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Power & Utilities

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facts and conditions that existed as of the balance sheet date. Utility F believed that in the absence of its decision to agree to the settlement, its regulator most likely would have continued to allow recovery of the deferred costs over the remaining two years.

Companies need to exercise judgment when there are surprise developments. For example, had there been any discussions with intervenors before the balance sheet date about the potential to forgo recovery of the deferred costs, or had testimony been filed advocating no further recovery, questions would have been raised as of the balance sheet date about the probability of recovery and the settlement may have indicated a Type 1 subsequent event. In most cases in which a rate order issued after year-end contains an unexpected ruling affecting a regulatory asset as of the balance sheet date, such a rate order is typically considered a Type 1 subsequent event if commission staff or intervenors have questioned the matter as part of the rate proceedings or it was clear that the item disallowed was subject to a prudency review in the current regulatory process.

Plant Abandonments and Disallowances of the Costs of Recently Completed Plants

ASC 980-360 provides guidance on accounting for (1) plant abandonments and (2) disallowances of the costs of recently completed plants. The guidance typically applies to operating assets or assets under construction, most commonly at electric generating plants, but can also apply to other assets such as transmission and distribution assets. Generally, "plant" could be viewed as anything capitalized in "plant in service" or in "construction work in progress."

For information about the related topics of impairment and disposal of long-lived assets, see Impairment Considerations below.

Plant Abandonment

ASC 980-360 states that when it becomes probable that an operating asset or an asset under construction will be abandoned, the associated cost should be "removed from construction work-in-process or plant-in-service." ASC 980-360 further indicates that if the regulator is likely to provide a full return on the recoverable costs, a separate asset should be established with a value equal to the original carrying value of the abandoned asset less any disallowed costs. If the regulator is likely to provide a partial return or no return, the new asset value should equal the present value of the future revenues expected to be provided to recover the allowable costs of the abandoned asset and any return on investment. The utility's incremental borrowing rate should be used to measure the present value of the new asset. Any disallowance of all or a part of the cost of the abandoned asset should be recognized as a loss when it is both probable and estimable. During the recovery period, the new asset should be amortized to produce zero net income on the basis of the theoretical debt and interest assumed to finance the abandoned asset. ASC 980-360 does not specify where the separate asset should be classified on the balance sheet; it only indicates that the cost amount should be removed from CWIP or plant in service. In practice, most companies have classified the separate asset as a regulatory asset or as a category of plant other than CWIP or plant in service.

Matters Related to Abandonment Accounting

The discussion above describes the overall accounting model for asset abandonments in a regulated environment; however, utilities should carefully assess facts and circumstances to determine what constitutes abandonment of an asset and the likelihood that abandonment will occur. While ASC 980-360 provides no explicit guidance on what constitutes an abandonment of an operating asset, an asset that will be retired in the near future and much earlier than its previously expected retirement date typically is subject to the ASC 980-360 disallowance test. Alternatively, if an asset is to be retired, but not in the "near future" and not much earlier than its previously expected retirement date, the use of abandonment accounting in accordance with ASC 980-360 may not be appropriate. Instead, the appropriate accounting may be to prospectively modify the remaining depreciable life of the asset in accordance with ASC 360-10-35. Under this accounting, depreciation would be accelerated to fully depreciate the asset to the expected early-retirement date. Determining whether

an early retirement of an asset constitutes an abandonment is a matter of judgment. Factors for entities to consider in evaluating whether a plant is being abandoned include the following:

- A change in remaining depreciable life of the operating asset outside the utility's normal depreciation study.
- Any accelerated depreciation because of a change in depreciable life that is not currently reflected in rates or expected to be reflected in rates in the near future.
- A retirement of the asset sooner than its remaining useful life and in the near future.
- A reduction in the estimated remaining depreciable life by more than 50 percent.

It may become probable, before a final decision has been made to retire a plant, that the plant will be abandoned. Factors for an entity to consider in assessing the likelihood of abandonment may include:

- If environmental rules require additional spending for the plant to continue operating after a certain date, whether management's cost-benefit analysis indicates that this additional spending is cost-justified.
- If a possible early-retirement decision will not be made for several years, whether the factors that most affect the decision (such as power and gas prices) could reasonably change in the next several years.
- If the decision to retire a plant requires approval from an RTO or a regulator, whether it is unclear that approval will be granted.

Entities concluding that a plant abandonment is probable should also consider the abandonment's impact on related items, such as materials and supplies, asset retirement obligations, and deferred taxes directly associated with the asset.

Reconsideration of Abandonment Decision

A regulated utility may have previously concluded that an asset abandonment was probable but subsequently conclude that this is no longer the case. A regulated utility may have also recorded an abandonment loss in an earlier period in which abandonment became probable. On the basis of these general facts, we believe that it would be reasonable for the regulated utility to reclassify the carrying amount of the asset to plant-in-service. Further, ASC 980-360-35-4 describes the notion of adjusting the amount of the abandoned asset as estimates change, which supports reversal of a charge from a prior period if the likelihood of abandonment is no longer probable. The accounting for the decision to "unabandon" an asset requires judgment and a careful assessment of the regulated utility's facts and circumstances.

Disallowances of Costs of Recently Completed Plants

ASC 980-360 stipulates that when a direct disallowance of the cost of a recently completed plant becomes probable and estimable, the estimated amount of the probable disallowance must be deducted from the reported cost of the plant and recognized as a loss. Future depreciation charges should be based on the written-down asset basis.

Utilities often do not record a disallowance before receipt of a rate order because the loss is not reasonably estimable. However, there could be circumstances in which a rate order has not been issued but a disallowance loss could be probable and reasonably estimable. If the prudency of a recently completed plant is being challenged in a current rate proceeding, a utility must use significant judgment in evaluating the likelihood and estimate

of a loss. If the utility does not record the loss in its financial statements, it should disclose the range of a reasonably possible loss in the footnotes if the loss could be material.

There is no specific guidance in (1) ASC 980-360 or ASC 360-10-35 defining a "recently completed plant" or (2) ASC 980-340 defining a "newly completed plant." In practice, these terms have effectively been defined on the basis of facts and circumstances, so some diversity has resulted. The starting point for determining what constitutes a recently completed plant or a major, newly completed plant is typically the time from the completion-in-service date until the plant owner files its initial rate request for inclusion of the plant in allowable costs. Unlike the phase-in plan guidance in ASC 980-340, which refers to "major" in connection with "newly completed plant," the disallowance guidance in ASC 980-360 refers to "recently completed plant" and does not introduce the concept of "major." As a result, in the evaluation of potential disallowances, the guidance in ASC 980-360 applies to all recently completed additions to PP&E, not just "major" new additions.

Questions that have arisen about the definition of a new or recently completed plant include:

- Is a newly acquired "used" plant (e.g., the purchase of a 10-year-old power plant) considered a new or recently completed plant?
- If a component of an asset is replaced (e.g., a replacement turbine at a power plant), is that replacement component considered a new or recently completed plant?

Because ASC 980-360 does not address these issues, diversity in practice has resulted.

ASC 980-360 also addresses explicit, but indirect, disallowances that occur when no return or a reduced return is permitted for all or a portion of the new plant. In the case of an indirect disallowance, if the regulator does not specify the amount of the disallowance, the amount must be calculated on the basis of estimated future cash flows. To determine the loss resulting from an indirect disallowance, entities should estimate and discount the future revenue stream/cash flows allowed by the regulator by using a rate consistent with that used to estimate the future cash flows. This amount should be compared with the recorded plant amount, and the difference should be recorded as a loss. Under this discounting approach, the remaining asset should be depreciated in a manner consistent with the rate-making and in a manner that would produce a constant return on the undepreciated asset that is equal to the discount rate. Although an explicit but indirect disallowance must be recorded as a loss, ASC 980-360-35-15 notes that "an entity is not required to determine whether the terms of a settlement agreement or rate order contain a hidden, indirect disallowance." For example, if a regulator provides a return on equity on a recently completed plant that is lower than other rate-base items but still a reasonable return, we would generally not view the provision of a lower return by the regulator as an indirect disallowance.

If an unregulated affiliate transfers a recently completed plant to the rate-regulated utility, because such plant costs are then subject to the provisions of ASC 980-10, impairment should be evaluated under ASC 980-360 at the time of the transfer.

Disallowances of costs for plants that are not recently completed are recognized in accordance with general U.S. GAAP. For example, assume that (1) a company puts a new plant into service and then goes through a rate case when the prudency of the costs are scrutinized and (2) the regulator concludes that the entire amount capitalized should be included in rate base, with depreciation expense on the entire capitalized amount included in cost of service. Further assume that the plant costs are questioned a few years later in the next rate case and that the regulator disallows a specific amount of the plant cost. A disallowance charge based on ASC 980-360 should not be recorded because that plant is no longer a recently completed plant. An entity should apply the impairment criteria in ASC 360 when evaluating disallowances of plant costs for PP&E that is not recently completed. However, because of the typically large grouping of assets based on the lowest level of cash flows for rate-regulated PP&E, it would be rare that an ASC 360 impairment charge would result from a disallowance of a "not recently completed" plant.

Accounting for Renewable Energy Certificates

Several states have adopted renewable portfolio standards that require specified levels of renewable energy production. In these states, electricity generators receive RECs for generating electricity from qualified renewable facilities and other entities