

TENNESSEE PUBLIC UTILITY COMMISSION



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In Re: *Joint Application of Limestone Water Utility Operating Company, LLC and Integrated Resource Management, Inc. D/B/A IRM Utility, Inc. for Approval of the Acquisition of and to Operate the Wastewater System of Integrated Resource Management, Inc. D/B/A IRM Utility, Inc. in Decatur County, Tennessee and to Transfer or Issue a Certificate of Public Convenience and Necessity*
Docket No. 23-00037

Dear Counsel:

To assist the Commission in its ongoing investigation of the above styled docket, it is requested that either joint or individual responses be provided to the following to obtain a full understanding of the operation of paragraphs 8 and 9 of the Stipulation and Settlement Agreement:

1. Please refer to paragraph 8 of the Stipulation and Settlement Agreement that states in part “any future proposed acquisition adjustment should be set aside in account 114.00 (Utility Plant Acquisition Adjustment)” and to paragraph 9 that states in part “the legal and regulatory costs associated with this transaction should be set aside in Account 183.002 (PSI – Legal).”

- a. Is it the parties' intent to record the value of any future proposed acquisition adjustment into USOA Asset Account 114.00 and reflect such value in the reported balance of this account? Please explain your response.
 - b. Is it the parties' intent to record the value of the legal and regulatory costs associated with this transaction into USOA Asset Account 183.002 and reflect such value in the reported balance of this account? Please explain your response.
2. In each prior acquisition case involving Limestone, the Commission has ordered that Limestone is not authorized to book a regulatory asset for ratemaking purposes for any portion of the amount by which the purchase price exceeds the book value of the acquired assets.¹ Is it the parties' intent to change the previously ordered accounting treatment for acquisition adjustments by setting aside any future proposed acquisition adjustment into USOA Asset Account 114.00? Please explain and reconcile your response to the Commission orders referenced in footnote 1.

If the parties do not intend to record the value of (1) any future proposed acquisition adjustment and (2) the legal and regulatory costs associated with this docket as assets in the accounting books and records of Limestone, and if the parties do not intend to change the accounting treatment of Limestone's acquisition transactions set forth in the Commission orders referenced in footnote 1, then disregard responding to item nos. 3 through 8.

¹ See *In re: Joint Application of Aqua Utilities Company, Inc. and Limestone Water Utility Operating Company, LLC for Authority to Sell or Transfer Title to the Assets, Property, and Real Estate of a Public Utility and for a Certificate of Convenience and Necessity*, Docket No. 19-00062, Order Approving Sale of Assets, Property, and Real Estate and Certificate of Public Convenience of Aqua Utilities Company, LLC Subject to Conditions and Requirements of the Tennessee Public Utility Commission, pp. 17-18 (Dec. 7, 2020);

In re: Application of Limestone Water Utility Operating Company, LLC for Authority to Sell or Transfer Title to the Assets, Property, and Real Estate of a Public Utility, Cartwright Creek L.L.C., and for a Certificate of Public Convenience and Necessity, Docket No. 21-00053, Order Approving Settlement Agreement and Transfer of Systems, and Granting Certificate of Convenience and Necessity, pp. 5,11 (Jan. 24, 2022);

In re: Application of Limestone Water Utility Operating Company, LLC for Authority to Sell or Transfer Title to the Assets, Property, and Real Estate of a Public Utility, Shiloh Falls Utilities, Inc., and for a Certificate of Public Convenience and Necessity, Docket No. 21-00055, Order Approving Settlement Agreement and Transfer of Systems, and Granting Certificate of Convenience and Necessity, pp. 5,12 (Dec. 2, 2022);

In re: Application of Limestone Water Utility Operating Company, LLC for Authority to Purchase Title to the Assets, Property, and Real Estate of a Water System Candlewood Lakes, and for a Certificate of Public Convenience and Necessity, Docket No. 21-00059, Order Approving Settlement Agreement and Transfer of Systems, Granting Certificate of Convenience and Necessity, and Disallowing Continuation of Candlewood Lakes POA's Water Availability Fee pp. 5,12 (Jan. 5, 2023);

In re: Application of Limestone Water Utility Operating Company, LLC for Authority to Purchase Title to the Assets, Property, and Real Estate of a Wastewater System, Chapel Woods, and for a Certificate of Public Convenience and Necessity, Docket No. 21-00060, Order Approving Settlement Agreement and Transfer of System, and Granting Certificate of Convenience and Necessity, pp. 5,11 (Dec. 2, 2022); and

In re: Expedited Joint Application of Limestone Water Utility Operating Company, LLC and DSH & Associates, LLC for Approval of the Acquisition of and to Operate the Wastewater System of DSH & Associates, LLC, at Lakeside Estates Development in LaFollette, Campbell County, Tennessee and to Transfer or Issue a Certificate of Public Convenience and Necessity, Docket No. 23-00016, Order Approving Settlement Agreement and Transfer of System, and Granting Certificate of Convenience and Necessity, pp. 5,14 (Dec. 26, 2023).

3. Please refer to the GAAP definition of “asset” set forth in SFAC No. 8, attached hereto as Attachment A.
 - a. If the parties’ intent is to record the value of any future proposed acquisition adjustment into USOA Asset Account 114.00, do the parties contend that this value constitutes a present right to an economic benefit for Limestone within the meaning of SFAC No. 8? Please explain.
 - b. If the parties’ intent is to record the value of the legal and regulatory costs associated with this transaction into USOA Asset Account 183.002, do the parties contend that this value constitutes a present right to an economic benefit within the meaning of SFAC No. 8? Please explain.
4. Please refer to the GAAP standards for recognition of assets created by rate regulators, such as the Commission, set forth in ASC 980, attached hereto as Attachment B, which are further discussed in section 12.02[2] of Hahne & Aliff’s “Accounting for Public Utilities,” attached hereto as Attachment C.
 - a. If the parties’ intent is to record the value of any future proposed acquisition adjustment into USOA Asset Account 114.00, do the parties contend it is probable that this value will be included as allowable costs in a future ratemaking action and that future revenue will be provided to permit recovery of this value, consistent with the standards set forth in ASC 980? Please explain.
 - b. If the parties’ intent is to record the value of the legal and regulatory costs associated with this transaction into USOA Asset Account 183.002, do the parties contend it is probable that this value will be included as allowable costs in a future ratemaking action and that future revenue will be provided to permit recovery of this value, consistent with the standards set forth in ASC 980? Please explain.
5. Please refer to paragraph 8 of the Stipulation and Settlement Agreement, which generally provides that Limestone is not requesting an acquisition adjustment in this docket, but that Limestone may in its initial rate case present evidence and argument regarding the value of an acquisition adjustment while the Consumer Advocate or other interested parties may oppose such value or present their own evidence and argument concerning such value. If the parties’ intent is to record any future proposed acquisition adjustment into USOA Asset Account 114.00, do the parties contend that such recording is consistent with the asset recognition standards referenced in item nos. 3 and 4, above, in light of the parties’ respective positions outlined in paragraph 8? Please explain.
6. Please refer to Commission Rule 1220-04-14-.04(2) regarding factors the Commission may consider when determining the recoverability of an acquisition adjustment. If the parties’ intent is to record the value of any future proposed acquisition adjustment into USOA Asset Account 114.00, do the parties contend that such recording is appropriate without consideration of Commission Rule 1220-04-14-.04(2) in this case? Please explain.

7. Please refer to paragraphs 9 and 13 of the Stipulation and Settlement Agreement which generally provide that the determination of recoverable regulatory and transaction costs will be deferred to Limestone's initial rate case and that, subject to certain limitations, Limestone may seek recovery of such costs while the Consumer Advocate or other interested parties may oppose such costs or present their own evidence and argument concerning the amount of such costs to be recovered in rates. If the parties' intent is to record the value of the legal and regulatory costs associated with this transaction in USOA Asset Account 183.002, do the parties contend that such recording is consistent with the asset recognition standards referenced in item nos. 3 and 4, above, in light of the parties' respective positions outlined in paragraphs 9 and 13? Please explain.
8. Please refer to Commission Rule 1220-04-14-.06 regarding the ratemaking principles the Commission may consider when determining the recoverability of regulatory, transaction and closing costs related to a utility acquisition. If the parties' intent is to record the value of the legal and regulatory costs associated with this transaction into USOA Asset Account 183.002, do the parties contend that such recording is appropriate without consideration of Commission Rule 1220-04-14-.06 in this case? Please explain.

Please provide all responses no later than 2:00 p.m. on Thursday, February 22, 2024. Responses may be submitted electronically at tpuc.docketroom@tn.gov with one hard copy mailed to the Docket Manager at the Tennessee Public Utility Commission, 502 Deaderick Street, 4th Floor, Nashville, Tennessee 37243.

Please contact me should you have questions or need clarification of any requested item. Thanks for your attention to this matter.

Sincerely,

A handwritten signature in dark ink, appearing to read "David N. Foster". The signature is written in a cursive, slightly stylized font.

David Foster, Director
Utilities Division

C: Docket File

ATTACHMENT A

Excerpt from "Statement of Financial Accounting Concepts No. 8"

Financial Accounting Standards Board (Dec 2021)

Statement of Financial Accounting Concepts No. 8
December 2021

Conceptual Framework for Financial Reporting

Chapter 4, *Elements of Financial Statements*

purposes other than to provide goods or services at a profit or profit equivalent, and resource providers do not focus primarily on profit as an indicator of a not-for-profit entity's performance.

E15. Providers of resources to a not-for-profit entity are interested in the services that the entity provides and its ability to continue to provide those services. Because profit indicators are not the focus of their resource allocation decisions, resource providers for not-for-profit entities need other information to assess an entity's performance during a period and how its managers have discharged their stewardship responsibilities, not only for the custody and safekeeping of the entity's resources but also for their efficient and effective use. That includes information about the amounts and kinds of inflows and outflows of resources during a period and the relationship of those resources with other information about service efforts.⁸

Definition of Elements

Assets

E16. An asset is a present right of an entity to an economic benefit.

Characteristics of Assets

E17. An asset has the following two essential characteristics:

- a. It is a present right.
- b. The right is to an economic benefit.

The combination of those two characteristics allows an entity to obtain the economic benefit and control others' access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others' access to the benefit to which the entity is entitled.

E18. Assets commonly have features that help identify them—for example, assets may be contractual, tangible, exchangeable, or separable. However, those features are not essential characteristics of assets. Their absence is not sufficient to preclude an item from qualifying as an asset.

E19. Essential to the definition of an asset is a right to an "economic benefit"—the capacity to provide services or benefits to the entities that use them. Generally, in a business entity, that economic benefit eventually results in potential net cash inflows to the entity. In a not-for-profit entity, that economic benefit is used to provide desired or needed goods or services to beneficiaries or other constituents, which may or may not directly result in net cash inflows to the entity. Some not-for-profit entities rely significantly on contributions or donations of cash to supplement

⁸Chapter 1 of this Concepts Statement, paragraph OB28.

selling prices or to replace cash or other assets used in providing goods and services. The relationship between the economic benefit of an entity's assets and net cash inflows to that entity can be indirect in both business entities and not-for-profit entities.

E20. An asset has the capacity to be beneficial to an entity by being exchanged for something else of value to the entity, by being used to produce something of value to the entity, or by being used to settle the entity's liabilities. Rights that give an entity no advantage beyond the common advantages of others because they are available to all do not qualify as assets. A right that is not restricted, such as a right to sue or a right to enjoy music, is not an asset of an entity. Access to a public road outside an entity's property might provide an economic benefit, but because the entity cannot restrict access to that road by others, the road is not an asset of the entity. Although proximity of the road might add value to the property, there is no right that has granted privileged access or advantage to the entity. A specific right to use a public highway from which a licensee might otherwise be excluded—for example, a license to operate a truck on the highways within a state—would create an economic benefit for the licensee, with respect to that license, even though it does not restrict access of others to the highway.

E21. Incurring a cost to acquire an item does not in itself qualify the item to meet the definition of an asset, for example, services provided by other entities, including personal services that are received and used simultaneously. They can be assets of an entity only momentarily—as the entity receives and uses them—although their use may create or add value to other assets of the entity. Rights to receive services of other entities for specified or determinable future periods can be assets of an entity.

Present right

E22. A right entitles its holder to have or obtain something or to act in a certain manner. Rights can be obtained in various ways. Often, rights are obtained by legal ownership, for example, owning a building. Legal ownership gives the owner access to economic benefits, including the ability to possess, use, and enjoy the right; to sell, donate, or exchange the right; or to exploit the right's value by, for example, pledging it as a security for borrowing.

E23. Legally enforceable rights to economic benefits can be obtained without legal ownership of the underlying benefit itself as is the case, for example, when property is leased or intellectual property is licensed or when an entity has the rights to specified certain cash flows, as in the case of a contract providing rights only to interest flows from a specified debt instrument. Other legally enforceable rights that give rise to assets include the right to require other parties to make payments or render services and the right to use a patent or a trademark. Legally enforceable rights include, among other rights, contractual rights (for example, rights from options held).

E24. Rights also might be enforceable by means equivalent to legal enforcement, such as those arising within a self-regulatory structure. If enforcement by other such means is sufficiently similar to legal enforcement, rights enforceable by those alternative enforcement mechanisms may be the equivalent of legally enforceable rights. An entity also can obtain economic benefits from a right in the absence of legally enforceable rights. For example, an entity might not have legally enforceable rights to secret know-how but can otherwise obtain economic benefits from it. The entity may use or sell the knowledge and restrict or otherwise prevent or limit others' access to the benefits.⁹

E25. To qualify as an asset of an entity, that entity need not have an *exclusive* right to an economic benefit. Rights, including the ability to restrict access to a benefit, and restrictions may be single (held or imposed solely by the entity) or shared (held or imposed in conjunction with others). Two or more entities might have different rights and share the same economic benefit at the same time or might otherwise have rights to the same economic benefits at different times. For example, lease arrangements unbundle the economic benefits of the underlying asset by giving (a) the lessee the right to hold and use the property and the lessor the right to receive lease payments for a specified interval and (b) the lessor the right to receive any residual value. Each entity has an asset based on its rights to a particular economic benefit, and the rights allow the entity to restrict access to the particular economic benefit.

E26. Two or more entities might have an undivided interest in an economic benefit, such as a parcel of land or mineral resources. Each entity has a right to economic benefits deriving from that right that might qualify as an asset, even though the right of each entity is subject, at least to some extent, to the rights of the other entity or entities. The entity with rights to an economic benefit is the one that can exchange some or all of those rights, use the items to which it has the rights to produce goods and services or reduce other expenditures, exact a price for others' use of the rights, or use the rights to settle liabilities or make distributions to owners.

E27. Assets may be intangible, and even if they are not separable or exchangeable, they may be useable by an entity in producing or distributing goods or services. For example, a license may be nontransferable and therefore not

⁹The Uniform Trade Secrets Act defines a "trade secret" as follows:

- Information, including a formula, pattern, compilation, program, device, method, technique, or process that:
 - Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and
 - Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

exchangeable; however, the license provides the right to engage in economically beneficial activities.

E28. To meet the definition of an asset, the right must be a present right; that is, the right exists at the financial statement date, not a right expected to occur in the future. The existence of a present right at the financial statement date means that the right and therefore the asset have arisen from past transactions or other past events or circumstances. Often, assets are obtained by purchasing or producing them, but other transactions, events, or circumstances may generate assets. Examples include the receipt of land or buildings from a government or contributions received by a not-for-profit entity. The means of acquiring rights does not affect whether the item meets the essential characteristics of an asset. However, an examination of the history of how potential rights may have been created might help to determine whether a present right exists at the financial statement date.

E29. Transactions or other events or circumstances expected to occur in the future do not give rise to assets today. An intention to purchase inventory does not by itself meet the definition of an asset. Equipment to be acquired next year is not a present right to that equipment today. A benefit that is expected only because of an anticipation of the action or performance of either a counterparty or the entity is not a present right. In contrast, an existing contract to purchase equipment (a right to purchase equipment) might give rise to an economic benefit that is distinct from the benefit embodied in the equipment itself.

E30. Sometimes present rights with uncertain amounts and timing are referred to as contingent assets. The term *contingent asset* has been a source of confusion because it is often thought to refer to circumstances in which the existence of a right depends on the occurrence or nonoccurrence of a future event. Absent a present right, the occurrence or nonoccurrence of a future event does not by itself give rise to an asset. Some items commonly described as contingent assets satisfy the definition of an asset because the contingency does not relate to whether a present right exists but instead relates to one or more uncertain future events that affect the amount of economic benefit for which a right exists. For those rights, the fact that the outcome is unknown affects the measurement but not the existence of the asset.

Right to an economic benefit

E31. Another essential characteristic of an asset is that the right of an entity must be to an economic benefit. An asset of an entity might be represented by rights to a particular property (such as the right to possess, use, and enjoy a parcel of land) or by rights to some or all the economic benefits derived from the property.

E32. Cash (including deposits in banks) is valuable because of what it can buy. It can be exchanged for virtually any good or service that is available, or it can be saved and exchanged for goods and services in the future. The purchasing power of cash is the basis of its value and economic benefit.

E33. To carry out their activities, both business entities and not-for-profit entities commonly produce goods or services. Both types of entities create utility and value in similar ways—by using goods or services to produce other goods or services. Business entities expect customers to pay for the utility and value added, and they price their outputs accordingly. Some not-for-profit entities distribute some or all of their outputs of goods or services at prices that include the utility and value they have added. Other not-for-profit entities commonly distribute the goods or services they produce to beneficiaries gratis or at nominal prices. Although that may make measuring the value of their outputs difficult, it does not deprive them of value.

E34. The ability of an entity to sell, transfer, license, or exchange a right provides evidence that the right presently exists, the entity controls access to that right, and the right is to an economic benefit. Some intangible assets arise from rights conveyed legally by contract, statute, or other means. For example, trademarks may be registered with the government. Contracts often are negotiated with customers or suppliers. The existence of contractual or other legal rights is a common characteristic of an intangible asset. However, if the right can be identified and, particularly, the identified right can be separated from the entity, it gives credibility that the right exists and that it is to an economic benefit.

E35. Many activities are undertaken with the expectation of obtaining an economic benefit in the future. Examples include research and development, advertising, training, start-up activities, and preoperating activities. While the costs incurred in those activities are not assets, the activities may result in an entity creating a right to an economic benefit and, therefore, obtaining an asset or enhancing an existing asset. For those and similar activities, assessments of when a present right exists and whether the right is to a related economic benefit may be especially uncertain. An entity (a) may have rights that are not to a discernible economic benefit or (b) may have identified future economic benefits to which it has no present rights. The practical problem is whether a right to a future economic benefit exists at a specified date.

E36. Some intangible items that do not arise from rights conveyed by contract or other legal means are nonetheless capable of being separated and exchanged for something of value. If an item is capable of being separated and exchanged for something of value, that would be evidence that a right exists and that the right is to an economic benefit. Others cannot be separated from an entity and sold or otherwise transferred, but still may represent rights to economic benefits. Generalizations about facts and circumstances that bring about internally generated intangible assets are so varied that whether an asset has been created often must be resolved at the standards level.

Liabilities

E37. A liability is a present obligation of an entity to transfer an economic benefit.

ATTACHMENT B

Account Standards Codification 980-340-25-1

Financial Accounting Standards Board

Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:

1. a

It is probable (as defined in Topic 450) 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.

2. 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.

A cost that does not meet these asset recognition criteria at the date the cost is incurred shall be recognized as a regulatory asset when it does meet those criteria at a later date.

Capitalize

Glossary Term Usage

See Topic(s): 980

Capitalize is used to indicate that the cost would be recorded as the cost of an asset. That procedure is often referred to as deferring a cost, and the resulting asset is sometimes described as a deferred cost.

Incurred Cost

Glossary Term Usage

See Topic(s): 980

A cost arising from cash paid out or obligation to pay for an acquired asset or service, a loss from any cause that has been sustained and has been or must be paid for.

Probable

Glossary Term Usage

See

Topic(s): 205, 310, 323, 325, 360, 450, 460, 470, 606, 705, 715, 718, 730, 815, 842, 944, 985

The future event or events are likely to occur.

Allowable Costs

Glossary Term Usage

See Topic(s): 980

All costs for which revenue is intended to provide recovery. Those costs can be actual or estimated. In that context, allowable costs include interest cost and amounts provided for earnings on shareholders' investments.

ATTACHMENT C

Excerpt from "Accounting for Public Utilities" § 12.02[2]

Robert L. Hahne • Gregory E. Aliff (Nov. 2019)

GASB Codification Section Re10.101 states:

“This section may be applied to activities reported in business-type activities that have regulated operations that meet all of the following criteria:

- a. 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.
- b. The regulated rates are designed to recover the specific regulated business-type activity’s costs of providing the regulated services.
- c. 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.”

This provides that state and local proprietary activities and enterprise funds that meet the scope criteria of ASC 980-10-15-2 may apply ASC 980 and related pronouncements.

[2] Regulatory Assets and Liabilities

ASC 980 recognizes that a principal consideration introduced by rate regulation is the cause-and-effect relationship of costs and revenues—an economic dimension that, in some circumstances, should affect accounting for rate-regulated utilities. Thus, a utility should capitalize a cost (as a regulatory asset) or recognize an obligation (as a regulatory liability) if it is probable that, through the ratemaking process, there will be a corresponding increase or decrease in future revenues.

ASC 980-340-25-1 states that the “rate actions of a regulator can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:

- (1) It is probable (as defined in ASC 450) that future revenues in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for ratemaking purposes.
- (2) Based on available evidence, the future revenue will be provided to permit recovery of the 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.”

An incurred cost is defined in ASC 980-10-20 as “a cost arising from cash paid out or obligation to pay for an acquired asset or service, a loss from any cause that has been sustained and must be paid for.” Equity return (or an allowance for earnings on shareholders’ investment), however, is not an incurred cost that would otherwise be charged to expense.

Rate-regulated utilities that are within the scope of ASC 980 are required to capitalize as a regulatory asset an incurred cost that would otherwise be charged to expense if future recovery in rates is probable. Probable is defined in ASC 450-20-25-1 as “likely to occur.” In this context, “probable” is considered a relatively high threshold and substantial evidence is typically required to support recognition of regulatory assets. Evidence that a regulatory asset is probable of recovery is a matter of professional judgment based on the facts and circumstances of each case. Utility management must positively represent that each regulatory asset is probable of recovery in future rates. Evidence that could support future recovery and corroborates utility management’s representation includes:

- (1) Rate orders from the regulator specifically authorizing recovery of the costs in rates.
- (2) Previous rate orders from the regulator allowing recovery for substantially similar costs.
- (3) Written approval from the regulator approving future recovery in rates.
- (4) Analysis of recoverability from internal or external legal counsel.

Under FERC accounting guidelines, regulatory assets are recorded for regulatory reporting purposes if the incurred cost is “expected” to be authorized for future rate recovery—a lower standard than under GAAP.

An incurred cost that does not meet the asset recognition criteria in ASC 980-340-25-1 at the date the cost is incurred should be recognized as a regulatory asset when it meets those criteria at a later date. Under ASC 980-340-35-1, previously disallowed costs that are subsequently allowed by a regulator to be recovered should be recorded as an asset, consistent with the classification that would have resulted had the cost initially been included in allowable costs. This provision applies to disallowed plant costs and regulatory assets created by actions of a regulator.

If a regulatory asset is recorded, but in a subsequent accounting period no longer meets the above criteria, the cost should then be charged to earnings. Thus, ASC 980-340-25-1 has a continuous probability standard to be met at each balance sheet date in order for a regulatory asset to remain recorded.

ASC 980-340-35-1 also concludes that a regulator can reduce or eliminate the value of an asset. If a regulator disallows recovery of all or a part of a regulatory asset, that part of the asset is to be written off. Although special rules apply to disallowances of a recently completed utility plant (see § 12.03[1][b], below), any write-down in the value of other assets is limited to the amount appropriate under GAAP, as applied by enterprises in general. Regulatory assets should be amortized over future periods consistent with the related increase in customer revenues.

ASC 980-405-25-1 also recognizes that the rate actions of a regulator can impose a liability on a utility, usually to its customers. The following are examples of ways in which regulatory liabilities can be imposed:

- (1) A regulator can require refunds to customers.
- (2) A regulator can provide current recovery in rates for costs not yet incurred.

- (3) A regulator can require that a gain be given to customers by amortizing amounts to reduce future rates.

ASC 980-405-40-1 notes that “actions of a regulator can eliminate a liability only if the liability was imposed by actions of the regulator.” Thus, a rate-regulated enterprise’s balance sheet should include all liabilities and obligations that an enterprise in general would record under GAAP, such as for capital leases, pension plans, compensated absences and income taxes. The SEC staff, in SAB Topic 10.F, *Utility Companies—Presentation of Liabilities for Environmental Costs*, clarified that such liabilities should not be offset with corresponding regulatory assets. Regulatory liabilities should be amortized over future periods consistent with the related decrease in customer revenues or as the related costs are incurred.

ASC 980 also sets forth specific standards for certain accounting issues. ASC 980-835-25-1 allows the capitalization of an AFUDC, if the regulator prescribes this method, rather than capitalizing interest on funds used during construction in accordance with the guidelines provided in ASC 835-20. This includes capitalization of the equity component of AFUDC. The FASB provided further guidance on the capitalization of AFUDC and on the capitalization of an equity return in nonconstruction circumstances in ASC 980-360 and ASC 980-340. ASC 980-340-25-5 through 25-6 does not permit capitalization of an equity return in general-purpose financial statements other than during construction or as part of accounting for phase-in plans and plant abandonments. The amount of any equity return capitalized for ratemaking purposes but not capitalized for financial reporting is required to be disclosed in the notes to financial statements.

ASC 980-810-45-1 provides that intercompany profits on sales to regulated affiliates should not be eliminated in general-purpose financial statements if the sales price to the regulated enterprise is reasonable and it is probable that future revenues allowed in the ratemaking process will provide for the recovery of such amounts.

ASC 980 originally did not allow the reporting of flowed-through impacts of current income taxes on the balance sheet but, instead, required disclosure in the notes to the financial statements of the net cumulative amounts of income tax timing differences for which an enterprise did not provide deferred income taxes. However, ASC 980 was modified in February 1992 by ASC 740 (see § 17.02[3]). ASC 740 requires the “liability” method of accounting for deferred income taxes. Because accumulated deferred income taxes are a liability under ASC 740, an income tax liability must be recorded for all temporary differences. As noted above, however, ASC 980 recognizes that rate actions of regulators can create assets. (In other words, if the future recovery of deferred income tax expense through rates is probable, these costs are to be capitalized as regulatory assets rather than expensed.) If a utility concludes that future recovery through rates is probable, it would record a corresponding regulatory asset in recognition of future recovery from customers related to temporary differences not considered in current rates. Likewise, if a temporary difference that results in a deferred tax asset will result in a rate reduction in a future period, a utility company would record a corresponding regulatory liability.

ASC 980-605-50-1 addresses the issue of accounting for significant refunds of revenue that had been recognized in prior periods. Such refunds may occur when interim rates have been implemented that are subject to refund. ASC 980 conforms to the requirements of ASC 250-10, which precludes recording these refunds as restatements of prior year financial statements. However, adjustments to prior interim periods of the current fiscal year for utility refunds is one of the restatement exceptions contained in ASC 250-10-45-25 if certain criteria are met:

- (1) The effect is material.
- (2) All or part of the refund is directly related to activities of specific prior interim periods.
- (3) The amount could not be reasonably estimated prior to the current interim period.

ASC 980 calls for disclosure of the effects on net income for the period in which the refund is recognized and also requires disclosure of the years in which the related revenue was previously recognized.

ASC 980 does not contain a specific standard on the issue of lease accounting. However, accounting for lease transactions is a good example of the application of the conclusion reached in ASC 980-405-40-1 (i.e., a regulator can eliminate only a liability it imposes). ASC 980-840-45-2 addresses accounting for leases directly and concludes that the regulator cannot affect the classification of a lease liability on the balance sheet. Therefore, when a lease is capitalizable under ASC 840-10 but is treated as an operating lease for ratemaking purposes, the balance sheet should still reflect the capitalizable asset and the related lease liability, but differences in expense recognition between ratemaking and GAAP should generally be reflected in the financial statements as regulatory assets or liabilities.

[3] Impact of Subsequent Events Related to Regulatory Matters

Regulatory developments often occur after the balance sheet date but before entities issue financial statements. The following information (1) outlines the appropriate accounting framework companies should use in considering the impact of subsequent events in general and (2) provides examples illustrating application of the framework in the financial statements of regulated entities.

ASC 855-10 prescribes the accounting for events and transactions that occur after the balance sheet date but before entities issue financial statements. Under ASC 855, there are two types of subsequent events. Type 1 subsequent events, which are recognized in the financial statements, provide additional evidence about conditions that existed as of the balance sheet date, including estimates inherent in the preparation of financial statements. Type 2 subsequent events provide evidence about conditions that did not exist as of the balance sheet date but arose after that date. Although Type 2 subsequent events are not recognized in the financial statements, material Type 2 events should generally be disclosed in the notes to financial statements.