

US REGULATORY ACCOUNTING SYSTEM



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Accounting and Regulation

- Accounting is a core regulatory skill.
- Accounting and accountability go hand in hand.
- Annual financial reports speak volumes.
- The regulatory auditor is a watchdog not a pit bull.

Accounting and Regulation

- Effect of Regulation:
 - Every regulatory decision suggests an accounting treatment.
 - Regulation of rates requires accounting information.
 - Uniformity in accounting information assists in regulation.

Accounting and Regulation

- UNIFORM SYSTEM OF ACCOUNTS (USOA).
- GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP).
- AUDIT CAPABILITY.
- REGULATORY RULES.

Overview of Uniform Systems of Accounts (USOA)

- What is a USOA?
 - Established by NARUC and FERC to control accounting along with IURC Orders.
 - Prescribe accounting classifications and instructions to achieve uniform accounting records.
 - Maintain consistent application among companies.
 - The basis to be used in the financial reports.

Overview of Uniform Systems of Accounts (USOA)

- How many USOAs are there?

Electric

- FERC: 18 CFR 101 as of August 8, 2003
- NARUC 1976
- RUS 7 CFR 1767 (electric coops, similar to the FERC USOA)

Also, Gas/Telecom/Water/Wastewater

Overview of Uniform Systems of Accounts (USOA)

What does a USOA look like?

- Definitions
- Accounting Instructions (General & Plant)
- Listing of Accounts:
 - Account Numbers
 - Account Titles
 - Definition of the transactions to be recorded in the account
 - Instructions on recording the transaction in the account

Exhibit 1

Uniform System of Accounts for Natural Gas Companies

Balance sheet assets and other debits	Utility plant
	Other property and investments
	Current and accrued assets
	Deferred debits
	Proprietary capital (stock)
	Long-term debt (bonds, other)
	Other noncurrent liabilities
	Current and accrued liabilities
Income accounts	Operating revenues
	Operating expense
	Maintenance expense
	Depreciation expense
	Amortization expense
	Regulatory debits and credits
Retained earnings accounts	Balance transferred from income
	Appropriations of retained earnings
	Dividends (preferred and common stock)
	Adjustments to retained earnings

Operating revenues	Sales of gas <ul style="list-style-type: none"> - Residential - Commercial and industrial - Public authorities - Sales for resale - Interdepartmental and intracompany
	Other operating revenues
Operation and maintenance expense accounts	Production expenses (fuel, labor, supervision) <ul style="list-style-type: none"> - Manufactured gas - Natural gas - Exploration and development - Other gas-supply expenses
	Gas storage, terminaling, and processing expenses
	Transmission expenses
	Distribution expenses
	Customer accounts expenses
	Customer service and informational expenses
	Administrative and general expenses

Adapted from Federal Energy Regulation Commission, *Uniform System of Accounts Prescribed for Natural Gas Companies Subject to the Provisions of the Natural Gas Act*
[http://www.ferc.gov/gas/gas_USOA/1-Table%20of%20Contents.pdf].

USOA - Account Numbering

- **100s** – Assets
- **200s** – Liabilities and Capital
- **300s** – Detailed Plant Accounts
- **400s** – Operating Revenues, Other Income & Income Deduction Accounts
- **500s** – Electric Expense Accounts & Wastewater Revenue Accounts
- **600s** – Water Expense Accounts incl. General
- **700s** – Gas Production Expense Accounts and Wastewater Expense Accounts
- **800s** – Gas Expense Accounts
- **900s** – General Expense Accounts

USOA - Detailed Accounts

- Detailed Plant Accounts (300s) flow into Account 101 Plant in Service.
- Detailed Operating Revenue Accounts (400s) flow into Account 400 Operating Revenues
- Detailed Operating Expense Accounts flow into Account 401 Operation Expense or Account 402 Maintenance Expense

USOA – Above or Below the Line

- Above-the-line or Below the-line?
- Review the Income Chart of Accounts
 - Find the determination of “Net Utility Operating Income”.
 - This is the line.
- Accounts above this line are “Above the Line”, i.e. recovered from ratepayers.
- Accounts below this line are “Below the Line”, i.e. recovered from shareholders.

USOA - Accounting to Record Plant Purchased, Sold or Retired

- **Gas & Electric: Plant Instruction 5**

Types of Property:

- Operating Units
- Retirement Units
- Less than Retirement Units

USOA – Plant Accounting for Operating Units

- Sale or Purchase:

In order for plant to go in or out of Account 101, it must go through Holding Account 102.

“Within six months ...the utility shall file with the Commission the proposed journal entries to clear from this account the amounts recorded herein.”

USOA – Plant Accounting for Operating Units

- Gain or Loss on disposal of an Operating Unit : Account 421.1 or 421.2.

USOA - Retirement Units

- The smallest item of property required to be written out of the plant account or not replaced through the maintenance accounts.
- An item of plant when retired, with or without replacement, is accounted for by crediting the book cost to the plant in which included.
- A Gain or Loss is not recognized upon disposal of the item of property.

USOA - Less than Retirement Units

- If an item smaller than a retirement unit is purchased or disposed of, the transaction is recorded to an operating or maintenance expense account.

USOA - NARUC Interpretations

- Accounting decisions should consider the Interpretations as though they were part of the text of the USOA.
- NARUC has issued Interpretations regarding the proper accounting for specific events:
 - **Electric and Gas in 1988**
 - **Electric, Gas, and Water in 1981**
 - **Water and Sewer in 1987**
- FERC issues Accounting Releases to express the views of the Chief Accountant on the appropriate accounting treatment of particular items within the USOA.

USOA - FERC Accounting Releases

- Informal interpretations of the USOA by the Chief Accountant at FERC.
- To be followed in the absence of specific instructions within the USOA and other authoritative decisions of FERC.
- General Instruction 5 provides that questions of doubtful interpretation should be submitted to the Commission.

USOA – Example of Interpretation

Question:

Is it permissible to charge the cost of maintenance of structures and improvements used exclusively for transportation, stores, shops, and laboratory to clearing accounts or is it mandatory that such maintenance costs be charged to Account 935 --Maintenance of General Plant?

Answer:

It is permissible to charge the cost of maintenance of structures and improvements used exclusively in connection with transportation, stores, shops, and laboratory to clearing accounts.

Generally Accepted Accounting Principles (GAAP) for Utilities

- The GAAP is an accounting frame for proper classification and treatment of the financial transactions, i.e. transactions to be classified and recorded as assets, liabilities, revenues, costs and expenses.
- Its complexity in some cases allows flexibility in their interpretation.

Generally Accepted Accounting Principles (GAAP) for Utilities

- Generally, utilities' financial statements follow the GAAP requirements.
- Some differences in the application of GAAP may occur between regulated and non-regulated businesses due to the rate-making process.

Generally Accepted Accounting Principles (GAAP) for Utilities

- In the unregulated world, the business reports the expense regardless of how abnormal it is whether from a size or timing point of view at the time it actually occurred.
- In the regulated world, due to the ratemaking process, such an expense could be deferred to a future period or amortized.

Generally Accepted Accounting Principles (GAAP) for Utilities

Statements of Financial Accounting Standards (SFAS) issued by the Financial Accounting Standards Board (FASB) to recognize the effects of rate regulations on certain accounting treatments.

- SFAS No. 71
- SFAS No. 90
- SFAS No. 92
- SFAS No. 101

GAAP for Utilities

- SFAS No. 71: Accounting for the Effects of Certain Types of Regulation
 - Applicable when:
 1. Rates are subject to approval by a regulator.
 2. Rates are designed to recover specific costs of providing service.
 3. Cost of service recovered from customers.

GAAP for Utilities

- SFAS No. 71

Capitalize a cost or recognize a liability if it is likely that a corresponding increase or decrease will take place in future revenues.

Example: An electric Utility may amortize the costs incurred due to storm damages. An unregulated business would record this expense at the time it was incurred.

GAAP for Utilities

- SFAS No. 90: “Regulated Enterprises-Accounting for Abandonment and Disallowances of Plant Costs”
- When it becomes evident that a plant will be abandoned, the cost should be removed from CWIP or UPIS.

GAAP for Utilities

- SFAS No. 90: If the regulator is to allow return on the investment for the abandoned plant, a new asset of the same value will be recognized in the balance sheet.
- Allows the capitalization of “Allowance for Funds Used During Construction” (AFUDC) only if it is likely to include them in allowable costs.

GAAP for Utilities

- SFAS No. 92: “Regulated Enterprises—Accounting for Phase-in Plans”
- Allows the creation of regulatory assets for phase-in plans under certain conditions:
 1. Regulator must approve the plan.
 2. Plan must specify timing of recovery of deferred costs.
 3. Recovery of deferred costs within 10 years.
 4. Percentage increase in rates every year no greater than the previous year.

GAAP for Utilities

- SFAS No. 101: “Accounting for the Discontinuation of Application of SFAS No. 71.”
- Requires a utility that is no longer eligible of SFAS No. 71 to report it in its financial statements.

GAAP for Utilities

- SFAS No. 101: What disqualifies the utility from regulatory ratemaking recognition:
 1. Deregulation.
 2. Change from cost-based rates to other forms.
 3. Inability of the utility to recover costs through rates whether due to Regulatory Resistance or Emerging Competition.

Audit Capability-Authority

- **IC 8-1-2-17**
Accounts; examination and audit
Sec. 17. The commission shall provide for the examination and audit of all accounts, and all items shall be allocated to the accounts in the manner prescribed by the commission.
(Formerly: Acts 1913, c.76, s.20.)
- **IC 8-1-2-18**
Books, accounts, papers, records, and memoranda; inspection and examination
Sec. 18. The agents, accountants or examiners employed by the commission shall have authority, under the direction of the commission, to inspect and examine any and all books, accounts, papers, records and memoranda kept by such public utility.
(Formerly: Acts 1913, c.76, s.21.)

Conducting an Audit

- **PRELIMINARIES**
- **INFORMATION SOURCES**
- **RATE BASE ITEMS**

AUDIT - PRELIMINARIES

- Scope of Audit
 - Lots of kinds of audits and reviews (purchased power, construction, rate case, management)
- Resource Constraints
 - Number of People / Timelines
 - Big Ticket Items versus Detail
 - In-house versus On-site

AUDIT - PRELIMINARIES

- Understand the Company's Accounting System
- USOA Familiarity (Instructions as well as Accounts)
- Chart of Accounts.
- How to get specific information from the system
 - Pulling invoices and work orders

AUDIT - PRELIMINARIES

➤ **Historical Data Analysis**

- Several years (3-5) of historical data
- Can usually be taken from annual reports
- Suggested Items to Include (additional detail as needed)
 - Each element of Rate Base
 - Each category of Revenue
 - Each category of Expense
 - Sales Units (minutes, kWh, Mcf)
 - Number of Customers (by class)
 - Number of employees
 - Other (miles of installed cable)

AUDIT - PRELIMINARIES

➤ **Focusing the Audit**

- Historic data spreadsheets
 - Look for biggest bang for ratepayers buck (salaries, depreciation, purchased power)
- Politically sensitive items
- Items of concern to Commissioners/public (e.g. newly named sports stadium, officers' bonuses)
- Drawing the line between regulated/unregulated

AUDIT – RECORDS TO REVIEW

- Audit Committee Minutes
- Billing Records
- Board of Director Minutes
- Chart of Accounts and Account Manual
- Construction Work Orders

AUDIT - RECORDS TO REVIEW

- Construction Budgets
- Continuing Property Records
- Depreciation Studies
- Franchise Fee Records
- General Ledger and Subsidiary Ledgers

AUDIT - RECORDS TO REVIEW

- Income Tax Returns
- Internal Audit Reports and Workpapers
- Invoices
- List of Property Units
- Monthly or Quarterly Operating/Financial Reports

AUDIT - RECORDS TO REVIEW

- Monthly or Quarterly Trial Balances
- Organizational Charts
- Payroll Records
- Property Tax Statements
- Sample of Customer Bills

AUDIT – TEST YEAR

- Defined:

Period of Measurement for a recent, consecutive 12 month period consisting of a full year of operations where data is readily available

- Historic or Future?

- Current or Stale?
- Representative of period in which rates will be in effect?

AUDIT - TEST YEAR ADJUSTMENTS

- Correcting
 - Removal of Prior Period Items from the Test Year
- Normalizing
 - Adjusting Revenues for Normalized Weather
- Pro Forma
 - Reflection of Authorized Salary Increases
 - General purpose is to transform the relationship that exists between the revenue requirement elements to make it reflective of what is expected to take place during the time the rates are expected to be in effect

AUDIT - RATE BASE

- It is the investment base to which a fair rate of return is applied to arrive at the net operating income requirement
- Original Cost
 - Cost of the Item at the time that asset was first put into utility service is the cost that remains with that asset throughout its life.

AUDIT - RATE BASE

Utility Plant In Service: Used and Useful

- Plant should be functioning and necessary to be included in rate computation
- Matching in-service date with timing included in rates – Commission Policy
- Look at major additions since last rate case or review – Type, need, cost, date in service.

AUDIT – RATE BASE

PLANT HELD FOR FUTURE

- Plan for Use
 - Is there a definite plan to use this plant in the future?
- Date of Use
 - When will this plant be used?

AUDIT – RATE BASE

- Construction Work in Progress (CWIP):

What is the Policy of the Regulator?

Allow/Disallow Plant in rates prior to being in service.

AUDIT – RATE BASE

Acquisition Adjustments

- Represents the difference between the original cost of plant and purchase price
- What is the Policy?
Allow or Disallow - Return on and Return of the Investment .

AUDIT - RATE BASE

CUSTOMER DEPOSITS

- Source of non-investor supplied capital
- Reduction to rate base. Interest treatment?
- Deposit policies – consistent with rules?
- Is company doing what it can to minimize uncollectibles?

AUDIT - RATE BASE

CASH WORKING CAPITAL

Measure of funding the daily expenditures to sustain on-going operations of the utility until those expenditures can be recovered through revenues

- Formula Method – most popular 45-days
- Balance Sheet Method
- Lead Lag Study

AUDIT - RATE BASE

CUSTOMER ADVANCES/CIAC

- Source of non-investor supplied capital
- Accounting treatment different for different industries
 - Water/Wastewater – contained in own account
 - Energy – already netted against costs in plant account
- Consistent with tariff
- Tax treatment

AUDIT - RATE BASE

- PREPAYMENT
 - Type of payment: Related to Service?
- MATERIALS AND SUPPLIES
 - Level of inventory: Reasonable or Excessive?
 - Use of 13 month average

AUDIT - Concluding

- What items are still to be provided and when?
- Has company agreed to any changes or corrections?
- What items are on auditor's to-do list for back in the office? (Checking language of prior orders to look up precedent)
- Preparing Work papers and Files

AUDIT - Concluding

- Think about what might be useful for those looking at information in several years for the next case
- Preparing Testimony and Exhibits or Other Recommendations



REGULATORY RULES

Accounting and Reporting

- Financial reporting requirements allow the Commission to oversee the utilities compliance with the accounting requirements.
- The IURC requires utilities to file annual reports.

Annual Reports

- *170 IAC 4-2-1.1* The IURC adopted FERC's rules and regulations governing the classification of accounts of all major private electric utilities.
- *170 IAC 4-2-2* The IURC adopted NARUC's classification of accounts for all other utilities.

Accounting

IC 8-1-2-10 “Accounting systems”

Every public utility shall keep and render to the commission, in the manner and form prescribed by the commission, uniform accounts of all business transacted. In formulating a system of accounting for any class of public utilities, the commission shall consider any system of accounting established by any federal law, commission or department and any system authorized by a national association of such utilities.

Accounting

IC 8-1-2-12 “Books, accounts, papers, and records”

The commission shall prescribe the forms of all books, accounts, papers and records required to be kept, and every public utility is required to keep and render its books, accounts, papers and records accurately and faithfully in the manner and form prescribed by the commission and to comply with all directions of the commission relating to such books, accounts, papers and records.

Accounting

IC 8-1-2-17 “Accounts; examination and audit”

The commission shall provide for the examination and audit of all accounts, and all items shall be allocated to the accounts in the manner prescribed by the commission.

IC 8-1-2-18 “Books, accounts, papers, records, and memoranda; inspection and examination”

The agents, accountants or examiners employed by the commission shall have authority, under the direction of the commission, to inspect and examine any and all books, accounts, papers, records and memoranda kept by such public utility.

Depreciation

IC 8-1-2-19, Depreciation account

Every public utility shall carry a separate, proper and adequate depreciation account whenever the commission, after investigation, shall determine that such depreciation account reasonably can be required. The commission, from time to time, shall ascertain and determine the proper and adequate rates of depreciation of the several classes of property of each public utility. The rates, tolls and charges shall be such as will provide the amounts required over and above the reasonable and necessary operating expenses, to maintain such property in an operating state of efficiency corresponding to the progress of the industry. Each public utility shall conform its depreciation accounts to such rates, so ascertained and determined by the commission. The commission shall make changes in such rates of depreciation, from time to time, as it may find necessary.

Depreciation

- **IC 8-1-2-20 “Depreciation account; rules, regulations, and forms”**

The commission shall also prescribe rules, regulations and forms of accounts regarding such depreciation, which the public utility is required to carry into effect.

- **IC 8-1-2-21 “Depreciation; rates, tolls, and charges”**

The commission shall provide for such depreciation in fixing the rates, tolls and charges to be paid by the public.

Construction accounts

- **IC 8-1-2-23**

The commission shall keep itself informed of all new construction, extensions and additions to the property of such public utility and shall prescribe the necessary forms, regulations and instructions to the officers and employees of such public utility for the keeping of construction accounts which shall clearly distinguish all operating expenses and new construction. Unless a public utility shall obtain the approval by the commission of any expenditure exceeding ten thousand dollars (\$10,000) for an extension, construction, addition or improvement of its plant and equipment, the commission shall not, in any proceeding involving the rates of such utility, consider the property acquired by such expenditures as a part of the rate base, unless in such proceeding the utility shall show that such property is in fact used and useful in the public service; Provided, That the commission in its discretion may authorize the expenditure for such purpose of a less amount than shown in such estimate.

Financial Statements

- **IC 8-1-2-26 “Financial statements and accounts”**
Each public utility shall furnish to the commission in such form and at such time as the commission shall require, such accounts, reports, and information as will show in itemized detail:
 - (1) the depreciation per unit;
 - (2) the salaries and wages separately per unit;
 - (3) legal expenses per unit;
 - (4) taxes and rentals separately per unit;
 - (5) the quantity and value of material used per unit;

Financial Statements

- (6) the receipts from residuals, byproducts, services or other sales, separately per unit;
- (7) the total and net cost per unit;
- (8) the gross and net profit per unit;
- (9) the dividends and interest per unit;
- (10) surplus or reserve per unit;
- (11) the prices per unit paid by consumer;
- (12) names of, and amount of fees paid to, legal counsel who are not employees;
- (13) names of, and amount of fees paid to, other consultants; and
- (14) such other items, whether of a nature similar to those hereinbefore enumerated or otherwise, as the commission may prescribe, in order to show completely and in detail the entire operation of the public utility in furnishing the unit of its product or service for the public.

Rates and Charges

IC 8-1-2-25 “Rates and charges; rules and regulations involving changes”

The commission shall ascertain, determine and order such rates, charges and regulations as may be necessary to give effect to such arrangement, but the right and power to make such other and further changes in rates, charges and regulations as the commission may ascertain and determine to be necessary and reasonable, and the right to revoke its approval and amend or rescind all orders relative thereto, is reserved and vested in the commission, notwithstanding any such arrangement and mutual agreement.