Public Service Commission of Wisconsin

Cheryl L. Parrino, Chairman
John T. Coughlin, Commissioner
Scott A. Neitzel, Commissioner

Jacqueline K. Reynolds, Executive Assistant
Lynda L. Dorr, Secretary to the Commission
Steven M. Schur, Chief Counsel

DATE MAILED

FEB 24 1995

To the Addressed Party:

File None

Re: Accounting and Ratemaking Treatment for Deferred Accounts

At its May 17, 1994 open meeting, the Commission reviewed and approved the Staff Accounting Policy Team's (SAPT) Statement of Position, 94-01, regarding the treatment of deferred accounts. The Commission also directed the Staff Accounting Policy Team to notify all utilities of the Statement of Position (SOP) to allow them to take the Commission position into account when making future rate case and other regulatory filings. This notification was provided by letter orders dated May 23, 1994 and May 27, 1994, from Lynda L. Dorr, Secretary to the Commission.

At the September 29, 1994 open meeting, the Commission modified the Deferred Accounts policy in its decision in the Wisconsin Power and Light Company (WP&L) rate case, docket 6680-UR-109. As a result of the WP&L decision, the Staff Accounting Policy Team revised SOP 94-01 to indicate that requests to record a Deferred Account for accounting purposes where staff recommends approval of such request shall be submitted to the Commission for its approval. For Deferred Accounts approved by the Commission for accounting purposes after September 29, 1994, staff shall not be required to re-evaluate the deferral in any rate case unless they believe that the circumstances in existence at the time of the Commission approval have changed. The SOP was further revised to waive the requirement for Commission approval for municipal utilities. The waiver for municipal utilities was in those cases where the utility is seeking approval of deferrals for accounting purposes only. The revised SOP as approved by the Commission in its February 21, 1995 open meeting, is attached.

If you have any questions regarding the revised SOP, please call the staff auditor assigned to your company's rate proceedings or Thomas J. Ferris of the Staff Accounting Policy Team. Mr. Ferris' telephone number is (608)266-1124.

By the Commission.

Signed 23rd day of February 1995.

Lynda L. Dorr

Lynda L. Dorr
Secretary to the Commission

LLD:TJF:H:\SAPT\DEFACCT.LTR

See attached Notice of Appeal Rights.

Attachment

Notice of Appeal Rights

Notice is hereby given that a person aggrieved by the foregoing decision has the right to file a petition for judicial review as provided in s. 227.53, Stats. The petition must be filed within 30 days after the date of mailing of this decision. That date is shown on the first page. If there is no date on the first page, the date of mailing is shown immediately above the signature line. The Public Service Commission of Wisconsin must be named as respondent in the petition for judicial review.

Notice is further given that, if the foregoing decision is an order following a proceeding which is a contested case as defined in s. 227.01(3), Stats., a person aggrieved by the order has the further right to file one petition for rehearing as provided in s. 227.49, Stats. The petition must be filed within 20 days of the date of mailing of this decision.

If this decision is an order after rehearing, a person aggrieved who wishes to appeal must seek judicial review rather than rehearing. A second petition for rehearing is not an option.

This general notice is for the purpose of ensuring compliance with s. 227.48(2), Stats., and does not constitute a conclusion or admission that any particular party or person is necessarily aggrieved or that any particular decision or order is final or judicially reviewable.

Revised 4/22/91

Original May 23, 1994
Revised February 21, 1995

STAFF ACCOUNTING POLICY TEAM

STATEMENT OF POSITION
94-01

DEFERRED ACCOUNTS

Introduction

According to accounting literature, there are four main types of deferred charges: 1) outlays from which the benefit will be enjoyed over an indefinite number of succeeding periods; 2) outlays in the nature of long-term prepaid expenses that are presumed to be of benefit over a fairly well-defined number of future periods; 3) prepaid expenses or costs; and 4) expenditures or losses that benefit no past, present or future period. In recent years, there have been debates as to the allowability of certain deferrals both for financial reporting purposes and for ratemaking purposes.

Statement of Financial Accounting Standards (SFAS) Number 71 recognizes that accounting by public utilities should follow ratemaking treatment of transactions when such accounting results in a more appropriate matching of revenue and expenses, and proper recognition of assets and liabilities of the affected utility. As a result of the ratemaking process, and with reasonable assurance by a regulatory commission of future cost recovery, utilities sometimes include allowable costs in a period other than the period in which those costs would be charged to expense by an unregulated enterprise in accordance with Generally Accepted Accounting Principles (GAAP). These differences usually relate to the timing of the recognition of a cost. The result of these timing differences is the creation of regulatory assets and liabilities.

In recent years, the Securities and Exchange Commission (SEC) and the Emerging Issues Task Force (EITF) of the Financial Accounting Standards Board (FASB) have under certain circumstances questioned the recording of regulatory assets and liabilities. The EITF consensus reached on Issue No. 92-12, Accounting for OPEB Costs by Rate-Regulated Enterprises, imposed time limits ("fence posts") for recovery of deferred costs and the recording of regulatory assets and liabilities. This EITF action and two other actions with regard to regulatory assets (EITF Issue No. 93-4, Accounting for Regulatory Assets, and EITF Issue No. 92-7, Accounting by Rate-Regulated Utilities for the Effects of Certain Alternative Revenue Programs) have given a clear indication that the future application of SFAS 71 will be significantly restricted. The SEC has supported these EITF actions.

For ratemaking purposes, costs are deferred for a number of reasons, including, but not limited to, the following:

1. In order to promote "intergenerational equity," the burden of an expenditure is spread over several years rather than one;
2. Utility ratemaking strives for rate predictability and stability; and
3. Where a rate case is not held each year, to include the full amount of a single period or unusual cost in a test year would result in over-recovery as it is collected each year. To exclude the full amount of a single period or unusual cost from a test year as being nonrecurring would leave the utility with no recovery.

A rate case test year can reflect a revenue requirement based on a current budgeted expense level approach or a normalized test year approach plus extraordinary items. Generally, in municipal water cases, the Commission has utilized a normalized test year approach in establishing the revenue requirement. For private utilities, especially in the years since the establishment of annual rate cases, the Commission has tended toward a budgeted test-year approach reflecting the amortization of specific deferred accounts.

With the recent actions of the EITF, the differences in rate case test-year approaches for treating deferrals, and the increasing number of deferrals allowed, the establishment of a standard policy for the ratemaking treatment of Deferred Accounts has become a priority. In addition, the recent decision of the Wisconsin Supreme Court in Wisconsin Power & Light Co. v. Public Service Commission, 181 Wis. 2d 385 (1994), has emphasized the need for a strict application of the prohibition against retroactive ratemaking. Since deferrals often allow for the recovery of past expenditures in future rates, they should be carefully scrutinized to ensure that they come within recognized exceptions to the prohibition against retroactive ratemaking.

Definitions

Attachment A shows a listing of the various deferred accounts which have been recorded for utilities. The deferred accounts are broken down into the following three categories: deferred accounts; accounting deferrals; and accounting accruals. Definitions of these account categories are:

a. Deferred Accounts: Those accounts that represent timing differences from when an expense is recognized currently for financial accounting based on GAAP and when an expense is recognized over future periods for regulatory accounting. Such deferrals are not required or promulgated by accounting principles, the Commission or legal requirements (e.g., state and/or federal tax laws).

b. Accounting Deferrals: Those deferrals that are required by the Commission, required by the federal agencies, required by state and/or federal laws, consistent with accounting practices set forth in an applicable Uniform System of Accounts (USOA) or consistent with accounting practices followed by nonregulated entities.

c. Accounting Accruals: Those accounts that represent the cumulative effect of converting from the cash to the accrual basis of accounting in accordance with GAAP.

The above categories do not include those Deferred Charges and Deferred Credits that are considered normal accruals, not subject to amortization. According to the Commission prescribed USOA, a utility is required to keep its accounts on the accrual basis. This requires the inclusion in its accounts of all known transactions of appreciable amounts which affect the accounts. In addition, the above categories do not include amounts that are required by the USOA to be recorded in Deferred Charges or Deferred Credits such as the cost of preliminary surveys, plans, investigations, etc., and evaluations, inventories, and appraisals taken in connection with the acquisition or sale of property.

Any reference to Deferred Accounts, deferrals or deferred amounts in the Recommendation section of this SOP includes the associated amortizations.

Recommendation

Current Rate Case Process

It is the position of the Staff Accounting Policy Team (SAPT) that in current rate cases, staff review existing and proposed deferrals using a normalized test year approach. Previous approval of these deferrals by Commission order or accounting letter shouldn't result in staff automatically including the amounts in a utility's test year revenue requirement. Staff needs to justify the inclusion of all such deferral amortizations in each individual rate case and all amounts should be considered at risk. Staff's review in current rate cases should consider the following steps:

1. Deferred amounts should be categorized as normal accruals required by the USOA or into one of the three categories discussed above and in Attachment A.

2. For those amounts categorized as "Deferred Accounts" (category a. above), staff should make a determination as to whether such deferrals can be reflected in a normalized test year revenue requirement.

3. For those amounts which cannot be reflected in a normalized test year revenue requirement, staff should make a determination as to whether the deferral represents an extraordinary expense that justifies such treatment and inclusion in the current case. In making this determination, staff should consider the evaluation criteria set forth later in this Statement of Position. Deferred charges and credits which are categorized as normal accruals, Accounting Deferrals or Accounting Accruals should be reflected in a normalized test year level and are not considered extraordinary amortizations.

4. In previous cases, the rate recovery of some deferrals have been explicitly approved based on a certain outcome. Staff should take these explicit approvals into account when making a determination as to the proper treatment of the applicable deferral in the current case.

5. In cases which are resolved outside of the normal hearing process, staff should inform the Commission how the deferral issue was addressed in a stipulation letter, memo to the Commission or some other form.

It is the position of the SAPT that the biennial rate case process established for major energy utilities is consistent with the use of a normalized test year. Furthermore, the strict application of the prohibition against retroactive ratemaking required under Wisconsin Power & Light Co. v. Public Service Commission, supra, is also consistent with the normalized test year, in conjunction with the standards for extraordinary amortizations set forth below.

Going Forward Process

On a going forward basis, it is the position of the SAPT that the revenue requirement treatment of deferred amounts be decided on a case-by-case basis. SAPT's position is that in future rate cases, staff should reflect a normal test year approach for determining revenue requirement with adjustments for material extraordinary amortizations. For Deferred Accounts approved by the Commission for accounting purposes after September 29, 1994, staff is not required to re-evaluate the deferral in any rate case unless they believe that the circumstances in existence at the time of the Commission approval have changed. For Deferred Accounts approved by the Commission for accounting or ratemaking purposes prior to September 29, 1994, or approved for municipal utilities in a staff accounting letter after September 29, 1994, in evaluating the reasonableness of an adjustment for material extraordinary amortizations, staff should take into account the criteria set forth in the next section. Deferred charges and credits which are categorized as normal accruals, Accounting Deferrals or Accounting Accruals should be reflected in a normalized test year level and are not considered extraordinary amortizations.

Evaluation Criteria

According to the USOA, those items related to the effects of events and transactions which have occurred during the current period and which are of unusual nature and infrequent occurrence shall be considered extraordinary items. Accordingly, they will be events and transactions of significant effect which are abnormal and significantly different from the ordinary and typical activities of the company and which would not be expected to recur in the foreseeable future.

It is the position of the SAPT that in evaluating the reasonableness of an adjustment for material extraordinary amortizations in a rate case that staff should take into account the criteria set forth below. The criteria may be considered individually or together with other criteria.

1. The amount is outside the control of the utility;
2. The expenditure is unusual (e.g., nontypical, noncustomary) and infrequently recurring (e.g., doesn't occur every 2 to 5 years);
3. The immediate recognition of the expenditure causes the utility serious financial harm or significantly distorts the current year's income; or
4. The immediate recognition of the expenditure causes significant ratepayer impact.

Accounting Letters

Nothing in this Statement of Position prevents a utility from recording deferred charges or credits for accounting and financial reporting purposes. According to the USOAs for electric, gas, municipal and telecommunications utilities, certain deferrals require approval from the Commission. It is the position of the SAPT that when evaluating the reasonableness of recording deferrals for accounting purposes, staff should take into consideration the processes and evaluation criteria discussed above. Privately-owned utility requests to record a Deferred Account for accounting purposes where staff recommends approval of such request, should be submitted to the Commission for its approval together with the reasons for the approval recommendation based on the above criteria. Any memo from staff to the Commission recommending the approval of a request to record a Deferred Account should include language that the recommendation is based on the conditions existing at the time of the utility's request. If such conditions change, staff will evaluate the reasonableness of an adjustment for material extraordinary amortizations in subsequent cases. It is also the position of the SAPT that the following language should be added to all accounting letter orders issued by the Commission approving the recording of Deferred Accounts:

> This authorization is for accounting purposes only and does not bind the Commission to any specific treatment for this item in any future proceeding involving rates or other matters before the Commission.

For municipal utilities seeking approval of deferrals for accounting purposes only, the requirement for Commission approval is waived. Such approvals are delegated to staff. The following language should be added to all accounting letters issued by the Commission staff approving the recording of Deferred Accounts:

> This staff authorization is for accounting purposes only and does not bind the Commission to any specific treatment for this item in any future proceeding involving rates or other matters before the Commission.

H:\SAPT\SOP9401.R1

PUBLIC SERVICE COMMISSION OF WISCONSIN

UTILITY DEFERRED ACCOUNTS

Deferred Accounts

ECC implementation expenses
AM/FM mapping
Budget system
Study for proposed fly ash system
Burlington Northern freight rate settlements
DOE line loss credits
Manufactured Gas Plant (MGP) cleanup
Uncollectible escrow
Deferred storage gas carrying costs
Kewaunee non fuel outage costs
ANR transition costs
NERCO Coal and Soo Line contract buyouts
Potential Montana tax assessment
Potential coal mine reclamation costs
Air emissions
Environmental cleanup
Operating reserves
Extraordinary maintenance and repairs
Early retirement losses (plant)
Plant acquisition adjustments
NSP Viking revenue requirement adjustment
Miscellaneous deferred accounts (net)

Accounting Deferrals

Unamortized loss on reacquired debt
Unamortized debt issuance expense
Long-term debt discount
Enrichment facilities (D&D)
Capitalized conservation
Operating investment tax credits
Deferred operating taxes (net)
Asset verification and continuing property records
Amortization of previously flowed-through tax amounts
Excess federal income tax rate differential
Deferred information system costs
Cost of preferred stock refinancing
Early retirement losses (people)

PUBLIC SERVICE COMMISSION OF WISCONSIN

UTILITY DEFERRED ACCOUNTS

Accounting Accruals

SFAS 106 transition obligation
SFAS 106 curtailment loss
SFAS 106 other amortizations
SFAS 112 cumulative effect
Deferred pension curtailment gain
SFAS 87 transition obligation
Compensated absences
Accounting for compensated absences (GASB 16)