



Accounting Systems in Utility Regulation I

Treatment of Depreciation

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Treatment of Depreciation

- What is Depreciation?
- *The American Institute of Certified Public Accounting Research and Terminology Bulletin #1 defines depreciation accounting as follows: Depreciation Accounting is a system of accounting which aims to distribute cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation. Depreciation for the year is a portion of the total charge under such a system that is allocated to the year. Although the allocation may properly take into account occurrences during the year, it is not intended to be a measurement of the effect of occurrences.*
- What does that mean?

Treatment of Depreciation

- Mass plant depreciation
- Iowa Curves
- Remaining life
- Net salvage
- Negative net salvage?
- The depreciation rate:

$$\text{Accrual Rate} = \frac{(\text{Original Cost of Asset} - \text{Depreciation Reserve}) - (\text{Net Salvage})}{\text{Estimated Average Remaining Life of Asset}}$$

Treatment of Depreciation

- How is depreciation calculated for accounting purposes and rate setting?
- $\frac{1}{12}$ of the depreciation rate x the average monthly plant in service balance, taken for 12 consecutive months is...
- The depreciation reserve and net plant

MPSC

Accounting systems in utility
regulation I:

Generally Accepted Accounting
Principles (GAAP)

GAAP

- The Financial Accounting Standards Board (FASB) is the highest authority in establishing generally accepted accounting principles for public and private companies, as well as non-profit entities.
- For local and state governments, GAAP is determined by the Governmental Accounting Standards Board (GASB).

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GAAP

Four Assumptions:

- Business Entity
- Going Concern
- Monetary Unit principle
- Time-period principle

GAAP

Four Principles:

- Cost principle
- Revenue principle
- Matching principle
- Disclosure principle

GAAP

Four Constraints

- Objectivity principle
- Materiality principle
- Consistency principle
- Prudence principle

GAAP

- Codification in Accounting - FASB Accounting Standards Codification
- The Codification is effective for interim and annual periods ending after September 15, 2009.
- The Codification reorganizes the thousands of U.S. GAAP pronouncements into roughly 90 accounting topics and displays all topics using a consistent structure.

MPSC

Accounting systems in utility
regulation I:

US Regulatory Uniform Systems
of Accounts (USOA)

USOA

- Created by FERC for Gas and Electric Utilities
- Approved and sometimes modified by state utility Commissions
- The MPSC last approved its USOA in 1986 for gas and electric utilities
- The MPSC is currently updating the USOA to the most recent FERC versions

USOA

- What is the Uniform System of Accounts?
- A list of account numbers, supported by definitions and instructions for each account, that shall be used uniformly by each utility, and supported by records.
- Why is there a Uniform System of Accounts?
- Comparability, Consistency, Accountability

MPSC

Accounting systems in utility regulation I:

Accuracy and Verification of Data Submitted by Utilities

Accuracy and verification of data submitted by utilities

Audit and review:

- The audit process: a financial audit
- Check underlying Account data
- Corroborate Information
- Test of internal Controls
- Substantive tests for material misstatements

Accuracy and verification of data submitted by utilities

Expert reviews by non-accountants:

- Engineering reviews
- Financial analysis
- Economic analysis
- Rate analysis

Accuracy and verification of data submitted by utilities

Auditing capabilities, discovery:

- Informal audit requests
- Emails and phone calls
- On-site audits
- Formal Discovery: involving the lawyers