

The team analyzed the current state and desired future state of the HRMS, and considered the short-term and long-term needs of Applicants in areas such as functionality, integration and interoperability, and technology.

Overall, the team found that the current HR system satisfies only 20% of Applicants' current and future functional needs, and that it simply needs to be replaced.[9] To this end, the team identified and evaluated four alternatives to meet Applicants' technical and functional requirements, categorized as: (1) downsize the platform; (2) outsource the system to an Application Service Provider; (3) purchase and install Best of Breed applications; and (4) purchase and install an integrated HR Suite product.[10] According to Applicants, "[a]fter the evaluation, the HRMS Project Team recommended an integrated HR Suite product which would automate CE business practices, allow self-service capabilities, improve accuracy, increase functionality to address unmet needs, and integrate systems to allow real time, accurate reporting thereby improving CE services to all employees and management."[11]

After deciding to proceed with the HR Suite Project, HECO, on behalf of HELCO, MECO, and HEI, conducted a bidding process in September 2004 to select a third-party HR Suite

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[9]See Application, at 37.

[10]A detailed discussion of the four alternatives is provided in the Application at pages 38 - 44, and in Exhibit E, attached to the Application.

[11]Application, at 38.

vendor. Three vendors submitted bids and provided a two-day demonstration of their software to Applicants. The bids were evaluated, and Oracle HRMS ("Oracle"), which partnered with Xcelicor, Inc. ("Xcelicor") to implement the Project, received the highest overall score in the evaluation process.

A proposed schedule, attached as Exhibit I to the Application, that was developed for the Project contemplates implementation in two phases. Applicants assert that the two-phased implementation approach, recommended by Xcelicor, is designed to optimize resources, meet business requirements, promote knowledge transfer, and minimize risk.

2.

Costs and Proposed Accounting Treatment for the Project

The costs to acquire and implement the HR Suite Project were originally estimated at $5,557,000 for Applicants, plus $99,000 for HEI, totaling $5,656,000.[12] Applicants propose to amortize the cost of the Project over twelve years (or such other amortization period that the commission finds reasonable). Applicants also represent that Project costs that have been identified for the specific companies (HECO, HELCO, MECO, and

[12]Applicants have since estimated increased costs for the Project of $6,341,113, which consists of: (1) computer hardware costs (and related AFUDC) to be capitalized of approximately $312,308; (2) software license fees and application development costs to be deferred (with related AFUDC) of approximately $4,504,936, which would then be amortized over twelve years; (3) business process reengineering and information technology transformation costs to be expensed of approximately $41,989; (4) certain application development costs ("Stage 2"), preliminary ("Stage 1"), and post-implementation ("Stage 3") costs to be expensed of approximately $1,481,879.

HEI) will be directly charged to the individual company; whereas shared costs, such as software license fees and development and implementation costs, will be allocated among the companies based on employee and retiree counts.

Applicants state that the accounting treatment of the Project will conform with Generally Accepted Accounting Principles ("GAAP"), including Emerging Issues Task Force bulletin 97-13 ("EITF 97-13"), "Accounting for costs Incurred in Connection with a Consulting Contract or an Internal Project that Combines Business Process Reengineering and Information Technology Transformation, and Statement of Position 98-1 ("SOP 98-1"), "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." Thus, Applicants maintain that any business process reengineering activities and certain overhead costs, such as general administration, will be expensed. Applicants further represent that, to the extent that these costs that should be expensed are included in the deferred costs, Applicants will, on a monthly basis, identify, track, and reclassify the costs, as appropriate.[13]

A detailed discussion of Applicants' proposed accounting treatment of Project costs is attached to the Application as Exhibit A. Applicants contend that the proposed accounting treatment for the Project is reasonable and consistent with the accounting treatment recently approved by the commission in two dockets involving the installation of new computer systems and infrastructure -- Docket No. 04-0131 (HECO's Outage

[13]See Application, at 49-50.

Management System or "OMS Project")[14] and Docket No. 04-0268 (Applicants' Customer Information System or "CIS Project").[15]

B.

The Parties' Statements of Position

On May 23, 2006, the Consumer Advocate filed its Statement of Position,[16] and on June 30, 2006, Applicants filed their Statement of Position. As discussed further below, on January 25, 2007, the Parties filed a letter agreement, which memorialized the agreements reached by the Parties with regard to the Application ("Letter Agreement"). In the Letter Agreement, the Parties stated that the recommendations in the Letter Agreement replace and supersede the recommendations in their respective Statements of Position. Thus, for background purposes only, the Parties' Statements of Position are summarized below.

1.

Consumer Advocate's Statement of Position

The Consumer Advocate focused its review on the following issues: (1) Is there a need to replace the existing HR systems? (2) Does the proposed HR Suite Project represent the

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[14]See Decision and Order No. 21899, filed on June 30, 2005, in Docket No. 04-0131 ("Decision and Order No. 21899").

[15]See Decision and Order No. 21798, filed on May 3, 2005, in Docket No. 04-0268 ("Decision and Order No. 21798").

[16]The Consumer Advocate previously filed a Preliminary Statement of Position on January 19, 2006, in which it noted various concerns it had with the Application, and its intention to participate in the docket.

most advantageous solution as compared to all alternatives? (3) Is the proposed cost and subsequent allocation among the entities to be supported by the new system reasonable? (4) Should the commission adopt the proposed accounting treatment for the costs to be incurred? (5) While not sufficient to support rejecting the request, should other concerns be addressed?

The Consumer Advocate, in sum, concluded that it does not object to the approval of the Application for the following reasons: (1) It appears that current technology can streamline and make more efficient existing HR processes; and (2) Current technology can better meet current and future functional HR needs.[17] The Consumer Advocate, however, predicated this conclusion on the commission's adoption of the following recommendations:

(1) If the total Project costs, especially for Stage 2 (as defined for purposes of SOP 98-1) increase beyond 10% of the costs identified in the Application, Applicants will have to meet their burden of proof to justify the reasonableness of those increases. Applicants will have to demonstrate that the increases did not occur because of a less than comprehensive up-front evaluation and planning process. Otherwise, those increases will not be recoverable from ratepayers.

(2) Applicants will develop and/or implement procedures to allocate an appropriate amount of the Project costs related to retirees. The purpose of these procedures is to account for the work consistently performed to support affiliated companies.

(3) Adjustments to disallow functions related to HR activities consistently disallowed by the commission when setting rates will be made. Some of those activities are the administration of 401(k) plans, and the development and tracking of bonuses and management incentives.

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[17]See Consumer Advocate's Statement of Position, at 35.

(4) If not already being done, Applicants will maintain the appropriate documentation to allow an independent evaluation of the accounting for the Project costs in accordance with GAAP, EITF 97-13, and SOP 98-1. Otherwise, unsupported costs will not be recoverable as Stage 2 costs and AFUDC on those costs will not be allowed.

(5) Finally, "while not a recommended condition of approval," the Consumer Advocate recommended that the commission urge Applicants to, where necessary, provide a more comprehensive analysis when evaluating investment alternatives for future projects. According to the Consumer Advocate, for information technology initiatives, this analysis should include, but not be limited to, evaluating existing performance standards as well as developing new standards, as appropriate, to gauge the cost effectiveness of current resource allocations.[18]

2.

Applicants' Statement of Position

In response to the Consumer Advocate's recommendations, above, Applicants asserted, among other things, the following:

(1) The Consumer Advocate's recommendation that Project costs in excess of 10% of the estimate in the Application be disallowed unless Applicants demonstrate that increases did not occur because of a "less than comprehensive up-front evaluation and planning process" is unreasonable because it seeks to change commission precedent and the requirements of Paragraph 2.3.g.2 of G.O. No. 7 and HRS § 269-16(b), and could prevent the recovery of legitimately incurred Project costs.

(2) In response to the Consumer Advocate's concern regarding allocation of Project costs relating to retirees, Applicants argued that their proposed methodology does not result in an unreasonable allocation of shared costs among the companies. Applicants nevertheless refined its originally proposed allocation percentage by company to

[18]See id. at 36-37.

propose the following allocation for shared costs: HECO - 67%; HELCO - 16%; MECO - 15%; HEI - 2%.[19]

(3) Regarding the Consumer Advocate's recommendation for adjustments to disallow functions related to HR activities consistently disallowed by the commission, Applicants maintained that the functions identified by the Consumer Advocate are considered an integral part of the compensation function of the software, and the costs associated with these functions cannot be separated out as a separate cost from the software license fees and associated hardware. However, to allay the Consumer Advocate's concerns, Applicants represented that they will keep track of the costs that are incurred, through specific work orders, for the functions identified by the Consumer Advocate.

(4) As to the Consumer Advocate's recommendation regarding maintenance of the appropriate accounting documentation, Applicants represented that: Applicants' establishment of various work orders should provide sufficient detail of how costs are classified; invoices from the vendor will be detailed to describe the work being performed to corroborate that charges are being included in the proper work order; internal labor costs will be charged to the various appropriate work orders; details of the work orders and invoices will be provided as requested; and Applicants are willing to work with the Consumer Advocate on the detailed activities that are associated with the appropriate work order.

(5) Applicants disagreed with the Consumer Advocate's recommendation that Applicants conduct a more comprehensive analysis in future technology projects. Applicants stated: "The Consumer Advocate's one dimensional emphasis on cost savings will be detrimental for the Companies as cost savings are generally not the primary driver for replacement projects. . . . While the Companies do agree that cost savings analyses are appropriate in certain situations, these analyses should not drive all projects, especially replacement projects where the benefits are functional or operational in nature."[20]

[19]Applicants originally proposed the allocation of: HECO - 71%; HELCO - 14%; MECO - 13%; HEI - 2%.

[20]Applicants' Statement of Position, at 45.

C.

The Parties' Letter Agreement

In their Letter Agreement, the Parties initially state that:

(1) The agreements in their Letter Agreement "are for the purpose of simplifying and expediting this proceeding, and represent a negotiated compromise of the matters agreed upon, and the consequences of such agreements shall be limited to the matters agreed to herein."

(2) The Parties "expressly reserve their right to take different positions regarding the matters agreed to herein in other proceedings."

(3) The Parties agree that the recommendations in their Letter Agreement replace and supersede the recommendations in the Consumer Advocate's Statement of Position and the recommendations and comments in Applicants' Statement of Position.

See Letter Agreement, at 1.

The Parties then agree to nine conditions in response to the Consumer Advocate's overall concerns, set forth as follows:

1. Applicants will submit an interim supplemental report, within thirty days after a contract has been signed with the vendor, which contains the name of the contractor selected, the scope of the contract, functional requirements, and cost of the Project.[21] This filing is not intended to result in any immediate regulatory action and should only be considered a notification requirement.

[21]Applicants will provide this information as well as other information concerning the contract to the commission and the Consumer Advocate pursuant to Protective Order No. 22297.

2. Applicants agree to file notification letters with the commission and the Consumer Advocate if and when there is a significant change in either the functionality or cost of the Project, from the baseline functionality or cost resulting from a gap fit analysis.[22] The term "significant" as used in this section is defined as an increase or decrease in functionality beyond the functionality identified as a result of the gap fit analysis, or an increase or decrease in projected cost of the Project (as stated in the Application or most recent estimate of the Project cost) of over five percent. This filing is not intended to result in any immediate regulatory action and should only be considered as a notification requirement. In addition, Applicants recognize that there is no guarantee that the costs in excess of the estimated Project costs, as set forth in the Application, will be recovered, and that Applicants must demonstrate the reasonableness of such costs.

3. Applicants will file within sixty days of commercial operation of Phase 2 of the HR Suite Project, a cost report that provides the appropriate work orders that state whether the HR Suite Project costs were capitalized, deferred, or expensed, along with summary supporting documentation. In

[22]After Project initiation, the Parties state that Applicants will conduct a gap fit analysis as part of an operations analysis that identifies the changes that need to be made to the HR Suite Project, either through configuration or technical development of upgradeable extensions, in order for the system to fully support Applicants' requirements. "The gap fit analysis is an end-to-end evaluation of the system and is expected to take place during the approximately five weeks of operations analysis in Phase 1, and three weeks into phase 2. The gap fit analysis will provide the Companies a more complete estimate of the cost and functionality of the Project." Letter Agreement, at 4 n.8.

general, to the extent that costs are properly classified as capital/deferred costs, the Consumer Advocate does not object to the accrual of AFUDC on those costs.

4. Applicants agree not to include in the cost of the Project the cost of any functionality that meets the following two-part test: (1) the functionality in question is not in the "core functionality" of the selected vendor's HRMS program; and (2) the functionality in question is considered "nice to have" by Applicants (in contrast to "need to have"). Applicants consider functionality that meets the two-part test above to be "optional functionality," as opposed to "core functionality."

Any optional functionality to the selected vendor's base HRMS program[23] that is not considered "need to have" by Applicants will be identified in the interim supplemental report. The Parties recognize that the selected HRMS program may have functionality that might be considered "nice to have" by Applicants, but which is part of the base HRMS program, and such "nice to have" functionality cannot be economically or technologically removed from the base HRMS program.

In addition, some of the necessary functionality for Applicants (i.e., "need to have") may not be in a vendor's base HRMS program, but is an option to the base HRMS program as the "core functionality" varies from vendor to vendor.[24] If requested by the Consumer Advocate, Applicants agree to include in their

[23]The Parties state that the base HRMS program means that the functionality cannot be removed without additional cost to the program price.

[24]In other words, there is no uniformity among vendors as to what is considered an HRMS' "core functionality."

interim supplemental report (referenced in Condition No. 3 above) the cost of optional functionality as defined in this Condition No. 4.

5. The Parties agree that the accounting treatment of the Project will be in conformance with GAAP, including EITF 97-13 and SOP 98-1.

a. The Parties agree that Applicants' establishment of various work orders detailed in response to CA-IR-24 and CA-SIR-18, and Condition No. 8 below, should be sufficient to capture the costs of the Project and to support that the costs are properly classified. To further support that the costs are properly classified, invoices from the vendors will be detailed to include descriptions of the activities performed to corroborate that the charges were posted to the proper expense or deferred work order. In addition, employees will maintain detailed timesheets, which will include descriptions of activities performed, to corroborate that internal labor costs were charged to the appropriate work orders. Details of the work orders, including the supporting invoices and timesheets will be provided as requested. If it is determined that the above measures do not adequately address presently unforeseen issues related to the classification of costs, the Parties will work together on the appropriate remedy to allay any concerns.

b. Applicants agree to provide the Consumer Advocate with supporting documentation, as described in a. above, on the categorization of costs related to reengineering, if any. The significance of identifying reengineering costs incurred as a result of the new HRMS is that these costs would be expensed.

c. Certain overhead costs, relating to corporate administration, might be included in the deferred costs as the current Ellipse system includes such costs as part of the normal overhead calculation process. The Parties agree that to the extent that certain overhead costs that should be expensed in accordance with SOP 98-1 are included in the deferred costs, Applicants will identify and track the overhead costs and reclassify the costs, as appropriate.

6. The Parties do not object to, and agree to a twelve-year amortization period for the Project.

7. The Parties agree to the allocation of Project costs by having those costs that are identified for the specific companies (HECO, HELCO, MECO, and HEI) charged directly to the individual company. The Parties agree that shared costs, such as software, license fees, and development and implementation costs, be allocated among companies using a weighted average. This weighted average is based on the five-year period (2001 through 2005) of productive labor hours by company for the retiree portion, and using the employee count by the company for the active employee portion.[25] The agreed-upon allocation of shared costs is as follows:

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[25]Applicants originally proposed that shared costs, such as software license fees and development and implementation costs, be allocated among companies based on employee and retiree counts as of the end of the prior year.

HECO	67%
HELCO	16%
MECO	15%
HEI	2%

If, in the future, an affiliated company is added or other significant event impacts the utilization of the Project or how labor is allocated among the affiliates, the allocation for the shared costs would be modified to consider the affiliated company or other significant event, as appropriate. Until then, the above values will be used to allocate the costs associated with the Project.

8. The Consumer Advocate identified functions for which costs have been previously excluded from revenue requirements relating to (1) calculation of the effect on payroll for various bonus plans for executive management; (2) determining eligibility for special bonuses; (3) calculating the recommended company bonus pool; and (4) 401(k) plans and its administration.[26] These functions, however, are part of the core software package, and the costs associated with these functions cannot be separated out as a separate cost from the software license fees and associated hardware. However, to allay the Consumer Advocate's concerns, the Parties agree that Applicants will keep track of the costs that are incurred specifically for the seven functions identified above. Specific deferred and expense work orders will

[26]Specifically, items 2.1.10, 2.1.11, 2.1.12, 2.2.7, 2.2.8, 2.2.9, and 3.7.3 of the functional checklist attached to Applicants' response to CA-IR-14. See also Applicants' response to CA-SIR-13.

be established for those functions, and when those specific functions are worked on, as compared to the entire HR Suite Project, the specific work orders will be charged and the costs accumulated for the Consumer Advocate's review.

9. Applicants acknowledge that the Consumer Advocate reserves the right to address the reasonableness of the amount of the Project costs deferred and included in each company's rate base pending a review of the final cost report submitted for the Project. Further, the Parties understand that any issues with the amount of Project costs to be included in rate base for ratemaking purposes will be addressed in a rate case conducted with a test year in which, or after which, the component is completed and placed in service.[27]

Finally, the Parties acknowledge that the reporting requirements addressed above are reasonable and consistent with Applicants' recent CIS Project and HECO's recent OMS Project.

In conclusion, the Parties recommend to the commission, subject to the agreements outlined in items (1) through (9) above, that:

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[27]In this regard, the Parties state:

> With respect to the Consumer Advocate's comments on potential cost increases exceeding the Project's estimate as presented in the application by more than 10%, the Consumer Advocate did not intend to change any regulatory standard with respect to such cost increase. Rather, the Consumer Advocate's intent was to clearly notify the Companies of the need to maintain adequate supporting documentation in order to meet the burden of proof standard related to any cost that may not appear to be prudently incurred.

Letter Agreement, at 7 n.11.

1. Applicants should be allowed to commit the funds for the purchase and installation of the HR Suite Project, in accordance with Paragraph 2.3.g.2 of G.O. No. 7;

2. Applicants should be allowed to defer certain computer software development costs for the HR Suite Project;

3. Applicants should be allowed to accumulate an AFUDC on the deferred costs during the deferral period;

4. Applicants should be allowed to amortize the deferred costs over twelve years; and

5. Applicants should be allowed to include the unamortized deferred costs in rate base.

II.

Discussion

A.

Commission's Review

The commission notes that the instant proceeding is similar to Docket Nos. 04-0131 and 04-0268 relating to HECO's OMS Project and Applicants' CIS Project. As in those dockets, Applicants in this docket seek permission to defer certain computer software development costs, accumulate AFUDC on the deferred costs during the deferral period, amortize the deferred costs, and include the unamortized costs in rate base. Also like Docket Nos. 04-0131 and 04-0268, Applicants have filed their Application under Decision and Order No. 18365 in HELCO's 2000 test year rate case, Docket No. 99-0207, which ordered that commission approval is required prior to incurring software development costs to be deferred and amortized for ratemaking purposes. As decided in Docket Nos. 04-0131 and 04-0268, the commission finds that it was appropriate for Applicants to file a specific request for approval of their proposed accounting treatment for the HR Suite Project in this docket. Furthermore, consistent with the commission's review in Docket Nos. 04-0131 and 04-0268, the commission's review below of the Application will focus on (1) the merits of the HR Suite Project; and (2) whether Applicants' proposed accounting treatment for the Project is reasonable.

Applicants also filed their Application under Paragraph 2.3.g.2 of G.O. No. 7, but did not do so in Docket Nos. 04-0131 and 04-0268, taking the position that: (1) proposed computer hardware costs (and related AFUDC to be capitalized) were estimated to be well below the $2.5 million threshold of Paragraph 2.3.g.2 of G.O. No. 7; and (2) the request to defer certain computer software development costs is not "plant replacement, expansion or modernization," as set forth in G.O. No. 7, Paragraph 2.3.g.2.[28] The Consumer Advocate did not concur with Applicants' position, but nonetheless "chose not to pursue the matter since the Companies' Application, if approved by the Commission, would allow the Companies to achieve the same end result as if the Application were filed under G.O.7[.]"[29] The commission agreed, and approved the applications filed in Docket

[28]See Decision and Order No. 21798, at 33-34; see also Decision and Order No. 21899, at 14.

[29]See, e.g., Parties' Letter Agreement, filed on April 13, 2005, in Docket No. 04-0268, at 2 n.3.

Nos. 04-0131 and 04-0268, stating:

> We agree that if this Application is approved by the commission, it would achieve virtually the same end result as if the Application were filed under G.O. No. 7. Accordingly, the commission need not decide in this instance whether the Utilities must file an application for approval of a capital expenditure project under G.O. No. 7.[30]

Although Applicants still maintain their position that G.O. No. 7 does not apply to their present requests for deferred accounting treatment relating to the HR Suite Project, they have nevertheless applied under G.O. No. 7 "in the abundance of caution and to avoid controversy."[31] The commission finds that this issue (i.e., whether Applicants must file an application specifically under G.O. No. 7, Paragraph 2.3.g.2 for the relief requested in the Application) has not been sufficiently addressed in the record in this docket (or in Docket Nos. 04-0131 and 04-0268), for the commission to make a determination on this issue at this time. Because, however, the commission approves the Application as filed under Decision and Order No. 18365, and approves the Parties' Letter Agreement, discussed below, the commission concludes, as it did in Docket Nos. 04-0131 and 04-0268, that it need not decide in this instance whether Applicants were also required to file the Application under G.O. No. 7, Paragraph 2.3.g.2.

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[30] Decision and Order No. 21798, at 36; <u>see also</u> Decision and Order No. 21899, at 15.

[31] Letter Agreement, at 2.

B.

Merits of the HR Suite Project

The stated goal of the HR Suite Project is to obtain a fully integrated software solution for human resource administration, benefits, compensation, and leave management. In particular, the Project is intended to, among other things, facilitate the delivery of timely information to and from employees, automate processes that are currently performed manually, store and secure human resource data more effectively, and provide the flexibility to support both new Federal and State laws and regulations and changes to current laws and regulations. Applicants claim that the resulting system will greatly reduce interfaces, eliminate redundant data entry, enhance HR capabilities, and enable valuable reporting capabilities.

Pursuant to the Parties' Letter Agreement, the Consumer Advocate does not object to approval of the Application. The Consumer Advocate also explicitly acknowledged in its Statement of Position that "the proposed replacement of the existing HR systems should result in more functionality to the Companies, more efficiency in its human resources processes and other positive project results for the employees. Thus, the Consumer Advocate acknowledges that the need for the instant project exists."[32]

Upon review of the entire record, which includes detailed discussions of the expected benefits of the HR Suite Project, the commission finds that the proposed purchase and

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[32]Consumer Advocate's Statement of Position, at 10.

installation of the Project by Applicants is reasonable and in the public interest.

C.

Proposed Accounting Treatment

The Parties have agreed that the proposed accounting treatment for the HR Suite Project will be in accord with GAAP, including EITF 97-13 and SOP 98-1. The commission finds that the Parties' proposed accounting treatment for the Project pursuant to the terms of the Letter Agreement, under the facts and circumstances of this docket, is reasonable and consistent with the commission's decisions in Docket Nos. 04-0131 and 04-0268, relating to HECO's OMS Project and Applicants' CIS Project.

The commission further finds that the Parties have taken sufficient steps to assure that the previous concerns of the Consumer Advocate have been alleviated. Applicants have agreed to, among other things: file notification letters with the commission and the Consumer Advocate if and when there is a significant change in either the functionality, or cost of the HR Suite Project; file a cost report that provides the appropriate work orders that state whether costs were capitalized, deferred, or expensed; exclude from the cost of the Project, subject to certain conditions, functionality that is considered "optional functionality," as opposed to "core functionality;" and separately account for costs that are incurred for functions that have been identified by the Consumer Advocate as previously excluded from revenue requirements.

Based on the foregoing, the commission finds reasonable, and therefore adopts, the Parties' agreed-upon nine conditions in their Letter Agreement. The commission furthermore concludes that the Parties' Letter Agreement, taken as a whole, is just and reasonable, and should be approved.[33] Accordingly, the commission approves Applicants' requests, as set forth in the Application and more specifically reflected and amended in the Parties' Letter Agreement, to defer certain computer development costs of the HR Suite Project, accumulate an AFUDC on the deferred costs during the deferral period, amortize the deferred costs over twelve years, and include the unamortized deferred costs in rate base.

III.

Orders

THE COMMISSION ORDERS:

1. Applicants' request to expend approximately $6,341,113 for the HR Suite Project is approved; provided that no part of the Project may be included in Applicants' rate base unless and until the Project is in fact installed, and is used and useful for public utility purposes.

2. Applicants' request to defer certain computer software development costs, accumulate AFUDC on the deferred costs during the deferral period, amortize the deferred costs over a twelve-year period, and include the unamortized deferred

[33]The commission's approval of the Parties' Letter Agreement and the methodologies used therein, is based on the facts and circumstances presented by the Parties in their Letter Agreement, and may not be cited as precedent in any future proceeding.

costs in rate base, are approved; subject to the commission's adoption of the Parties' nine conditions set forth in Section I.C. of this Decision and Order, and incorporated herein by reference.

3. Unless otherwise ordered, Applicants shall adhere to the conditions in their Letter Agreement, and file the following reports or information with the commission, with copies served upon the Consumer Advocate:

A. An interim supplemental report, within thirty days after a contract has been signed with the vendor, which contains the name of the contractor selected, the scope of the contract, functional requirements, and cost of the Project.

B. Notification letters to the commission and the Consumer Advocate if and when there is a significant change in either the functionality or cost of the HR Suite Project.

C. Within sixty days of the commercial operation of Phase 2 the HR Suite Project, a cost report that provides the appropriate work orders that state whether the Project costs were capitalized, deferred, or expensed, along with summary supporting documentation.

4. Applicants shall conform to the commission's orders set forth above. Any failure to adhere to the commission's orders shall constitute cause for the commission to void this Decision and Order, and may result in further regulatory action as authorized by law.

DONE at Honolulu, Hawaii MAY - 3 2007.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By Carlito P. Caliboso
Carlito P. Caliboso, Chairman

By John E. Cole
John E. Cole, Commissioner

APPROVED AS TO FORM:

Kaiulani Kidani Shinsato
Kaiulani Kidani Shinsato
Commission Counsel

2006-0003.sl

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 23413 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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DATED: MAY - 3 2007