EEI Corporate Accounting Committee
AGA Accounting Services Committee

Above the Line, Below the Line:
Accounting for Non-Recovered Items and Disallowed Costs

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Objectives

• Discuss rate making formula and financial information

• Discuss the Uniform System of Accounts (USOA)

• Highlight key Below the Line items

• FERC Audit Findings
The Rate-Making Formula and Its Components

Rate Base
\[ \times \text{ Allowed Rate of Return} \]
\[ = \text{ Required Return (i.e., operating income)} \]
\[ + \text{ Operating Expenses, Depreciation, Taxes} \]
\[ = \text{ Revenue Requirement} \]
Accounting Characteristics of Utilities

- Rate Regulation requires accounting information
- Sound regulation requires sound accounting

![Accounting Characteristics Diagram]

Supplies Information → Accounting → Affects Accounting Data → Rate Regulation → Supplies Information
Regulated Utility Financial Statements

• Traditional approach
  • Items from regulatory reporting
  • Net utility plant/capitalization
  • Above-the-line/below-the-line
  • Income taxes included in operating expenses

• More current approach
  • Similar to a manufacturing or consumer business company
  • Current assets/current liabilities
  • Income taxes excluded from operating expenses
  • Deregulated/ing companies have begun to use this format
Accounting Characteristics of Utilities

• Regulated by state or federal commission – regulation of rates and revenues affect accounting
  • The cause-and-effect relationship of costs and revenues is the principal economic effect of regulation that affects accounting for regulated enterprises.

• Most commissions have direct accounting jurisdiction for regulatory reporting

• Investor owned entities are subject to the requirements of the SEC
Accounting – Tool of Regulation

• Regulatory commissions require uniformity because uniformity assists in regulation

• Transactions must be recorded in conformity with commission policy so that it will be useable in rate proceedings

• The authority granted to commissions is desirable for comparability but sometimes it is different then what is required by GAAP
FERC USOA

• Two part income statement
  • “Above-the-line” expenses and revenues included in rate-setting process
  • “Below-the-line” expenses and revenues not included in the rate-setting process
Quiz: Above the Line or Below the Line?

- Purchased Power
- Charitable Contributions
- Life Insurance Premiums
- Administrative Expenses
- Taxes
### Above the Line Costs

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating revenues</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>Operating expenses:</td>
<td></td>
</tr>
<tr>
<td>Purchased power</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Operating and maintenance</td>
<td>160,000</td>
</tr>
<tr>
<td>Administrative and general</td>
<td>90,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>10,000</td>
</tr>
<tr>
<td>General taxes</td>
<td>6,000</td>
</tr>
<tr>
<td>Income taxes</td>
<td>43,300</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>1,309,300</td>
</tr>
<tr>
<td>Operating income</td>
<td>$190,700</td>
</tr>
</tbody>
</table>
Below the Line Costs

<table>
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<th>Description</th>
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<tbody>
<tr>
<td>Operating income</td>
<td>$190,700</td>
</tr>
<tr>
<td>Other income and deductions:</td>
<td></td>
</tr>
<tr>
<td>Non-regulated revenue</td>
<td>1,000</td>
</tr>
<tr>
<td>Interest income</td>
<td>500</td>
</tr>
<tr>
<td>Allowance for equity funds</td>
<td>6,500</td>
</tr>
<tr>
<td>Other deductions</td>
<td>(3,000)</td>
</tr>
<tr>
<td>Taxes applicable to other income and deductions</td>
<td>(2,500)</td>
</tr>
<tr>
<td>Income and deductions-net</td>
<td>2,500</td>
</tr>
<tr>
<td>Income before interest charges</td>
<td>193,200</td>
</tr>
<tr>
<td>Interest charges:</td>
<td></td>
</tr>
<tr>
<td>Interest on debt</td>
<td>109,000</td>
</tr>
<tr>
<td>Allowance for borrowed funds</td>
<td>(5,800)</td>
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<td>Interest charges-net</td>
<td>103,200</td>
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<td>$90,000</td>
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Sources of FERC Accounting Guidance

• Uniform System of Accounts
• Accounting Rulemakings
• Accounting Guidance
• Accounting Releases
FERC USOA

• Code of Federal Regulations
  • Title 18
  • Parts 1-399
  • Part 101 - UNIFORM SYSTEM OF ACCOUNTS PRESCRIBED FOR PUBLIC UTILITIES AND LICENSEES SUBJECT TO THE PROVISIONS OF THE FEDERAL POWER ACT
  • Part 201 - UNIFORM SYSTEM OF ACCOUNTS PRESCRIBED FOR NATURAL GAS COMPANIES SUBJECT TO THE PROVISIONS OF THE NATURAL GAS ACT
FERC USOA

• There are 24 General Instructions in FERC
• 16 Electric Plant Instructions
• 4 Operating Expense Instructions
FERC USOA

• Sections of the System of Accounts
  • Order of Applicability
  • Definitions
  • General Instructions
  • Electric Plant Instructions / Gas Plant Instructions
  • Operating Expense Instructions
  • Balance Sheet Chart of Accounts
  • Electric Plant Chart of Accounts / Gas Plant Chart of Accounts
  • Income Chart of Accounts and Descriptions
  • Retained Earnings Chart of Accounts and Descriptions
  • Operating Revenue Chart of Accounts and Descriptions
  • Operation and Maintenance Expense Chart of Accounts and Descriptions
FERC USOA

- **Revenues and Expenses from nonutility operations** *(417 and 417.1)*
  These accounts shall include revenues and expenses applicable to operations which are nonutility in character but nevertheless constitute a distinct operating activity of the enterprise as a whole.

- **Nonoperating rental income (418)**
  This account shall include all rent revenues and related expenses of land, buildings, or other property included in account 121, Nonutility Property, which is not used in operations covered by account 417 or 417.1.

- **Equity in earnings of subsidiary companies** *(418.1)*
  This account shall include the utility's equity in the earnings or losses of subsidiary companies for the year.
**FERC USOA**

- **Interest and dividend income (419)**
  
  This account shall include interest revenues on securities, loans, notes, advances, special deposits, tax refunds and all other interest-bearing assets, and dividends on stocks of other companies, whether the securities on which the interest and dividends are received are carried as investments or included in sinking or other special fund accounts.

- **Allowance for other funds used during construction(419.1)**
**FERC USOA**

• **Miscellaneous nonoperating income (421)**
  
  This account shall include all revenue and expense items except taxes properly includible in the income account and not provided for elsewhere.
FERC USOA

• Gain/Loss on disposition of property (421.1 and 421.2)
  This respected account shall be credited or charged with the
gain/loss on the sale, conveyance, exchange, or transfer of utility
or other property to another. Amounts relating to gains on land
and land rights held for future use recorded in account 105,
Electric Plant Held for Future Use.

• Miscellaneous amortization (425)
  This account shall include amortization charges not includible in
other accounts which are properly deductible in determining the
income of the utility before interest charges.
FERC USOA

• Donations (426.1)
  This account shall include all payments or donations for charitable, social or community welfare purposes.

• Life insurance (426.2)
  This account shall include all payments for life insurance of officers and employees where company is beneficiary (net premiums less increase in cash surrender value of policies).

• Penalties (426.3)
  This account shall include all payments for life insurance of officers and employees where company is beneficiary (net premiums less increase in cash surrender value of policies).
FERC USOA

• Expenditures for certain civic, political and related activities (426.4)
  This account shall include expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda, legislation, or ordinances or approval, modification, or revocation of franchises; or for the purpose of influencing the decisions of public officials, but shall not include such expenditures which are directly related to appearances before regulatory or other governmental bodies in connection with the reporting utility's existing or proposed operations.

• Other Deductions (426.5)
  This account shall include other miscellaneous expenses which are nonoperating in nature.
• Interest on long-term debt (427)
  This account shall include the amount of interest on outstanding long-term debt issued or assumed by the utility, the liability for which is included in account 221, Bonds, or account 224, Other Long-Term Debt.

• Amortization of debt discount and expense (428)

• Amortization of loss on reacquired debt (428.1)

• Amortization of premium on debt—Cr (429)

• Amortization of gain on reacquired debt—Credit (429.1)
**FERC USOA**

- **Interest on debt to associated companies (430)**
  This account shall include the interest accrued on amounts included in account 223, Advances from Associated Companies, and on all other obligations to associated companies.

- **Other Interest Expense (431)**

- **Allowance for borrowed funds used during construction—Credit (432)**
FERC USOA

• Extraordinary income and deductions (434 and 435)

These accounts shall include gains/losses of unusual nature and infrequent occurrence, which would significantly distort the current year's income computed before Extraordinary Items.
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Income Tax Presentation

• Taxes applicable to other income / deductions
  • Taxes Other Than Income Taxes (408.2)
  • Income Taxes-Federal (409.2)
  • Income Taxes-Other (409.2)
  • Provision for Deferred Inc. Taxes (410.2)
  • (Less) Provision for Deferred Income Taxes-Cr. (411.2)
  • Investment Tax Credit Adj.-Net (411.5)
  • (Less) Investment Tax Tax Credits (420)
Income Tax Presentation

Income Statement Presentation

• Below the line income tax expense or benefit applies to the various pre tax revenue and expense amounts that are classified below the line.

• Best practice—prepare a separate effective tax rate analysis for the above the line and below the line accounts
Income Tax Presentation

- Interest on tax refunds or deficiencies shall not be included in these accounts but in account 419, Interest and Dividend Income, or account 431, Other Interest Expense, as appropriate.

- Gains/Losses attributable to the reacquisition of debt should be allocated between utility and non-utility
Income Tax Presentation

- Gains/Losses attributable to the reacquisition of debt should be allocated between utility and non-utility
- Tax effect of interest allocated between utility and non-utility
- Interest and penalties on tax deficiencies to be charged to Account 431, Interest Expense and Account 426.3, Penalties, respectively
Derivative Instruments and Hedging Activities

- Docket A101-1-000

- The accounting for the changes in the fair value of derivative instruments depends upon its intended use and designation.
  - Record the change in the fair value of derivative instruments that are not designated as hedges in Account 124, Other Investments, and reflect any gains or losses in Account 421, Miscellaneous Nonoperating Income, or Account 426.5, Other Deductions, respectively.
  - The ineffective portion of a fair value hedge transaction will be reflected in the same income or expense account that would have been used if the hedged item had been disposed of or settled.
Other Considerations

• AR-12 Discriminatory Employment Practices
  • The Uniform System of Accounts provides that all charges to utility operating expense accounts must be just and reasonable. Expenditures resulting from employment practices that were found to be discriminatory by a judicial or administrative decree or that were the result of a compromise settlement or consent decree, that can be readily identified and quantified should not be considered as just and reasonable charges to utility operations and should be classified to the appropriate nonoperating expense accounts.
  • Fines or penalties are to be recorded in Account 426.3, Penalties, and all other costs are to be recorded in Account 426.5, Other deductions
FERC Audit Findings

• FERC 2013 Report on Enforcement”
  • “Formula Rate Matters. DAA rigorously examines the accounting that populates formula rate recovery mechanisms that are used in determining billings to wholesale customers. In recent formula rate audits, DAA observed certain patterns of noncompliance in the following areas:
    • Merger Goodwill...
    • Depreciation Rates...
    • Merger Costs...
    • Tax Prepayments...
    • Asset Retirement Obligation (ARO) ...
    • Below-the-Line Costs – attempting to move below-the-line costs into formula rates (e.g., lobbying, charitable contributions, fines and penalties, and compromise settlements arising from discriminatory employment practices)
    • Improper Capitalization…”
FERC Audit Findings

• Example Findings
  • *[The Company]* incorrectly recorded $X in payments resulting from compromise settlements in above-the-line accounts, rather than below-the-line, as required.
  • *[The Company]* incorrectly recorded $X in charitable contributions and lobbying costs in above-the-line accounts, rather than below-the-line, as required.

• Service Company billings were not appropriately allocated to appropriate accounts
Questions?
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