

## Regulatory accounting and GASB 62 applications (With specific example for contributions in aid of construction)

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With the issuance of Government Accounting Standards Board (GASB) Statement 62, utilities required to follow governmental accounting standards will no longer be allowed to follow any Financial Accounting Standards Board (FASB) guidance, including that for regulatory accounting (FAS 71/ASC980). GASB 62 *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* is effective for financial statements for periods beginning after December 15, 2011.

This article explores the answers to some of the allowable uses of regulatory accounting under GASB 62.

### FAS 71/ASC 980 lives on in GASB 62

#### *FAS 71/ASC 980—Accounting for the Effects of Certain Types of Regulation*

ASC 980 is the accounting tool used by public utilities where strictly following GASB does not necessarily meet their business model and the intent of certain accounting transactions that will benefit future periods or be charged against future periods. This is also the manner in which public utilities recover their costs through rates charged to their ratepayers, make their operating benchmarks comparable to their investor-owned peer utilities, and also match their accounting to utility industry standards.

GASB 62 has codified ASC 980 in a form that will allow public utilities a seamless transition without change to their current application of regulatory accounting under ASC 980. GASB 62 discusses using these regulated accounting rules in paragraphs 476–500 of the standard.

### Regulated accounting under GASB 62

GASB 62 uses the term “Regulated Operations,” and discusses regulated accounting rules under paragraphs 476–500 of the standard.

#### Regulated accounting defined

The standard states that regulated accounting rules ... “may be applied to business type activities that have regulated operations that meet all of the following criteria:

1. The regulated business-type activity’s rates for regulated services provided to its customers are established by, or are subject to approval by, an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers;
2. The regulated rates are designed to recover the specific regulated business-type activity’s costs of providing the regulated services, and;
3. In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the regulated business-type activity’s costs can be charged to and collected from customers. This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalized costs.”

These are substantially the current rules followed under ASC 980.

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## Application of ASC 980 rules under GASB 62

GASB 62 goes on to discuss how regulators may adjust rates for cost or revenue deferrals and the related accounting considerations that will be in play, depending on those regulator actions. Remember, for most public utilities the regulator is the city council or utility governing board.

The standard states that, “Rate actions of a regulator can provide a business-type activity with reasonable assurance of the existence of an asset. A regulated business-type activity should capitalize all or part of an incurred cost (that otherwise would be charged to expense) if both of the following criteria are met:

- a. **It is probable that future revenue in an amount at least equal to the capitalized cost** will result from inclusion of that cost in allowable costs for rate-making purposes, and;
- b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator’s intent clearly be to permit recovery of the previously incurred cost.”

Finally, the standard provides for return of revenues to customers, stating that, “A regulator can require that a gain or other reduction of net allowable costs be given to customers over future periods. That would be accomplished, for rate-making purposes, by amortizing the gain or other reduction of net allowable costs over those future periods and reducing rates to reduce revenues in approximately the amount of the amortization. *If a gain or other reduction of net allowable costs is to be amortized over future periods for rate-making purposes, the regulated business-type activity should not recognize that gain or other reduction of net allowable costs in the current period. Instead, it should be deferred for future reductions of charges to customers that are expected to result.*”

## Standard uses of regulatory accounting

Again, “intent” is the key element in the use of regulatory deferrals (i.e., how will we recover these costs from our ratepayers or defer revenue recognition to future periods to mitigate rate impacts). Typical uses of regulatory assets and liabilities include:

### Regulatory assets

- > Extraordinary maintenance costs such as planned unit outages, weather damage, or other unforeseen events
- > Premature losses on asset retirements
- > Decommissioning of generating units
- > Future recoverable costs (i.e., the difference between depreciation and debt service on bond financed plant) used to smooth the earnings impact
- > Long-term deferred receivables
- > Deferred power costs to be recovered in the future
- > Mark-to-market derivative and investment losses
- > Advanced debt refunding losses

## Regulatory liabilities

- > Rate stabilization (funded or unfunded)—the difference of earnings over bond coverage to be used in future periods to offset anticipated increases in power costs and other expenses
- > Deferred costs collected in rates now that will be expended in future periods—such as those for future maintenance projects or decommissioning expenses
- > Contributions in aid of construction

## Use of regulatory accounting and contributions in aid of construction

The use of regulatory accounting is well suited for deferring recognition of contributions in aid of construction for utility plant additions.

Under GASB 33—*Accounting and Reporting for Non-Exchange Transactions*, utility plant received from customers or developers is required to be recognized as revenue in the period of the transaction. Under the utility business model this does not necessarily make sense, as the utility will record depreciation on these contributed assets in future periods, while recognizing the full revenue of the contribution in a single period.

The application of regulatory accounting in this instance allows the income impact of the transaction to be matched over the depreciable life of the contributed assets, resulting in an income impact of zero.

For example, let's assume these events:

1. A subdivision developer constructs \$1 million of utility infrastructure (services, mains, etc.) and turns this infrastructure over to the utility per the utility's service territory rules. This infrastructure will be maintained and eventually replaced by the utility.
2. The useful life of this infrastructure is thirty years

The entries under two scenarios to record these events are as follows:

### GASB 33 required method

1. Receipt of utility infrastructure—

Debit	<i>Utility Plant in Service</i>	\$1,000,000	
Credit	<i>Revenues</i>		\$1,000,000
2. Record annual depreciation expense over thirty years

Debit	<i>Depreciation Expense</i>	\$33,333	
Credit	<i>Accumulated Depreciation</i>		\$33,333

Using this method results in revenue recognition of \$1 million in the year of the transaction, but recognition of the related expense over thirty years—violating the common accounting principle of matching.

## Using regulatory accounting to reflect the impact of the transaction on utility income and rates

The impact above can be mitigated through the use of regulatory accounting, as follows:

1. Receipt of utility infrastructure—

Debit	<i>Utility Plant in Service</i>	\$1,000,000	
Credit	<i>Deferred Regulatory Liability</i>		\$1,000,000

*The regulatory liability is a balance sheet account*

2. Record annual depreciation expense over thirty years

Debit	<i>Depreciation Expense</i>	\$33,333	
Credit	<i>Accumulated Depreciation</i>		\$33,333

3. Record recognition of deferred revenue over thirty years

Debit	<i>Deferred Regulatory Liability</i>	\$33,333	
Credit	<i>Depreciation Expense</i>		\$33,333

Using this method makes the annual impact to utility income zero—reflecting that the utility must recognize depreciation expense for a utility plant that it did not finance and which is offset by the contribution for that infrastructure.

Replacement financing of that plant after thirty years when it is fully depreciated is a separate question from this accounting approach.

### Other thoughts

As with ASC 980, Baker Tilly recommends that utilities document their cost or revenues for deferral and seek governing board approval for such items either through a blanket resolution for routine items, or through board action, passing resolutions for specific material items. Documentation should reflect the cost or revenues to be deferred, pertinent details of the transaction, and the intended rate recovery or revenue return period. Changes in any circumstances should be reflected in future accounting from the point of the change in circumstances.

### Summary

GASB 62 *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* appears to have addressed any concerns public utilities may have about their use of FASB pronouncements, especially ASC 980 for regulated accounting. While there will be a note needed in your utility's financial statements about implementing GASB 62 (effective for periods beginning after December 15, 2011), there should be no change in your financial statements if you're currently using ASC 980.

As always, we seek your input into practical application of the new statement. If you have comments or ideas, please respond to [russ.hissom@bakertilly.com](mailto:russ.hissom@bakertilly.com), or post your comments to our Utility Accounting Issues Forum on LinkedIn. For a link to the page, visit [www.bakertilly.com/powerup](http://www.bakertilly.com/powerup).