980 Regulated Operations
360 Property, Plant, and Equipment
35 Subsequent Measurement

General Note: The Subsequent Measurement Section provides guidance on an entity's subsequent measurement and subsequent recognition of an item. Situations that may result in subsequent changes to carrying amount include impairment, fair value adjustments, depreciation and amortization, and so forth.

General

> Abandonments

>> Accounting for Abandonments

980-360-35-1 When it becomes probable (likely to occur) that an operating asset or an asset under construction will be abandoned, the cost of that asset shall be removed from construction work-in-process or plant-in-service.

980-360-35-2 The entity shall determine whether recovery of any allowed cost is likely to be provided with either of the following:

a. Full return on investment during the period from the time when abandonment becomes probable to the time when recovery is completed

b. Partial or no return on investment during that period.

980-360-35-3 That determination shall focus on the facts and circumstances related to the specific abandonment and shall also consider the past practice and current policies of the applicable regulatory jurisdiction on abandonment situations. Based on that determination, the entity shall account for the cost of the abandoned plant as follows:

a. Full return on investment is likely to be provided. Any disallowance of all or part of the cost of the abandoned plant that is both probable and reasonably estimable (as defined in Topic 450) shall be recognized as a loss, and the carrying basis of the recorded asset shall be correspondingly reduced. The remainder of the cost of the abandoned plant shall be reported as a separate new asset.

b. Partial or no return on investment is likely to be provided. Any disallowance of all or part of the cost of the abandoned plant that is both probable and reasonably estimable shall be recognized as a loss. The present value of the future revenues expected to be provided to recover the allowable cost of that abandoned plant and return on investment, if any, shall be reported as a separate new asset. Any excess of the remainder of the cost of the abandoned

plant over that present value also shall be recognized as a loss. The discount rate used to compute the present value shall be the entity's incremental borrowing rate, that is, the rate that the entity would have to pay to borrow an equivalent amount for a period equal to the expected recovery period. In determining the present value of expected future revenues, the entity shall consider such matters as the following:

1. The probable time period before such recovery is expected to begin

2. The probable time period over which recovery is expected to be provided.

If the estimate of either period is a range, the guidance in Section 450-20-55 shall be applied to determine the loss to be recognized. Accordingly, the most likely period within that range shall be used to compute the present value. If no period within that range is a better estimate than any other, the present value shall be based on the minimum time period within that range.

980-360-35-4 The recorded amount of the new asset shall be adjusted from time to time as necessary if new information indicates that the estimates used to record the separate new asset have changed. The rate order is usually viewed as the confirming event, permitting an estimate of the loss to be refined at that time. However, a loss shall not be recognized unless it is probable that a loss has occurred and the amount can be reasonably estimated. If those criteria are not met at the time of an initial rate order, the loss shall not be recognized at that time.

980-360-35-5 The estimates used to record the separate new asset include both of the following:

a. The determination of whether full return on investment will be provided and, if not, the probable time period before recovery is expected to begin and the probable time period over which recovery is expected to be provided

b. The amount of any probable and reasonably estimable disallowance of recorded costs of the abandoned plant.

980-360-35-6 The amount of the adjustment shall be recognized in income as a loss or gain. The recorded carrying amount of the new asset shall not be adjusted for changes in the entity's incremental borrowing rate.

980-360-35-7 During the period between the date on which the new asset is recognized and the date on which recovery begins, the carrying amount shall be increased by accruing a carrying charge. The rate used to accrue that carrying charge shall be as follows:

a. If full return on investment is likely to be provided, a rate equal to the allowed overall cost of capital in the jurisdiction in which recovery is expected to be provided shall be used.

b. If partial or no return on investment is likely to be provided, the rate that was used to compute the present value shall be used.

980-360-35-8 During the recovery period, the new asset shall be amortized as follows:

a. If full return on investment is likely to be provided, the asset shall be amortized in the same manner as that used for rate-making purposes.

b. If partial or no return on investment is likely to be provided, the asset shall be amortized in a manner that will produce a constant return on the unamortized investment in the new

asset equal to the rate at which the expected revenues were discounted.

> > Income Tax Effects

980-360-35-9 Usually, the net loss on an abandonment shall be computed by discounting the after-tax future revenues expected to be allowed by the regulator at an after-tax incremental borrowing rate and comparing the result to the recorded net investment in the abandoned plant. If that discounted present value is less than the recorded net investment, a net loss shall be recognized. However, the present accounting model generally does not permit display of losses on a net-of-tax basis. As a result, the net loss on an abandonment is grossed up for display purposes.

980-360-35-10 The computation of a loss on an abandonment (see Example 1 [paragraph 980-360-55-2]) is intended to approximate the economic effects of the regulator's rate actions in the preceding paragraph. The computation is based on both of the following general assumptions about the rate-making methods used for income taxes:

a. Deferred income taxes are allocated to the assets that resulted in those deferred income taxes. Under that assumption, if certain assets are included in the rate base (that is, a return is allowed on those assets), the deferred income taxes allocated to those assets are deducted from the rate base in computing the investment on which a return will be allowed. Similarly, if certain assets are excluded from the rate base (that is, a return is not allowed on those assets), the deferred income taxes allocated to those assets are not deducted from the rate base in computing the investment on which a return will be allowed.

b. Income taxes that result from recovery of the recorded cost of the abandoned plant will be treated as **allowable costs** when those income taxes become payable to the extent those income taxes do not represent repayment of an income tax benefit that has already accrued to the entity's shareholders.

980-360-35-11 If the rate-making methods used for an entity differ from the assumptions stated in the preceding paragraph, the computation used to compute the loss on the abandonment shall be different from that described in paragraph 980-360-35-9 and illustrated in Example 1 (see paragraph 980-360-55-2). The computation shall be changed to reflect the different economics of those different rate-making methods. For example, if the regulator deducts all existing deferred income taxes from the rate base in determining the investment on which a return will be provided (instead of allocating deferred income taxes between items included in the rate base and items excluded from the rate base), the procedure effectively disallows a return on the gross investment in the abandoned plant instead of disallowing a return on the net investment, and the recognized loss shall reflect a disallowance of a return on the gross investment in the abandoned plant.

> Cost Disallowances

> > Recently Completed Plants

980-360-35-12 When it becomes probable that part of the cost of a recently completed plant will be disallowed for rate-making purposes and a reasonable estimate of the amount of the disallowance can be made, the estimated amount of the probable disallowance shall be deducted from the reported cost of the plant and recognized as a loss. Section 450-20-55 provides guidance for making a reasonable estimate of the amount of a loss. If part of the cost is explicitly, but indirectly, disallowed (for example, by an explicit disallowance of return on

investment on a portion of the plant), an equivalent amount of cost shall be deducted from the reported cost of the plant and recognized as a loss.

>> Excess Capacity

980-360-35-13 Excess capacity disallowances relate to part of the cost of service of a recently completed plant and are based on a finding that an entity's reserve capacity exceeds an amount deemed to be reasonable. If an excess capacity disallowance is ordered by a regulator without a specific finding that the entity should not have constructed that capacity or should have delayed the construction of that capacity, the rate order raises questions about whether the entity meets the criteria of paragraph 980-10-15-2 for application of this Topic, in that it is not being regulated based on its own cost of service. However, because such a rate order itself is neither a direct disallowance nor an explicit, but indirect, disallowance of part of the cost of the plant, this Section does not specify the accounting for it. If an excess capacity disallowance is ordered by a regulator with a specific finding that the entity should not have constructed that capacity or should have delayed the construction of that capacity, the rate order may be an explicit, but indirect, disallowance of part of the cost of the plant, and the entity shall account for the substance of that order as set forth in the preceding paragraph.

980-360-35-14 If a regulator has included a recently completed plant in rates based on the assumed cost of another plant rather than based on the cost of the plant that exists, then the entity is not being regulated based on its own cost, and the criteria of paragraph 980-10-15-2 for application of this Topic do not appear to be met. If the rate order is based on a finding that, based on factors that were known during the construction, the entity should not have constructed the plant that it did construct, the order may be an explicit, but indirect, disallowance, and it shall be accounted for as set forth in paragraph 980-360-35-12. Otherwise, unless the order is being appealed, the entity shall consider discontinuing application of this Topic.

980-360-35-15 Regulators have considerable discretion in selecting a rate that represents a fair return on equity investment, and that specific matters included in a settlement agreement might not be apparent. Explicit, but indirect, disallowances shall be reported as disallowances; however, an entity is not required to determine whether the terms of a settlement agreement or rate order contain a hidden, indirect disallowance.

>> Examples of Cost Disallowances

980-360-35-16 The following Examples illustrate specific situations related to cost disallowances:

a. Example 2 (see paragraph 980-360-55-14) illustrates a disallowance of plant cost.

b. Example 3 (see paragraph 980-360-55-18) illustrates a disallowance of plant cost resulting from a cost cap.

c. Example 4 (see paragraph 980-360-55-26) illustrates an explicit, but indirect, disallowance.