

## **Regulatory Assets and Liabilities**

### **Summary of Issue**

Regulatory assets and liabilities are expenses, revenues, gains or losses that would be normally be recognized in net income in one period, but for an order of a regulatory commission specifying a different recovery period in retail rates. It could be argued that “regulatory assets” are better described as past costs, which the regulator allows the utility to recover through higher retail rates in the future. Another way of looking at this issue that these assets are, in reality, regulatory losses resulting from a price cap imposed in the past by a regulator.

For PNW investor-owned utilities, regulatory assets and liabilities are a significant portion of the balance sheet, range from a low of 25% to more than 90% of a utility’s net plant investment. Table 1 shows net plant investment, regulatory assets and liabilities from 2002 through 2006 for all PNW investor-owned utilities except for PacifiCorp.

Examples of costs that can be deferred and included as a regulatory asset with PUC approval include: fuel costs subject to a PCA, storm damage, gains on reacquired debt, deferred compensation plans, stranded costs, phase-in plans, deferred income taxes, asset retirement obligations, asset impairment or disposal under FASB 144, rate case expenses and intervenor funding, buyout costs for non-utility generation, deferred purchase capacity costs, deferred demand-side management costs, U.S. Department of Energy (USDOE) nuclear fuel enrichment clean-up fee, deferred revenue related to income taxes associated with allowance for funds used during construction (AFUDC), unamortized loss on reacquired debt, and deferred return on sales of emission allowances. The above list is only representative of the deferred costs and revenues that would be found in a typical FERC Form No.1 or a commission rate or accounting order.

There are two major issues for the new ASCM relating to regulatory assets and liabilities. First, how should regulatory assets and regulatory liabilities be functionalized between generation transmission and distribution, and second, for the production and transmission related assets, what rate of return, if any, should the utility earn on these items for purposes of determining a utility’s ASC. The list of separate and discrete deferred assets and liabilities could easily exceed a thousand with sufficient time on Google!

A related issue is identification of regulatory assets and liabilities so that an ASC determination can be made. FERC Form No. 1 descriptions of these items are cryptic in the best of circumstances and do not provide enough information for informed decisions for ASC treatment.

## Pre-decisional - for discussion purposes only

### Background

Regulatory Assets and Liabilities, accounts 182.3 and 254 in the FERC Uniform System of Accounts, were established in March of 1993 in FERC Order No. 552 which established uniform accounting treatment for allowances associated with the 1990 Clean Air Act. Order No. 552 also dealt more broadly with accounting for regulatory assets and liabilities for electric and gas utilities.<sup>1</sup>

The issue of regulatory assets and liabilities are a subset of the larger issue of the difference between accounting for utilities that are subject to price regulation and Generally Accepted Accounting Principles (GAAP). The issue can be traced back to the Internal Revenue Act of 1954 which permitted use of accelerated depreciation for income taxes purposes. In 1962, the Accounting Principles Board (precursor to FASB) issued Opinion No. 2, which dealt comprehensively with the issue of accounting for industries subject to price regulation, was prepared in response to questions surrounding the creation of investment tax credits by Congress. Opinion No. 2 stated that all companies are subject to GAAP, but that differences may arise, generally surrounding recognition of cost, for companies subject to price or rate regulation.<sup>2</sup>

In 1982, FASB Statement No. 71 “Accounting for the Effects of Certain Types of Regulation” was issued in response to concerns that Opinion No. 2 permitted any accounting treatment as long as was approved by a regulatory body. “FASB Statement No. 71 recognizes that a principle consideration introduced by rate regulation is a cause-and-effect relationship of cost and revenues- an economic dimension that, in some circumstances, should affect accounting for rate regulated utilities.”<sup>3</sup> Accounting different from GAAP required substantiation such as a rate order or accounting order.

Four years later, largely in response to commission ordered disallowances and phase-in plans which often stretched out recovery of expensive nuclear plants over many years, FASB issued Statement No. 90 “Regulated Industries- Accounting for Abandonments and Disallowances of Plant Costs.” The Statement required a detailed set of accounting requirements for asset abandonments, disallowances and phase-in plans. For phase-in plans, the utility could only capitalize deferred costs if the following four criteria are met:

- 1) PUC order for the phase-in plan
- 2) Order specifies when recovery will occur
- 3) Utility will recover all deferred costs within ten years
- 4) Percent increase in future years is not greater than prior years (no backloading)<sup>4</sup>

In response to electric utility restructuring that was gaining momentum in the US, FASB issued Statement No. 101, “Regulated Enterprises-Accounting for the Discontinuation of

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<sup>1</sup> G. Hahne and G. Aliff, *Public Utility Accounting* 11-5 (Mathew Binder 2005).

<sup>2</sup> Ibid., 12-2

<sup>3</sup> Ibid., 12-5 (Mathew Binder 2005)

<sup>4</sup> Ibid., 12-16

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Application of FASB Statement No. 71” in December 1988. The Statement said that utilities should discontinue application of FASB No. 71 if the utility:

- 1) is deregulated
- 2) under a regulatory approach is no longer cost-based
- 3) is subject to competition that limits the ability to recover costs
- 4) is subject to regulatory decisions that limit the utility to recover costs<sup>5</sup>

### **Do State PUCs Allow a Return on Regulatory Assets and Liabilities**

Review of numerous commission orders on the subject of rate of return on regulatory assets and liabilities revealed no consistent treatment of the issue. Some commissions do not allow a return on regulatory assets and others allow some sort of return on a case-by-case basis. For those that do allow a return, some use the approved ROE, others use a lower rate based on utility borrowing costs or other some other rate.

### **Treatment - 1984 ASCM**

Because regulatory assets and liabilities, accounts No.182.3 and No. 254 in the FERC Uniform System of Accounts, were established in March of 19933, the 1984 ASCM is silent on the issue. BPA’s decision on this issue will have an affect on the 2002 – 2009 ASC determination

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<sup>5</sup> Ibid., 12-17

Table 1

<b>Summary of Deferred Assets and Deferred Liabilities</b> <b>Investor-Owned Utilities 2002 through 2006</b> <b>Portland General Electric</b>					
Year	Net Plant in Service	Deferred Assets	% of Net Plant	Deferred Liabilities	% of Net Plant
2002	\$1,857,690,673	\$700,077,028	37.69%	\$564,308,241	30.38%
2003	1,880,470,827	566,450,385	30.12%	572,468,144	30.44%
2004	1,875,386,030	496,872,469	26.49%	608,773,699	32.46%
2005	1,909,487,290	578,183,927	30.28%	717,365,994	37.57%
2006	1,894,794,301	664,789,497	35.09%	611,247,370	32.26%

<b>Summary of Deferred Assets and Deferred Liabilities</b> <b>Investor-Owned Utilities 2002 through 2006</b> <b>Puget Sound Power &amp; Light</b>					
Year	Net Plant in Service	Deferred Assets	% of Net Plant	Deferred Liabilities	% of Net Plant
2002	\$2,301,068,893	\$763,270,926	33.17%	\$1,043,066,464	45.33%
2003	2,286,680,783	838,126,507	36.65%	1,018,122,910	44.52%
2004	2,339,228,981	848,132,126	36.26%	1,062,210,581	45.41%
2005	2,592,754,225	936,128,076	36.11%	1,181,457,175	45.57%
2006	3,066,096,096	1,136,646,117	37.07%	1,178,055,547	38.42%

<b>Summary of Deferred Assets and Deferred Liabilities</b> <b>Investor-Owned Utilities 2002 through 2006</b> <b>Avista Utilities</b>					
Year	Net Plant in Service	Deferred Assets	% of Net Plant	Deferred Liabilities	% of Net Plant
2002	\$1,206,195,203	\$443,938,853	36.80%	\$535,788,341	44.42%
2003	1,309,044,927	438,013,241	33.46%	566,645,699	43.29%
2004	1,326,731,686	428,982,406	32.33%	601,471,693	45.33%
2005	1,487,262,648	403,526,254	27.13%	675,181,617	45.40%
2006	1,490,400,426	484,199,368	32.49%	576,833,230	38.70%

Table 1

<b>Summary of Deferred Assets and Deferred Liabilities</b> <b>Investor-Owned Utilities 2002 through 2006</b> <b>Idaho Power Company</b>					
Year	Net Plant in Service	Deferred Assets	% of Net Plant	Deferred Liabilities	% of Net Plant
2002	\$1,792,458,015	\$650,062,474	36.27%	\$800,417,308	44.65%
2003	1,981,078,331	616,257,810	31.11%	1,867,932,822	94.29%
2004	2,009,145,679	617,804,386	30.75%	961,026,762	47.83%
2005	2,112,881,122	629,637,669	29.80%	1,042,495,122	49.34%
2006	2,177,938,407	645,699,285	29.65%	953,195,185	43.77%

<b>Summary of Deferred Assets and Deferred Liabilities</b> <b>Investor-Owned Utilities 2002 through 2006</b> <b>Northwestern</b>					
Year	Net Plant in Service	Deferred Assets	% of Net Plant	Deferred Liabilities	% of Net Plant
2002	\$875,032,155	\$406,627,081	46.47%	\$449,281,291	51.34%
2003	881,318,045	549,202,859	62.32%	563,557,246	63.94%
2004	886,663,228	539,471,197	60.84%	606,342,708	68.38%
2005	885,471,684	274,286,868	30.98%	342,364,823	38.66%
2006	930,124,684	242,978,137	26.12%	312,008,691	33.54%