Statement of Financial Accounting Standards No. 101

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Regulated Enterprises—Accounting for the Discontinuation of Application of FASB Statement No. 71

December 1988

Financial Accounting Standards Board
of the Financial Accounting Foundation
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Statement of Financial Accounting Standards No. 101

Regulated Enterprises—Accounting for the Discontinuation of

Application of FASB Statement No. 71

December 1988

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Paragraph Numbers

FAS 101: Regulated Enterprises—Accounting for the Discontinuation of Application of FASB Statement No. 71

FAS 101 Summary

This Statement specifies how an enterprise that ceases to meet the criteria for application of FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation,* to all or part of its operations should report that event in its general-purpose external financial statements.

An enterprise's operations can cease to meet those criteria for various reasons, including deregulation, a change in the method of regulation, or a change in the competitive environment for the enterprise's regulated services or products. Regardless of the reason, an enterprise whose operations cease to meet those criteria should discontinue application of that Statement and report that discontinuation by eliminating from its statement of financial position the effects of any actions of regulators that had been recognized as assets and liabilities pursuant to Statement 71 but would not have been recognized as assets and liabilities by enterprises in general. However, the carrying amounts of plant, equipment, and inventory measured and reported pursuant to Statement 71 should not be adjusted unless those assets are impaired, in which case the carrying amounts of those assets should be reduced to reflect that impairment. The net effect of the adjustments should be included in income of the period of the change and classified as an extraordinary item.

This Statement is effective for discontinuations of application of Statement 71 occurring in fiscal years ending after December 15, 1988 but its adoption may be delayed until the issuance of annual financial statements for the fiscal year that includes December 15, 1989. Retroactive application to discontinuations reported prior to fiscal years ending after December 15, 1988 by restatement of the financial statements for the period including the date of discontinuation and periods subsequent to the date of the discontinuation is permitted but not required.

INTRODUCTION

1. FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation,* requires that an enterprise's operations meet specific criteria for application of that Statement. Statement 71 does not address the accounting that should result when an enterprise's operations

cease to meet those criteria. Since Statement 71 was issued, deregulation of certain industries and changes in the method of regulating others have caused several enterprises to discontinue application of Statement 71 for some or all of their operations.

2. The FASB has been informed that the methods used to account for those discontinuations have varied in practice. In its October 15, 1984 Issues Paper, *Application of Concepts in FASB Statement of Financial Accounting Standards No. 71 to Emerging Issues in the Public Utility Industry,* the AICPA Public Utility Subcommittee requested that the Board specify the appropriate accounting to reflect the discontinuation of application of Statement 71.

3. As a condition for its initial and continuing application, Statement 71 requires that an enterprise's operations meet the three criteria specified in paragraph 5 of Statement 71:

a. The enterprise's rates for regulated services or products 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 enterprise's costs of providing the regulated services or products.
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 enterprise'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. [Footnote reference omitted.]

4. Failure of an enterprise's operations to continue to meet the criteria in paragraph 5 of Statement 71 can result from different causes. Examples include the following:

a. Deregulation
b. A change in the regulator's approach to setting rates from cost-based rate making to another form of regulation
c. Increasing competition that limits the enterprise's ability to sell utility services or products at rates that will recover costs
d. Regulatory actions resulting from resistance to rate increases that limit the enterprise's ability to sell utility services or products at rates that will recover costs if the enterprise is unable to obtain (or chooses not to seek) relief from prior regulatory actions through appeals to the regulator or the courts.

Regardless of the reason for an enterprise's discontinuation of application of Statement 71, this Statement specifies how that discontinuation shall be reported in the enterprise's general-purpose external financial statements.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Discontinuation of the Application of Statement 71

5. When an enterprise determines that its operations in a regulatory jurisdiction no longer meet the criteria for application of Statement 71, that enterprise shall discontinue application of that Statement to its operations in that jurisdiction. If a separable portion of the enterprise's operations within a regulatory jurisdiction ceases to meet the criteria for application of Statement 71, application of that Statement to that separable portion shall be discontinued. That situation creates a presumption that application of Statement 71 shall be discontinued for all of the enterprise's operations within that regulatory jurisdiction. That presumption can be overcome by establishing that the enterprise's other operations within that jurisdiction continue to meet the criteria for application of Statement 71.

Accounting to Reflect the Discontinuation of Application of Statement 71

6. When an enterprise discontinues application of Statement 71 to all or part of its operations, that enterprise shall eliminate from its statement of financial position prepared for general-purpose external financial reporting the effects of any actions of regulators that had been recognized as assets and liabilities pursuant to Statement 71 but would not have been recognized as assets and liabilities by enterprises in general. However, the carrying amounts of plant, equipment, and inventory measured and reported pursuant to Statement 71[1] shall not be adjusted unless those assets are impaired, in which case the carrying amounts of those assets shall be reduced to reflect that impairment. Whether those assets have been impaired shall be judged in the same manner as for enterprises in general. The net effect of the adjustments required by this Statement shall be included in income of the period in which the discontinuation occurs and shall be classified as an extraordinary item.

7. An enterprise that discontinues application of Statement 71 shall no longer recognize the effects of actions of a regulator as assets or liabilities unless the right to receive payment or the obligation to pay exists as a result of past events or transactions and regardless of future transactions.

Disclosures

8. For the period in which an enterprise reflects the discontinuation of application of Statement 71 to all or a separable portion of its operations, the enterprise shall disclose the reasons for the discontinuation and identify the portion of its operations to which the application of Statement 71 is being discontinued.

9. The disclosure requirements of APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions,* for extraordinary items apply to the net adjustment reported in the statement of operations as a result of applying this Statement.

Amendment to Opinion 30

10. This Statement amends Opinion 30 only to the extent that classification of the net effect of discontinuing the application of Statement 71 as an extraordinary item pursuant to paragraph 6 of this Statement shall be made without regard to the criteria in paragraph 20 of that Opinion.

Effective Date and Transition

11. This Statement shall be effective for discontinuations of application of Statement 71 occurring in fiscal years ending after December 15, 1988. If an enterprise has issued financial statements in which the provisions of this Statement have not been applied to a discontinuation occurring in the fiscal year that includes December 15, 1988, the financial statements for the interim period of the discontinuation and subsequent interim periods within that fiscal year shall be restated. For discontinuations reported in fiscal years ending prior to December 15, 1988, retroactive application by restatement of the financial statements for the period including the date of discontinuation and periods subsequent to the date of discontinuation is permitted but not required. Any financial statements restated shall disclose the nature of the restatement and its effect on income before extraordinary items, extraordinary items, net income, and related per share amounts for each period restated. Interim and annual financial statements for periods that ended prior to the date of discontinuation of application of Statement 71 shall not be restated.

12. Enterprises with discontinuations occurring in fiscal years that include December 15, 1988 or December 15, 1989 may delay adopting this Statement until the issuance of annual financial statements for the fiscal year that includes December 15, 1989. Enterprises delaying adoption of this Statement shall, when adopting this Statement, restate their interim and annual financial statements for the period including the date of discontinuation and periods subsequent to that date and shall disclose the nature of the restatement and its effect on income before extraordinary items, extraordinary items, net income, and related per share amounts for each period restated.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative vote of six members of the Financial Accounting Standards Board. Mr. Lauver dissented.

Mr. Lauver dissents from the issuance of this Statement because it does not require the effects of all specialized practices followed while an enterprise applied Statement 71 to be eliminated from the balance sheet at the time the enterprise discontinues application of that Statement. Specialized practices whose effects are not required to be eliminated upon discontinuing application of Statement 71 are capitalizing an allowance for earnings on shareholders' investment, capitalizing interest on bases different from those permitted by Statement 34 and capitalizing profits on intercompany sales. The effects of those specialized practices that are permitted to remain in the balance sheet have been reported as components of asset accounts (inventory and plant) that would have existed absent those components rather than in separate asset accounts and are said, therefore, not to represent assets resulting solely from actions of regulators. Mr. Lauver believes that the effects of all specialized practices followed while applying Statement 71 are assets (or liabilities) resulting solely from actions of regulators, are substantively the same regardless of balance sheet classification, and should be eliminated to enhance subsequent comparability with other enterprises that are not subject to Statement 71 and to enhance distinctions from enterprises that continue to be subject to Statement 71.

As indicated herein, a rationale for conclusions expressed in this Statement is that, although conceptually correct to eliminate from the balance sheet all effects of the specialized practices followed while applying Statement 71, the cost of doing so, for the practices mentioned in the preceding paragraph, would exceed the benefits derived and that elimination is prohibited by this Statement. Although Mr. Lauver believes it is appropriate for a standard setter to refrain from requiring a conceptually correct solution when costs are judged to exceed benefits, he believes it is inappropriate to preclude a conceptually correct solution in financial statements of an enterprise that concludes that the benefits it perceives will exceed the costs that it alone will bear.

Members of the Financial Accounting Standards Board:

Dennis R. Beresford, *Chairman*
Victor H. Brown
Raymond C. Lauver
James J. Leisenring
C. Arthur Northrop
A. Clarence Sampson
Robert J. Swieringa

Appendix A

EXAMPLES OF THE APPLICATION OF THIS STATEMENT TO SPECIFIC SITUATIONS

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Appendix A: EXAMPLES OF THE APPLICATION OF THIS STATEMENT TO SPECIFIC SITUATIONS

13. This appendix provides examples of the application of this Statement to some specific situations. The examples do not address all possible applications of this Statement.

Assets Recorded Based Solely on Expected Future Revenue to Be Provided by the Regulator

14. Utility A operates solely in one regulatory jurisdiction. At December 31, 19X1, Utility A concludes, based on current market conditions, that it no longer meets the criteria for the application of Statement 71. Utility A's statement of financial position at December 31, 19X1 includes the following items:

a. Deferred purchased power costs (costs of power used for operations in prior periods that were expected to be recovered from customers as a result of an automatic adjustment clause)
b. Deferred costs of abandoned plant (costs for which recovery was being provided through rates)
c. Deferred costs of repairing storm damage.

How should those items be reported at December 31, 19X1?

15. All of those items should be eliminated from the enterprise's statement of financial position when it ceases to apply Statement 71. The resulting charge to income, net of any related tax effects, should be reported as an extraordinary item in the period that includes December 31, 19X1. The enterprise should no longer defer those costs and report them as assets because they could not be reported as assets by enterprises in general. Enterprises in general would report a receivable for those items only if a right to receive payment exists as a result of past events or transactions and regardless of future transactions (such as future sales).

16. For example, a contract between a supplier and a customer for the sale of fuel oil may specify that next year's sales price will be adjusted based on the supplier's current-year cost of fuel oil. Even though it is probable that a future economic benefit (the ability to charge a higher price in the future) will result from the supplier's current-year cost of fuel oil, no asset exists at the end of the current year because the transactions (sales to the customer) that give the supplier control of the benefit are in the future. However, if the contract provides that the customer is obligated to pay additional amounts related to past purchases and regardless of future purchases, the supplier has an asset and it does not matter whether that payment is made in a single amount or when the customer will pay for next year's purchases.

Liabilities Recorded Based Solely on Actions of the Regulator

17. Utility B operates in two regulatory jurisdictions, State 1 and State 2. Forty percent of Utility B's operations are located in State 1 and 60 percent in State 2; system-wide assets, liabilities, and certain gains and losses are allocated 40 percent to State 1 and 60 percent to State 2. At December 31, 19X2, Utility B concludes, based on current and expected future market conditions in State 1, that it no longer meets the criteria for application of Statement 71 to its operations in State 1. No similar conditions exist in State 2, and actions of State 1's regulators are not expected to influence the decisions of regulators in State 2. Utility B's statement of financial position at December 31, 19X2 includes the following items:

Deferred gain on restructuring debt, being amortized for rate-making purposes on an allocated basis by both states	$50,000
Revenues collected subject to refund in prior years in State 1, expected to be refunded through future rates	$75,000

How should those items be reported at December 31, 19X2?

18. The portion of the deferred gain allocable to State 1 (determined in the example to be 40 percent of $50,000, or $20,000), net of any related tax effects, should be eliminated from the enterprise's statement of financial position when it ceases to apply Statement 71 to its operations in State 1. No adjustment should be made for the deferred gain applicable to State 2. The regulatory-created accrual for revenues subject to refund in State 1, net of any related tax effects, should be eliminated. Whether any liability related thereto exists should be determined under generally accepted accounting principles for enterprises in general. For example, amounts that were collected in the current or prior periods for which refunds will be made *regardless of future sales* should continue to be reported as liabilities after application of Statement 71 is discontinued. The credit to income resulting from the above adjustments, net of any related tax effects, should be reported as an extraordinary item in the period that includes December 31, 19X2.

Regulatory-Created Assets Resulting from the Recording of Deferred Income Taxes Not Recognized for Rate Making

19. Utility C operates solely in one regulatory jurisdiction. At June 30, 19X3, Utility C concludes, based on new legislation, that it no longer meets the criteria for application of Statement 71. Utility C had adopted FASB Statement No. 96, Accounting for Income Taxes, in 19X2 and because of applying Statement 71 had recorded a regulatory-created asset of $650,000 for deferred taxes resulting from temporary differences that had not been recognized in the rate-making process but that were expected to be recovered in the future. What reporting is required for that regulatory-created asset?

20. Utility C should eliminate that regulatory-created asset from its statement of financial position when the enterprise ceases to apply Statement 71. The charge to income, net of any related tax effects, should be reported as an extraordinary item in the period that includes June 30, 19X3.

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Appendix B: BASIS FOR CONCLUSIONS

Introduction

21. This appendix summarizes considerations that were deemed significant by members of the Board in reaching the conclusions in this Statement. It includes reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others.

22. An FASB Exposure Draft, *Regulated Enterprises—Accounting for the Discontinuation of Application of FASB Statement No. 71,* was issued for public comment on July 8, 1988. The Board received 81 letters of comment in response to the Exposure Draft. The Board concluded that it could reach an informed decision on the basis of existing information without a public hearing.

Overall Conclusions on the Discontinuation of Application of Statement 71

23. For an enterprise with operations that meet the criteria for application of Statement 71, actions of a regulator may result in the recognition of assets and liabilities because the regulator may specify the amount and timing of recognition of allowable costs for rate-making purposes.

24. The conclusion that the criteria of Statement 71 are no longer met as a result of changes in circumstances is a significant event in terms of financial reporting for an enterprise. An objective of financial reporting is to achieve comparability of accounting information. Paragraph 119 of FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information,* states that this objective "is not to be attained by making unlike things look alike any more than by making like things look different." In this instance, achieving that objective requires reporting the effect of that significant event so that an enterprise that discontinues application of Statement 71 is distinguished from an enterprise that does not.

25. When an enterprise determines that it ceases to meet the criteria for application of Statement 71, assets and liabilities recognized solely because of judgments about the effects of actions of the regulator cease to meet the criteria for recognition. The Board concluded that the change in circumstances that led to the discontinuation of application of Statement 71 should be reported in financial statements. The approach set forth in the Exposure Draft required adjusting the financial statements of the enterprise so that they are comparable, at the date of the change and in future periods, with the financial statements of other enterprises that had never applied Statement 71.

26. Most respondents disagreed with the Exposure Draft's requirement to adjust the amounts recorded as plant, equipment, and inventory to the amounts that would have been recorded had the enterprise never applied Statement 71. The reasons given by those respondents for not adjusting the amounts recorded as plant, equipment, and inventory when discontinuing the application of Statement 71 included (a) viewing the allowance for funds used during construction as an acceptable substitute for interest that would have been capitalized under FASB Statement No. 34, *Capitalization of Interest Cost,* (b) the general notion, as expressed in paragraph 88 of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises,* that "once an asset or liability is recognized, it continues to be measured at the amount initially recognized until an event that changes the asset or liability or its amount occurs and meets the recognition criteria," (c) the precedent that the adoption of Statement 34 by enterprises in general was prospective, and (d) the assertion that the cost of obtaining the information necessary to adjust the amounts recorded as plant, equipment, and inventory exceeded the benefits derived from the adjustments.

27. Other respondents agreed with the Exposure Draft's requirement to adjust the amounts recorded as plant, equipment, and inventory to the amounts that would have been recorded had the enterprise never applied Statement 71. Those respondents viewed the differences in amounts recorded as plant, equipment, and inventory due to application of Statement 71 as no different from the separately identified effects of actions of a regulator recognized as assets and liabilities, such as deferred storm damage costs or deferred gains on reacquired debt. Those respondents agreed that those amounts should be eliminated upon the discontinuation of application of Statement 71.

28. Absent impairment, this Statement does not permit adjustment of the carrying amounts of plant, equipment, and inventory measured and recorded pursuant to Statement 71 when an enterprise discontinues application of Statement 71 to all or a portion of its operations. Some Board members agree that the allowances for funds used during construction were an acceptable substitute for the amounts of interest that would have been capitalized in accordance with Statement 34 and that once an asset is measured and recognized pursuant to generally accepted accounting principles, the cost basis of that asset, absent impairment or the occurrence of other events that change the asset or its amount, should not be adjusted. Other Board members believe that, in principle, the carrying amounts of plant, equipment, and inventory should be adjusted to the amounts that would have been recorded had Statement 71 never been applied but that the cost of determining and removing the allowance for funds used during construction and intercompany profit and of computing the interest that would have been capitalized in accordance with Statement 34 would exceed the benefits derived.

29. The Board considered permitting but not requiring enterprises that discontinue application of Statement 71 to adjust their carrying amounts of plant, equipment, and inventory to the amounts that would have been recorded had Statement 71 never been applied. Some Board members did not believe that adjustments to the carrying amounts of those assets were appropriate absent impairment. Other Board members believed the advantages of prescribing a

consistent method of discontinuing application of Statement 71 were sufficient to outweigh their concern about prohibiting an enterprise from using what those Board members believe to be the conceptually correct approach. For those reasons, this Statement does not permit enterprises that discontinue application of Statement 71 to adjust the carrying amounts of plant, equipment, and inventory to the amounts that would have been recorded had Statement 71 never been applied.

30. In determining the appropriate financial reporting for an enterprise that discontinues application of Statement 71, the Board considered whether the accounting for a change in circumstances should be based on the guidance contained in APB Opinion No. 20, *Accounting Changes.* The Board recognizes that the change from one accounting model to another is an unusual accounting event that is different from a discretionary change in accounting because the former is dictated by changed circumstances. That change is somewhat analogous to a "change in estimate effected by a change in accounting principle," described in paragraphs 11 and 32 of Opinion 20, that is required to be accounted for as a change in estimate. The Board concluded that, because the change in circumstances eliminates the justification for recognizing assets and liabilities whose recognition was based solely on judgments made about the effect of the rate-making process, that change should be reported as a separate component of net income of the period of the change.

31. The discontinuation of application of Statement 71 may, in some circumstances, not meet the criteria for extraordinary items in paragraph 20 of Opinion 30. The Board concluded that extraordinary-item treatment represents a practical and reasonable way to classify the adjustments resulting from the discontinuation of Statement 71 in a statement of operations. This Statement amends Opinion 30 to the extent that classification of the net effect of discontinuing the application of Statement 71 as an extraordinary item is made without regard to the criteria in paragraph 20 of that Opinion.

32. Some respondents asserted that an enterprise that discontinues the application of Statement 71 can justify continued recognition of assets and liabilities arising from the rate-making process because of judgments about the probability of their recovery from or payment to ratepayers. Those assertions were typically based on definitions of assets and liabilities in paragraphs 25 and 35 of FASB Concepts Statement No. 6, *Elements of Financial Statements,* which state:

> Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.
>
> Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. [Footnote references omitted.]

33. Statement 71 recognizes that in certain circumstances the rate-making process provides a link between costs and revenues in one period and revenues in the future. When an enterprise

meets the criteria for the application of Statement 71, the rate-making process can affect the recognition of assets and liabilities. The Board believes that continuing to recognize assets and liabilities based solely on judgments about the rate-making process is not appropriate when an enterprise ceases to meet the criteria for application of Statement 71. After an enterprise ceases to meet the criteria for application of Statement 71, it is in a position comparable to enterprises in a number of industries that are subject to regulation but do not apply Statement 71.

34. For enterprises that cease to meet the criteria for applying Statement 71 and continue to be subject to rate regulation, that regulation is similar to a contractual obligation to sell goods or services in the future at an established price or to other forms of price control. A contract that an enterprise in general believes is probable of generating higher than normal gross profits in the future does not provide a basis for the current recognition of an asset representing the anticipated "excess" gross profits related to that contract, nor does it provide a basis for deferring contract-related costs that would otherwise be charged to expense. Similarly, a contract that is probable of generating a lower than normal gross profit does not create a liability unless the contract meets the criteria of FASB Statement No. 5, *Accounting for Contingencies,* for accrual of a loss contingency.

35. This Statement does not provide detailed guidance for reaching judgments about whether application of Statement 71 should be discontinued. Similarly, Statement 71 does not provide detailed guidance for reaching judgments about whether it is appropriate to apply Statement 71. Because applicability of Statement 71 is and must remain a matter of judgment and because the objectives are clear, the Board decided that it was unnecessary to prescribe detailed guidance for reaching the judgments required by this Statement and by Statement 71.

36. Some respondents asked that this Statement define the term *costs* as it is used in the examples in paragraph 4. Some respondents argued it should be defined as "allowable costs" and other respondents argued it should be defined as "incurred costs." The term *costs* is used in paragraph 4 of this Statement consistent with its usage in paragraph 5 of Statement 71. As explained in paragraph 67 of the Basis for Conclusions to Statement 71, the term costs in paragraph 5 of Statement 71 is based on allowable costs.

Application of Overall Conclusions to Specific Items

37. The Board concluded that the approach required by this Statement would be easier to understand and implement with examples. Therefore, an appendix with examples is included.

38. The Exposure Draft included a reference to the use of estimates, averages, and computational shortcuts when implementing its provisions because of its requirement to adjust fixed assets to the amounts that would have been recorded had Statement 71 never been applied. This Statement requires significantly fewer adjustments to fixed assets than the approach in the Exposure Draft, and the Board concluded that the specific reference to the use of estimates, averages, and computational shortcuts was unnecessary.

39. Some respondents to the Exposure Draft disagreed with its application to "separable portions" of an enterprise's operation, and other respondents suggested that a separable portion of an enterprise should be no less than an enterprise's operations within a regulatory jurisdiction or a reportable segment as defined in FASB Statement No. 14, *Financial Reporting for Segments of a Business Enterprise.* Those respondents stated that discontinuing application of Statement 71 for a portion of an enterprise's operations or a portion of an enterprise's operations within a regulatory jurisdiction would not be meaningful and could be confusing to preparers and users of the financial statements. Other respondents agreed with discontinuing application of Statement 71 for separable portions of an enterprise's operations and indicated that this was consistent with the application of Statement 71. Paragraph 6 of Statement 71 states:

> If some of an enterprise's operations are regulated and meet the criteria of paragraph 5, this Statement shall be applied to only that portion of the enterprise's operations.

40. This Statement does not modify paragraph 6 of Statement 71. Statement 71 is applied to separable portions of an enterprise's operations, and therefore the discontinuation of application of Statement 71 should be applied to separable portions of an enterprise's operations. The separable portion may be an enterprise's operations within a regulatory jurisdiction or a smaller portion (such as a customer class within a regulatory jurisdiction), either of which could require the allocation of system-wide assets and liabilities.

41. This Statement does not modify FASB Statement No. 90, *Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs.* If the substance of the actions of the regulator for a separable portion of an enterprise's operations is an explicit, but indirect, disallowance of costs of a recently completed plant, that disallowance should be accounted for as prescribed by Statement 90. The application of Statement 71, as amended, is not optional. An enterprise's operations that meet the criteria for application of Statement 71 are required to be reported consistent with Statement 71, and an enterprise whose operations cease to meet the criteria for application of Statement 71 is required to discontinue application of Statement 71 as prescribed in this Statement.

42. This Statement requires that the carrying amounts of the plant, equipment, and inventory measured and recorded pursuant to Statement 71 not be adjusted unless those assets are impaired. Paragraph 7 of Statement 71 states:

> Authoritative accounting pronouncements that apply to enterprises in general also apply to regulated enterprises. However, enterprises subject to this Statement shall apply it instead of any conflicting provisions of standards in other authoritative pronouncements. [Footnote reference omitted.]

The carrying amounts of plant, equipment, and inventory for enterprises applying Statement 71 differ from those for enterprises in general only because of the allowance for funds used during construction, intercompany profit, and disallowances of costs of recently completed plants. If any other amounts that would not be includable in the carrying amounts of plant, equipment, or inventory by enterprises in general are included in or netted against the carrying amounts of plant, equipment, and inventory, those amounts should be separated from the carrying amounts of plant, equipment, and inventory and accounted for as prescribed in this Statement. For example, postconstruction operating costs that were capitalized pursuant to paragraph 9 of Statement 71 represent the effects of actions of a regulator regardless of their classification in the financial statements and should be accounted for as this Statement prescribes for the effects of actions of a regulator. Another example of the effect of actions of a regulator that would require adjustment is the cumulative difference, if any, between recorded depreciation and depreciation computed using a generally accepted method of depreciation.

43. Several respondents requested that this Statement address the accounting for reapplication of Statement 71 by an enterprise that had previously discontinued application of Statement 71 for all or a portion of its operations. The Board noted that the accounting for the initial application of Statement 71 has not been raised as an issue that needs to be addressed by the Board. In addition, some Board members believe that circumstances warranting reapplication of Statement 71 will occur rarely, if at all. The Board concluded that the accounting for the initial application or reapplication of Statement 71 is beyond the scope of this Statement.

44. Several respondents suggested that this Statement should require disclosures about the discontinuation of application of Statement 71, such as disclosing the reasons for the discontinuation and the portions of the enterprise's operations that do and do not apply Statement 71. In addition, for enterprises that discontinue application of Statement 71 but continue to be subject to rate regulation, some respondents suggested that the Statement require disclosure of the rate-making concepts used by the regulator and the factors that are considered in establishing rates and, to the extent that past events will be reflected in future prices, identify and quantify those regulatory actions.

45. The Board concluded that disclosure of the reasons for discontinuing application of Statement 71 and disclosure of the portion of an enterprise's operations for which the application of Statement 71 is being discontinued would provide useful information; therefore, this Statement requires disclosure of that information. The Board concluded that it would not be appropriate to require disclosure of the effects of regulation for enterprises that discontinue application of Statement 71 but continue to be subject to regulation without addressing disclosure requirements for enterprises that have never applied Statement 71 but are subject to regulation. However, the Board encourages disclosures about the discontinuation of application of Statement 71 and the nature and effects of continuing regulation that would make the financial statements more informative and meaningful.

Effective Date and Transition

46. The Board considered whether this Statement should be applied retroactively to all enterprises that have previously discontinued application of Statement 71. The Board recognized that applying this Statement only to future discontinuations would diminish both comparability of financial statements among enterprises that have discontinued application of Statement 71 using different methods and consistency within an enterprise that reports discontinuations for portions of its operations in different periods using different methods. Although requiring restatement would increase comparability among companies discontinuing application of Statement 71 and consistency within a few enterprises that have previously discontinued the application of Statement 71 to a portion of their operations during fiscal years ending before December 15, 1988, the Board believes that those benefits do not justify the costs that would be incurred. Therefore, the Board decided that application of this Statement should be required for discontinuations occurring in annual periods ending after that date, with retroactive application to previously reported discontinuations permitted but not required. In no event should the interim or annual financial statements for periods that ended prior to the date of discontinuation of application of Statement 71 be restated.

47. Some respondents requested a delay of the effective date or a transition period to allow affected enterprises the time necessary to compute the effect of the discontinuation of application of Statement 71 pursuant to this Statement and, if necessary, time to resolve problems created by the accounting required by this Statement for loan indentures or other agreements. The Board believes that because plant, equipment, and inventory are not required to be restated for certain items as was required in the Exposure Draft, it would be rare that an enterprise would cease to meet the criteria for application of Statement 71 and would not know the accounting effect of the discontinuation. However, the Board concluded, primarily because this Statement is being issued late in the year in which it becomes effective, to allow for a delay in its required adoption.

Footnotes

FAS101, Footnote 1--The carrying amounts of plant, equipment, and inventory for enterprises applying Statement 71 differ from those for enterprises in general only because of the allowance for funds used during construction, intercompany profit, and disallowances of costs of recently completed plants. If any other amounts that would not be includable in the carrying amounts of plant, equipment, or inventory by enterprises in general (such as postconstruction operating costs capitalized pursuant to paragraph 9 of Statement 71) are included in or netted against the carrying amounts of plant, equipment, or inventory, those amounts shall be accounted for as this Statement prescribes for the effects of actions of a regulator.