Accounting and Auditing Regulatory Operations—ASC 980
Agenda

What’s driving costs for utility companies

Mechanisms used by regulators to manage cost increase

Accounting and auditing considerations
Macro environment

• Public utilities are embarking on major capital expenditure programs for:
  - Infrastructure investments, including transmission and distribution assets
    ◦ Gas main renewal and pipeline integrity projects
    ◦ Focus on reliability and addressing aging infrastructure
    ◦ Transmission to serve new generation resources (e.g. renewables, gas plants)
    ◦ Replacement of coal plants or coal to gas switching (4 GW of retirements in ‘14 vs 17 GW in ‘15)
    ◦ Smart grid, Storm hardening
  
• Other increasing costs - Demand side management programs, protection from cyber/physical threats, property taxes, and inflation

• The sluggish economy and demand side management/energy efficiency has slowed energy consumption
Key reminders for ASC 980

- Applies to external financial statement of entities meeting three criteria:
  - Rates subject to review/approval by independent third-party regulator
  - Rates based on costs of the entity
  - Given current conditions, rates approved can be charged to and collected from ratepayers
Mechanisms used by regulators

- Deferred recovery plans
- Rate freezes
- Phase-in plans
Deferred recovery plans

• Causes
  - Increases in purchase power costs, O&M, Depreciation or Interest

• Variability in plan
  - Rates remained fixed/moderate increases
  - Mechanism to track costs
  - Different from typical tracking mechanisms
    ◦ Generally track the under/over collection
    ◦ Based on current costs

• Considerations
  - ASC 980-10-15-2(b) – Relationship between costs and revenues
Rate freezes

• Causes
  - Similar to cost deferral plan, can be more broad
  - Saw specifically in periods of rising commodity prices
• Similar to deferred recovery plan
• Considerations
  - ASC 980-10-15-2(b)
    ◦ Length of plan
    ◦ Expected stability of costs during rate freeze period
**Phase-in plans**

- Delays of a recovery of utility plant, typically to avoid significant increases in rate
- Any method of recognition of allowable costs in rates that meets all of the following criteria:
  - Adopted by the regulator in connection with a major, newly completed plant of the regulated entity
  - Defers the rates intended to recover allowable costs beyond the period in which those allowable costs would be charged to expense under GAAP
  - Defers the rates intended to recover allowable costs beyond the **routinely used** period
- Includes application of an alternative depreciation method or lower rates than typically applied
Phase-in plans

• Implied disallowance
  - Allowable costs immediately charged to expense
  - Unless, this method was routinely used prior to 1982

• Recognition of a regulatory asset?
  - Generally, no - Current recovery of costs is a basic premise of regulatory accounting
  - Judgment required
Other depreciation recovery methods

- Changes in depreciable lives
  - Change in estimate for US GAAP?
  - Difference between GAAP books and regulatory books
- Increases regulatory lag
- Implied disallowance
## Impairment ASC 980 vs. ASC 360

<table>
<thead>
<tr>
<th>ASC 360</th>
<th>ASC 980 - Abandonment</th>
<th>ASC 980 - Disallowances</th>
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<tbody>
<tr>
<td>• Two-step impairment model based on triggers</td>
<td>• Measured as difference between carrying value and present value of future cash flows</td>
<td>• Disallowance recorded as a reduction of the utility plant balance</td>
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<td>• Does not allow subsequent increases in plant</td>
<td>• Amount to be recovered is recorded as a regulatory asset</td>
<td>• Record subsequent regulatory recoveries as utility plant</td>
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<tr>
<td>• Subsequent regulatory recoveries are recorded as reg asset</td>
<td>• Subsequent changes, record an adjustment to the reg asset</td>
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Alternative revenue programs

• Some regulators of utilities have also authorized the use of additional, alternative revenue programs
• Not your traditional cost-of-service revenue model
• Challenging guidance that can be too liberally applied without appropriate accounting/audit consideration
• This guidance enables utilities to record equity return in advance of billing
  - Regulated utilities are not able to record equity return on deferred assets until those are billed through rates
  - This guidance creates the lone exception
Alternative revenue programs

Could be an alternative revenue program:

• Purpose to authorize additional revenues in specified circumstances
• Nature consistent with ASC 980-605
• Incremental revenue to be recognized is driven by factors outside the regulated entity’s control or as a result of the achievement of certain objectives
• Criteria in ASC 980-605-25-4 are explicitly met

Likely not an alternative revenue program:

• Purpose is to provide timely recovery of a cost of service (or changes to cost of service)
• Nature inconsistent with ASC 980-605
• Structured to address rate lag
• Costs incurred (and to be recovered) represent costs controlled by the regulated entity
• Uncertainty as it relates to one or more of the three criteria in ASC 980-605-25-4
**Alternative revenue programs**

Key considerations

Consider the guidance as having two gates:

- **Gate 1** – Is the mechanism Type A or Type B
- **Gate 2** – Does the mechanism meet the 3 criteria of ASC 980-605-25-4
  - Established by an order w/automatic rate adjustment
    - This is not your traditional ASC 980-340 probability model
    - Amount of additional revenues are objectively determinable
    - Additional revenues must be collected in 24 months
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