Statement of Financial Accounting Standards No. 92

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Regulated Enterprises—Accounting for Phase-in Plans

an amendment of FASB Statement No. 71

August 1987

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 MERRITT 7, P.O. BOX 5116, NORWALK, CONNECTICUT 06856-5116

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FAS 92 Summary

This Statement amends FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, to specify the accounting for phase-in plans.

When a utility completes a new plant, conventional rate-making methods establish rates to recover the allowable costs of the plant. Those allowable costs include current operating costs, depreciation, interest on borrowed funds invested in the plant, and an allowance for earnings for the utility (an amount intended to represent a fair return on shareholders' investment in the plant).

The cost of electric utilities' plants constructed in recent years has been much greater than the cost of those completed in earlier years, so that, for some utilities, conventional rate-making methods would result in significantly increased rates when a newly completed plant goes into service. In such cases, some regulators have adopted phase-in plans to moderate the initial rate increase. The objective of those plans is to increase rates more gradually than would be the case under conventional rate making, while providing the utility eventual recovery of all of its allowable costs and a return on investment.

This Statement requires allowable costs deferred for future recovery under a phase-in plan related to plants completed before January 1, 1988 and plants on which substantial physical construction has been performed before January 1, 1988 to be capitalized if each of four criteria is met. Those criteria are (a) the plan has been agreed to by the regulator, (b) the plan specifies when recovery will occur, (c) all allowable costs deferred under the plan are scheduled for recovery within 10 years of the date when deferrals begin, and (d) the percentage increase in rates scheduled for each future year under the plan is not greater than the percentage increase in rates scheduled for each immediately preceding year. If any of those criteria is not met, allowable costs deferred under the plan would not be capitalized. Instead, those costs would be recognized in the same manner as if there were no phase-in plan.

This Statement also reiterates that Statement 71 does not permit an allowance for earnings on shareholders' investment to be capitalized in general-purpose financial statements when it is capitalized for rate-making purposes other than during construction and, with this Statement, as part of a phase-in plan.

This Statement is effective for fiscal years beginning after December 15, 1987, and it applies to existing and future phase-in plans. Application of this Statement to phase-in plans that do not meet the criteria of this Statement will be delayed if the regulated enterprise has filed a rate application to have those phase-in plans modified to meet the criteria of this Statement or intends to do so as soon as practicable and it is reasonably possible that the rate application will be successful. In that case, this Statement will be applied to those phase-in plans when the regulator amends or refuses to amend those plans.

INTRODUCTION

1. FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, was issued in December 1982. Shortly after the Statement was issued, major events in the electric utility industry caused the Board to review the effects of the Statement on the accounting for those events. After that review, the Board decided to amend Statement 71 to provide more specific guidance on the accounting for some of those events and to change the accounting for others.

2. FASB Statement No. 90, *Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs*, addresses the accounting for some of those events. This Statement amends Statement 71 to specify the accounting for phase-in plans.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Accounting for Phase-in Plans

3. The term *phase-in plan* is used in this Statement to refer to any method of recognition of allowable costs [1] in rates that meets all of the following criteria:

a. The method was adopted by the regulator in connection with a major, newly completed plant of the regulated enterprise or of one of its suppliers or a major plant scheduled for completion in the near future (hereinafter referred to as "a plant").
b. The method defers the rates intended to recover allowable costs beyond the period in which those allowable costs would be charged to expense under generally accepted accounting principles applicable to enterprises in general.
c. The method defers the rates intended to recover allowable costs beyond the period in which those rates would have been ordered under the rate-making methods routinely used prior to 1982 by that regulator for similar allowable costs of that regulated enterprise.

4. If a phase-in plan is ordered by a regulator in connection with a plant on which no

substantial physical construction had been performed before January 1, 1988, none of the allowable costs that are deferred for future recovery by the regulator under the plan [2] for rate-making purposes shall be capitalized for general-purpose financial reporting purposes (hereinafter referred to as "financial reporting").

5. If a phase-in plan is ordered by a regulator in connection with a plant completed before January 1, 1988 or a plant on which substantial physical construction had been performed before January 1, 1988, the criteria specified below shall be applied to that plan. If the phase-in plan meets all of those criteria, all allowable costs that are deferred for future recovery by the regulator under the plan shall be capitalized for financial reporting as a separate asset (a deferred charge). If any one of those criteria is not met, none of the allowable costs that are deferred for future recovery by the regulator under the plan [3] shall be capitalized for financial reporting. The criteria to determine whether capitalization is appropriate are:

a. The allowable costs in question are deferred pursuant to a formal plan hat has been agreed to by the regulator.
b. The plan specifies the timing of recovery of all allowable costs that will be deferred under the plan.
c. All allowable costs deferred under the plan are scheduled for recovery within 10 years of the date when deferrals begin.
d. The percentage increase in rates scheduled under the plan for each future year is no greater than the percentage increase in rates scheduled under the plan for each immediately preceding year. That is, the scheduled percentage increase in year two is no greater than the percentage increase granted in year one, the scheduled percentage increase in year three is no greater than the scheduled percentage increase in year two, and so forth.

Modifications of and Supplements to Phase-in Plans

6. Except as provided in paragraph 18 of this Statement, when an existing phase-in plan is modified or a new plan is ordered to replace or supplement an existing plan, the above criteria shall be applied to the combination of the original plan and the new plan. The date when deferrals begin, used in applying the criterion in paragraph 5(c), would be the date of the earliest deferral under either the new or the old plan, and the final recovery date would be the date of the last recovery of all amounts deferred under the plans.

Interrelationship of Phase-in Plans and Disallowances

7. A phase-in plan, as defined in paragraph 3, is a method of rate making intended to moderate a sudden increase in rates while providing the regulated enterprise with recovery of its investment and a return on that investment during the recovery period. A disallowance is a rate-making action that prevents the regulated enterprise from recovering either some amount of its investment or some amount of return on its investment. Statement 90 specifies the accounting for disallowances of plant costs. If a method of rate making that meets the criteria of this

Statement for a phase-in plan includes an indirect disallowance of plant costs, that disallowance shall be accounted for in accordance with Statement 90.

Allowance for Earnings on Shareholders' Investment Capitalized for Rate-making Purposes

8. If specified criteria are met, paragraph 9 of Statement 71 requires capitalization of an incurred cost that would otherwise be charged to expense. An allowance for earnings on shareholders' investment [4] is not "an incurred cost that would otherwise be charged to expense." Accordingly, such an allowance shall not be capitalized pursuant to paragraph 9 of Statement 71.

9. In specified circumstances, paragraph 15 of Statement 71 requires capitalization of an allowance for earnings on shareholders' investment (a designated cost of equity funds) during construction. Paragraph 5 of this Statement requires capitalization of an allowance for earnings on shareholders' investment for qualifying phase-in plans. If an allowance for earnings on shareholders' investment is capitalized for rate-making purposes other than during construction or as part of a phase-in plan, the amount capitalized for rate-making purposes shall not be capitalized for financial reporting.

Financial Statement Classification of Amounts Capitalized under Phase-in Plans

10. Cumulative amounts capitalized under phase-in plans shall be reported as a separate asset in the balance sheet. The net amount capitalized in each period or the net amount of previously capitalized allowable costs recovered during each period shall be reported as a separate item of other income or expense in the income statement. Allowable costs capitalized shall not be reported as reductions of other expenses.

Disclosure

Phase-in Plans

11. The terms of any phase-in plans in effect during the year or ordered for future years shall be disclosed. This Statement does not permit capitalization for financial reporting of allowable costs deferred for future recovery by the regulator pursuant to a phase-in plan that does not meet the criteria of paragraph 5 of this Statement or a phase-in plan related to a plant on which substantial physical construction was not completed before January 1, 1988. Nevertheless, the financial statements shall include disclosure of the net amount deferred at the balance sheet date for rate-making purposes and the net change in deferrals for rate-making purposes during the year for those plans.

Allowance for Earnings on Shareholders' Investment Capitalized for Rate-making Purposes

12. The nature and amounts of any allowance for earnings on shareholders' investment

capitalized for rate-making purposes but not capitalized for financial reporting shall be disclosed.

Amendments to Existing Pronouncements

13. This Statement amends Statements 71 and 90 as follows:

a. The following sentence is added to the end of the footnote, added by paragraph 9(b) of Statement 90, at the end of the first sentence of paragraph 9 of Statement 71:

> Phase-in plans shall be accounted for in accordance with FASB Statement No. 92, *Regulated Enterprises—Accounting for Phase-in Plans*.

b. Paragraph 13 of Statement 71, as amended by Statement 90, is superseded by the following:

> Appendix B, Statement 90, and Statement 92 illustrate the accounting for the effects of regulation.

c. Paragraph 14 of Statement 71 is superseded by the following:

> The following specific standards and the standards in Statements 90 and 92 are derived from the general standards in paragraphs 9-12. The specific standards in paragraphs 15-17 and the standards in Statement 90 and Statement 92 shall not be used as guidance for other applications of the general standards in paragraphs 9-12.

d. Paragraph 9(d) of Statement 90 is deleted.

Effective Date and Transition

14. Except as provided in paragraph 17 below, this Statement shall be effective for fiscal years beginning after December 15, 1987 and interim periods within those fiscal years. Earlier application is encouraged. At the date of initial application of this Statement, existing phase-in plans shall be evaluated under the criteria of paragraph 5 of this Statement. If those existing plans do not meet those criteria, all allowable costs deferred by the regulator under those phase-in plans [5] that have previously been capitalized shall be written off. The provisions of this Statement that address capitalization of an allowance for earnings on shareholders' investment other than during construction or as part of a phase-in plan (paragraphs 8 and 9) shall not be applied to amounts capitalized in fiscal years prior to the initial application of this Statement.

15. Retroactive application of the provisions of this Statement that address accounting for phase-in plans (paragraphs 5-7, 10, and 11), in fiscal years for which financial statements have previously been issued, is permitted. If those provisions are applied retroactively, the financial

statements of all prior periods presented shall be restated. In addition, the restated financial statements shall, in the year this Statement is first applied, disclose the nature of any restatement and its effect on income before extraordinary items, net income, and related per share amounts for each period presented and on retained earnings at the beginning of the earliest period presented.

16. If financial statements for prior fiscal years are not restated as permitted by paragraph 15, the effects of applying this Statement to existing phase-in plans shall be reported as the cumulative effect of a change in accounting principle, as described in APB Opinion No. 20, *Accounting Changes*, and the effect of adopting this Statement on income before extraordinary items, net income, and related per share amounts shall be disclosed.

17. Application of this Statement to an existing phase-in plan shall be delayed if both of the following conditions are met:

a. The enterprise has filed a rate application to have the plan amended to meet the criteria of paragraph 5 of this Statement or it intends to do so as soon as practicable.
b. It is reasonably possible that the regulator will change the terms of the phase-in plan so that it will meet the criteria of paragraph 5 of this Statement.

If those conditions are met, the provisions of this Statement shall be applied to that existing phase-in plan on the earlier of the date when one of those conditions ceases to be met or the date when a final rate order is received, amending or refusing to amend the phase-in plan. However, if the enterprise delays filing its application for the amendment or the regulator does not process that application in the normal period of time, application of this Statement shall not be further delayed.

18. In applying the criteria of paragraph 5 to a plan that was in existence prior to the first fiscal year beginning after December 15, 1987 and that was revised to meet the criteria of this Statement pursuant to paragraph 17 above, the 10-year criterion (paragraph 5(c)) and the requirement that the percentage increase in rates scheduled under the plan in each future year be no greater than the percentage increase scheduled under the plan for each immediately preceding year (paragraph 5(d)) shall be measured from the date of the amendment rather than from the date of the first scheduled deferrals under the original plan.

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

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

Mr. Lauver dissents from the issuance of this Statement because it permits including in income an imputed allowance for earnings on shareholders' investment during a phase-in period.

He believes that accounting is inappropriate on conceptual grounds because the allowance should be included in income only at the time it is a component of prices charged to customers for services.

Further, he believes it is unwise policy, in the present environment, to authorize special accounting during a phase-in period. Phase-in plans are instigated because rates that would otherwise be charged are unacceptable to customers. Whatever might have been the case in a prior era, evidence now abounds, in the form of disallowances, temporary or indefinite omission of costs from rate base, competition, actual and planned deregulation, and inability to earn allowed rates of return, that the relationship between present costs and future revenues is too tenuous to warrant accounting predicated on the assumption that the marketplace will accept charges tomorrow that it finds unacceptable today.

Mr. Lauver also dissents to the issuance of this Statement because it does not require elimination from balance sheets of certain amounts capitalized as an allowance for earnings on shareholders' investment even though not in compliance with unambiguous provisions of Statement 71 that have been reiterated in this Statement and even though inconsistent with the accounting required for nonqualifying phase-in plans. He believes it is unwise policy to grant an amnesty-like approval of accounting that was determined to be inappropriate in both Statement 71 and this Statement.

Members of the Financial Accounting Standards Board:

Dennis R. Beresford, *Chairman*
Victor H. Brown
Raymond C. Lauver
David Mosso
C. Arthur Northrop
Robert J. Swieringa
Arthur R. Wyatt

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

19. This appendix provides guidance for application of this Statement to some specific situations. The guidance does not address all possible applications of this Statement. All examples assume that the enterprise meets the criteria of paragraph 5 of Statement 71 for the application of Statement 71 by the enterprise.

20. Specific situations discussed in this appendix are:

Accounting for a Phase-in Plan That Includes an Indirect Disallowance

21. Utility A is an electric utility that operates solely in a single-state jurisdiction. On January 1, 19X1, Utility A's new electric generating plant becomes operational. The cost of that plant is $1 billion.

22. Utility A's regulator orders that the costs of the newly completed plant be phased in over a three-year period, as follows:

19X1—A portion of the return (interest and an allowance for earnings on shareholders' investment) on unrecovered investment is deferred by excluding 25 percent of the cost of the plant from the rate base.

19X2—All of the remaining cost of the plant is to be included in the rate base with no recovery of previously deferred amounts.

19X3—All of the remaining cost of the plant is to be included in the rate base. Also, additional revenue is to be provided equal to the return on unrecovered investment excluded from rates in year 1.

The order does not provide for recovery in any year of a return on Utility A's investment in the deferred amounts. Utility A's weighted-average cost of capital in its latest rate case was 11 percent.

23. The phase-in plan is partially a disallowance of plant costs because no return on investment is provided for the deferred amounts. That disallowance should be recognized in accordance with Statement 90 when it became probable. The amount of equivalent cost disallowed should be determined as shown in Schedule 1. The recorded cost of the plant should be reduced by that amount, and a corresponding loss should be reported in 19X1.

Schedule 1

Utility A
Determination of Effective Disallowance
Return on Investment Disallowed for Amounts Deferred under Phase-in Plan
(in thousands)

	(1)	(2)	(3)	(4)
Month	Cost Deferral (Recovery)	Cumulative Amount Deferred	R.O.I. on Cumulative Deferral	Effective Disallowance
1	$ 2,292	$ 2,292	$ 21	$ 0
2	2,291	4,583	42	21
3	2,292	6,875	63	41
4	2,292	9,167	84	61
5	2,291	11,458	105	80
6	2,292	13,750	126	99
7	2,292	16,042	147	118
8	2,291	18,333	168	137
9	2,292	20,625	189	155
10	2,292	22,917	210	173
11	2,291	25,208	231	190
12	2,292	27,500	252	207
13	0	27,500	252	224
14	0	27,500	252	222
15	0	27,500	252	220
16	0	27,500	252	218
17	0	27,500	252	216
18	0	27,500	252	214
19	0	27,500	252	212
20	0	27,500	252	210
21	0	27,500	252	208
22	0	27,500	252	206
23	0	27,500	252	204
24	0	27,500	252	202
25	(2,292)	25,208	231	201
26	(2,291)	22,917	210	182

27	(2,292)	20,625	189	164
28	(2,292)	18,333	168	146
29	(2,291)	16,042	147	129
30	(2,292)	13,750	126	112
31	(2,292)	11,458	105	95
32	(2,291)	9,167	84	78
33	(2,292)	6,875	63	62
34	(2,292)	4,583	42	46
35	(2,291)	2,292	21	31
36	(2,292)	0	0	15
Total loss to be recognized in 19X1				$5,099

Computations:
Column (1)—Cost of plant ($1 billion) × .25 × 11% ÷ 12
Column (2)—Column (2) for prior month + Column (1) for current month
Column (3)—Column (2) × 11% ÷ 12
Column (4)—Present value (at beginning of month 1) at 11% (.9167 per month) of amount in Column (3) for prior month

24. The disallowance will reduce revenues only in years 1 through 3, so the depreciation charge that would otherwise be recognized for that plant in years 1 through 3 should be reduced by the amount of the effective disallowance attributable to those years (the amount in column 4 of Schedule 1). Amounts deferred under the plan (the amount for months 1-12 in column 1 of Schedule 1) should be capitalized as a separate asset, and that asset should be amortized as recovery occurs (in months 25-36), using the amounts in column 1 of Schedule 1.

Application of the Definition of a Phase-in Plan

"Mirror CWIP"

25. "Mirror CWIP" is one means of moderating the sudden, one-time increase in rates that would otherwise result from placing a newly completed utility plant in service. Under "mirror CWIP," increasing amounts of construction work in progress (CWIP) are included in the current rate base in the periods before the plant goes into service, providing the utility with a current return on a portion of its investment in construction while the construction proceeds. After the plant is placed in service, a decreasing amount of plant-in-service is excluded from the rate base each year, "mirroring" the pattern in which the construction was included in the rate base. The result of this procedure is to increase rates while the plant is under construction and to reduce the increase in rates in the initial years of the plant's service life.

26. For rate-making purposes, no allowance for funds used during construction is recognized on the portion of the construction that is included in the rate base while the asset is under construction, and an allowance for funds used during construction is recognized on the portion of the plant-in-service that is subsequently excluded from the rate base after the plant is placed in service. The same total amount is capitalized as if no construction had been included in the

current rate base. Is "mirror CWIP" a phase-in plan under the definition of this Statement? What financial reporting is appropriate for a "mirror CWIP" plan?

27. The "mirror CWIP" arrangement described above is not a phase-in plan under the definition used in this Statement because it does not defer recovery of costs that would not have been deferred under the methods of rate making used prior to 1982. Rather, it effectively provides a temporary loan from customers to the utility during construction and requires repayment of that loan after the plant is placed in service.

28. If the arrangement is known to be a "mirror CWIP" arrangement at the time of the construction (for example, if that arrangement is required by law or has been specifically ordered by the regulator), an allowance for funds used during construction should be accrued on the total cumulative construction cost in each period for financial reporting. The revenue collected as a result of inclusion of construction in the current rate base should be recorded as a liability to customers, with disclosure of the approximate timing of the repayment that will be required under the "mirror CWIP" arrangement.

29. If the arrangement is not known to be a "mirror CWIP" arrangement when the construction is included in the rate base but the regulator later orders a "mirror CWIP" arrangement, the accounting described in paragraph 28 should be implemented as soon as the nature of the arrangement becomes known. That will require an adjustment for the cumulative effect of the arrangement to date. An amount should be capitalized, with a corresponding accrual of an allowance for funds used during construction, when the "Mirror CWIP" arrangement becomes known. Current revenues should be reduced by an equal amount, and a corresponding liability to customers should be recognized. That amount should be the amount that would have been capitalized if the arrangement had been known to be a "mirror CWIP" arrangement when the revenue was collected during construction. That capitalized amount should be reported in the year in which the "mirror CWIP" arrangement becomes known in the same manner as if it had been capitalized during construction.

Sale with Leaseback—Capital Lease

30. Utility B sells its interest in a newly completed electric generating plant for an amount equal to its cost and leases that interest back under a lease that requires equal annual payments. The sale meets the criteria of FASB Statement No. 66, *Accounting for Sales of Real Estate*, for recognition as a sale, and the leaseback meets the criteria of FASB Statement No. 13, *Accounting for Leases*, for a capital lease. Utility B's regulator includes the lease rentals in allowable cost as they accrue. In the past, Utility B's regulator has treated other leases entered into by Utility B in the same manner, but those leases were for much less significant items of equipment—not for an interest in an electric generating plant. Is this rate-making method a phase-in plan under the definition in this Statement?

31. The rate-making method described is a phase-in plan under the definition in this Statement. Generally accepted accounting principles applicable to enterprises in general require

a capital lease to be accounted for much like a purchase of the leased property. The resulting expense related to the lease consists of interest on the remaining lease obligation and depreciation based on the method used for similar owned property. In the early years of a lease, the lease rentals included in allowable cost as they accrue are significantly less than the sum of interest on the lease obligation and depreciation on the leased asset. Thus, significant deferrals will result. The method also defers recognition of expenses compared with the methods of expense recognition used by Utility B's regulator for similar assets of Utility B prior to 1982 because Utility B's interests in electric generating plants were included in allowable costs in the past based on current provisions for depreciation and for the cost of capital invested in the plants. The use of this rate-making method in the past for leases of equipment does not change this conclusion. The definition is based on the method of rate making used prior to 1982 for similar allowable costs. Similar allowable costs would be those resulting from electric generating plants.

Sale with Leaseback—Operating Lease

32. Utility C sells its interest in a newly completed electric generating plant for an amount equal to its cost and leases that interest back under a lease that requires equal annual payments. The sale meets the criteria of Statement 66 for recognition as a sale, and the leaseback meets the criteria of Statement 13 for an operating lease. Utility C's regulator includes the lease rentals in allowable cost as they accrue. In the past, Utility C's regulator has treated other leases entered into by Utility C in the same manner, but those leases were not for an interest in an electric generating plant. Is this rate-making method a phase-in plan under the definition in this Statement?

33. The rate-making method applied to Utility C is not a phase-in plan under the definition in this Statement because it recognizes rent expense for rate-making purposes in the same way as that expense would be recognized for enterprises in general for this type of lease.

Sale with Leaseback—Profit Recognition Accelerated

34. Utility D sells its interest in a 5-year-old electric generating plant for an amount that exceeds its undepreciated cost by $500,000 and leases that interest back. The leaseback term is 20 years, and there are no renewal options. The sale meets the criteria of Statement 66 for recognition as a sale with full profit recognition, and the leaseback meets the criteria of Statement 13 for an operating lease. Utility D's regulator includes the lease rentals in allowable cost as they accrue and orders Utility D to amortize the profit, for rate-making purposes, over 10 years. The sale occurred at a time when Utility D was about to place a newly completed plant in service. Utility D has not had any similar transactions in the past. Is this rate-making method a phase-in plan under the definition in this Statement?

35. The rate-making method described is a phase-in plan under the definition in this Statement. Generally accepted accounting principles applicable to enterprises in general require

a profit on a sale-leaseback transaction to be amortized over the term of the leaseback. Amortization of that profit, for rate-making purposes, over 10 years when generally accepted accounting principles applicable to enterprises in general require amortization over the 20-year leaseback term is equivalent to a deferral of allowable costs. In view of the timing of the rate order on the sale-leaseback transaction, the presumption is that the order was issued in connection with the newly completed plant. The method cannot be compared with methods in use prior to 1982 because Utility D has had no previous transactions of this type.

Modified Depreciation Method

36. Utility E's regulator orders it to depreciate its new electric generating plant, for rate-making purposes, by using an annuity method. Under the method ordered, depreciation increases each year so that the total of depreciation and return on investment stays approximately level over the life of the plant. In the past, Utility E's regulator required the use of straight-line depreciation for electric generating plants. Is this rate-making method a phase-in plan under the definition in this Statement?

37. The rate-making method applied to Utility E is a phase-in plan under the definition in this Statement because (a) it defers depreciation expense compared with the depreciation methods that are acceptable under generally accepted accounting principles applicable to enterprises in general (annuity methods of depreciation are not acceptable under generally accepted accounting principles applicable to enterprises in general) and (b) it defers depreciation expense compared with the method of depreciation used by Utility E's regulator for Utility E's electric generating plants prior to 1982.

Deferral of Costs Before a Rate Order Is Issued

38. Utility F completes construction of a nuclear generating plant and places that plant in service. Utility F's regulator decides that it will complete its examination of the prudence of Utility F's construction cost before rates are adjusted to reflect the cost of operating the plant. During the examination and until rates are adjusted, the regulator orders Utility F to capitalize its net cost of operating the plant (operating costs, depreciation, allocable interest cost, and an allowance for earnings on shareholders' investment, all net of savings that result from operation of the new plant). Is the resulting deferral for rate-making purposes a phase-in plan? What accounting is required for financial reporting?

39. The resulting deferral is not a phase-in plan. The regulator's order to capitalize an amount pending completion of a rate hearing is designed to protect the utility from the effects of regulatory lag [6] in the absence of a rate order—a routine procedure on the part of regulators. The definition of a phase-in plan in this Statement is not intended to encompass actions of a regulator that are designed to protect a utility from the effects of regulatory lag in the absence of a rate order, nor is it intended to encompass the regulator's subsequent treatment of any allowable costs that result from those actions.

40. Under paragraph 9 of Statement 71, Utility F should capitalize that portion of the amount capitalized for rate-making purposes that represents incurred costs that would otherwise be charged to expense, provided that it is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of those costs in allowable costs for rate-making purposes. Otherwise, Utility F should not capitalize those costs.

41. Since the situation in this example is neither during construction nor a phase-in plan, Statement 71 does not permit capitalization of an allowance for earnings on shareholders' investment. Accordingly, Utility F should not capitalize, for financial reporting, the portion of the amount capitalized for rate-making purposes that represents an allowance for earnings on shareholders' investment. If recovery of that allowance subsequently occurs, increased earnings during the recovery period will result.

Interaction of Disallowance with Deferral of Costs Before a Rate Order Is Issued

42. Six months after the accounting order referred to in the previous example, Utility F's regulator approves part of the cost of the new plant but disallows $600,000,000—consisting of construction expenditures of $570,000,000 and amounts capitalized for rate-making purposes during this 6-month operating period prior to the rate order of $30,000,000. The recorded cost of the plant before consideration of the disallowance is $4,500,000,000. During this 6-month period, Utility F has capitalized $500,000,000 of net cost for rate-making purposes. This $500,000,000 consists of an allowance for earnings on shareholders' investment of $200,000,000 and incurred costs that would otherwise be charged to expense of $300,000,000. For rate-making purposes, the balance sheet accounts, before and after the disallowance, are as follows:

	Balance before Disallowance	**Disallowance (in thousands)**	**Balance after Disallowance**
Plant in Service	$4,500,000	$(570,000)	$3,930,000
Amounts Capitalized Pending Rate Order	500,000	(30,000)	470,000
Combined totals	$5,000,000	$(600,000)	$4,400,000

For financial reporting, how should the disallowance be recognized?

43. Statement 90 requires a disallowance of plant costs to be recognized as a loss. Utility F should perform the following analysis to determine the loss that should be recognized and how it will be allocated:

a. Assuming that $300,000,000 of the $500,000,000 capitalized for rate-making purposes during the 6-month period was also capitalized for financial reporting (the $200,000,000 allowance for earnings on shareholders' investment would not be capitalized), the total loss recognized by Utility F for financial reporting should be the amount that reduces the combined total of Plant in Service and Amounts Capitalized Pending Rate Order ($4,800,000,000) to the combined total that will be honored for rate-making purposes ($4,400,000,000). The recognizable loss is $400,000,000.

b. Utility F should allocate to Plant in Service the lesser of the amount of the disallowance that was allocated to Plant in Service by the regulator ($570,000,000) or the total disallowance recognized for financial reporting ($400,000,000), or $400,000,000.

c. Utility F should allocate the rest of the disallowance recognized for financial reporting, if any, to Amounts Capitalized Pending Rate Order. In this case, no amount is allocated to that asset.

The recognition of the disallowance and the effect of that recognition on the financial reporting balance sheet accounts are as follows:

	Balance before Disallowance	**Recognition of Disallowance (in thousands)**	**Balance after Disallowance**
Plant in Service	$4,500,000	$(400,000)	$4,100,000
Amounts Capitalized Pending Rate Order	300,000		300,000
Combined totals	$5,000,000	$(400,000)	$4,400,000

Interaction of Deferral of Costs Before a Rate Order Is Issued with a Subsequent Phase-in Plan

44. Utility G's fact situation is identical to that of Utility F, described in the above examples, except that Utility G's regulator approves all of the costs related to the newly completed plant. Utility G's regulator adopts a formal phase-in plan intended to provide recovery of amounts deferred under the plan and amounts capitalized, for rate-making purposes, during the six-month period from the plant's in-service date to the date of the rate order. How does the phase-in plan affect the financial reporting of the costs deferred during the six-month period?

45. The phase-in plan does not affect the financial reporting of those previously deferred costs described in paragraphs 40 and 41, nor does the existence of those previously deferred costs affect the financial reporting of the phase-in plan. Accordingly, the allowance for earnings on shareholders' investment that was not capitalized previously during the period preceding issuance of the rate order may not be capitalized upon adoption of the phase-in plan.

Appendix B

BASIS FOR CONCLUSIONS

CONTENTS

Appendix B: BASIS FOR CONCLUSIONS

Introduction

46. 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.

Definition of Phase-in Plans

47. This Statement specifies a phase-in plan definition different from that specified in the December 19, 1985 Exposure Draft, *Regulated Enterprises—Accounting for Phase-in Plans, Abandonments, and Disallowances of Plant Costs*. Comments received on the definition in the Exposure Draft indicated that (a) the definition might encompass some methods of rate making that had been routinely followed for years, (b) the definition could be interpreted to encompass some methods of expense recognition that are accepted for enterprises in general, and (c) the definition was considered ambiguous for phase-in plans related to a supplier's newly completed plant. The Board adopted the definition in this Statement to avoid those problems. The definition now focuses on methods of rate making that defer recognition of allowable costs that would not be deferred under generally accepted accounting principles applicable to enterprises in general and that defer recognition of allowable costs that would not have been deferred by a regulator under the methods of rate making used by that regulator for that same utility in the past.

Accounting for Phase-in Plans

Origin and Nature of Phase-in Plans

48. When a utility places a newly completed plant in service, traditional rate-making procedures establish rates to recover the allowable costs of that plant. The allowable costs include an allowance for return on the utility's remaining investment in the plant, which is greatest in the first year of the plant's service life and decreases thereafter as the plant is depreciated.

49. In recent years, a combination of circumstances caused traditional rate-making procedures to result in a phenomenon called *rate spike*. Rate spike is a major, one-time increase in rates that can result from the inclusion of the cost of new plants in rates under traditional rate-making procedures. One cause of rate spike was the high cost of nuclear power plants. The cost of those

plants escalated far beyond initial expectations. Another cause was the high cost of capital. Return on investment, which is based on the cost of capital, is a major part of the cost of operating a nuclear plant. Finally, demand for many utilities' services has not grown in recent years to the extent that was expected when the decision was made to construct many of the recently completed plants. As a result, plants that were expected to be needed to meet demand have created excess capacity. The increased efficiency of the new plants has not been sufficient to offset the high construction and capitalized capital costs of those plants and the return on investment that would have been included in rates under traditional rate-making procedures.

50. Phase-in plans were developed to alleviate the problem of rate spike. Those plans are intended to moderate the initial increase in rates that would otherwise result from placing newly completed plants in service by deferring some of that rate increase to future years and providing the utility with return on investment for those deferred amounts. Instead of the traditional pattern of an increase in allowable costs followed by decreasing allowable costs for utility plants after the plants are placed in service, phase-in plans create a pattern of gradually increasing allowable costs for the initial years of the plant's service life.

Questions Raised by Phase-in Plans

51. Phase-in plans raise three questions under Statement 71. First, the very existence of a phase-in plan, whereby rate increases are postponed, calls into question whether future rates to be charged to and collected from customers will in fact be set at levels that will recover the enterprise's costs. Paragraph 5(c) of Statement 71 requires that such an assumption be reasonable as a threshold condition for application of that Statement.

52. Some phase-in plans have been discussed in public forums as ways of retaining major customers. Utility officials have stated that major industrial customers would leave their utility's service area or develop alternative sources of supply if rates were increased under normal rate-making procedures sufficiently to recover the costs of a newly completed plant. If rates cannot, immediately after a new plant is put in service, be set at levels to permit recovery of allowable costs, a question arises as to whether economic conditions or customer acceptance will permit collecting rates in the future that ultimately will recover costs.

53. The second question relates to paragraph 5(b) of Statement 71, which requires that rates be designed to recover the specific enterprise's costs of providing the regulated services or products as a condition for application of that Statement. In the past, regulators sometimes have provided rates to recover costs in periods other than the period in which the costs would be charged to expense under generally accepted accounting principles applicable to enterprises in general. The rationale for such differences has been that (a) costs like storm damage or plant abandonments were infrequently occurring and should be spread among customers of multiple years or (b) the regulator did not agree that the cost was a valid period cost of the period in which it would be recognized by nonregulated enterprises. Deferred income tax expense is an example of the latter category. Under phase-in plans, allowable costs that for years have been

agreed to be costs of a period are charged to customers in a different period mainly *because otherwise rates are judged to be unacceptably high*.

54. If one accepted a premise that, in periods when rates would be unacceptably high, costs can be moved to a future period, the economic discipline inherent in a process of charging customers for the costs of the services they use would be absent. No constraint would exist on the rate-making process. In the extreme case, nothing would prevent a regulator from providing customers with free electricity and promising recovery of the costs of producing that electricity in future years when an improved local economy might be expected. Some Board members believe that the premise that rates in a given period are based on the cost of services provided to customers in that period provides a necessary constraint to accounting for the type of regulation that was addressed by Statement 71.

55. The third question raised by a phase-in plan is whether it is appropriate to capitalize an allowance for earnings on shareholders' investment after a plant begins operations. Paragraph 15 of Statement 71 requires capitalization of such an allowance as part of the acquisition cost of an asset *during construction*. Statement 71 does not permit capitalization of such an allowance under any other circumstances.

56. The Board notes that an allowance for earnings on shareholders' investment is different from other costs for which recovery is provided by regulators. An allowance for earnings on shareholders' investment is not an incurred cost but is a computed amount of earnings to which equity shareholders are deemed to be entitled if their capital is prudently employed in providing services to customers. Capitalizing such an allowance increases currently reported income. Some believe that this result is inappropriate and that income should not be recognized until revenues in the form of billable rates for services are realized. They acknowledge that a partial exception is permitted in Statement 71 for an allowance for funds used during construction but question whether that partial exception should be extended to the case of phase-in plans. They view the current recognition of that future income, by capitalizing an allowance for earnings on shareholders' investment, as recognition of income that is not yet earned. This view, in part, led to the Board's decision, in Statement 71, to permit capitalization of an allowance for earnings on shareholders' investment only as part of the acquisition cost during construction of an asset.

Board Conclusions about Phase-in Plans

57. After considering comments received in comment letters on the Exposure Draft, the Board considered the possibility of not permitting any capitalization of allowable costs deferred pursuant to phase-in plans. For the reasons outlined above, the existence of phase-in plans calls into question the applicability of Statement 71. Observation of the actions of regulators over the past few years, since the first phase-in plan was initiated, suggests that some regulators did not view their actions or the resulting accounting to be constrained by the overriding principle that the cost of current services generally should be charged to current customers. Phase-in plans have evolved from a tightly controlled plan, which deferred recovery of some costs for a short

number of years and promised recovery of those deferrals through an automatic rate adjustment mechanism within a brief time period, to open-ended plans that deferred costs indefinitely and promised recovery only when, and if, future demand grew to the point that the capacity in question was needed. The Board was concerned that such developments might undermine the credibility of financial reporting under Statement 71.

58. Despite those concerns, the Board decided against a blanket prohibition against capitalization, for financial reporting, of amounts capitalized for rate-making purposes under phase-in plans. Rather, the Board decided that capitalization of allowable costs deferred under some types of phase-in plans should be permitted. The Board believes that if any phase-in plans are to result in capitalization of the allowable costs that are deferred pursuant to the plans, those plans should meet stringent criteria so that they will not undermine the credibility of financial reporting under Statement 71. The Board adopted the four criteria in paragraph 5 as the minimum set of criteria that it believes would satisfy that objective.

59. Many respondents to the Exposure Draft urged the Board not to impose the 10-year criterion, which they view as an arbitrary limit. The Board recognizes that the 10-year period is arbitrary, but any other period (for example, the life of the plant) would be equally arbitrary. Cost of service regulation is based on implicit presumptions that (a) operating expenses should normally be recovered in the period in which the expenses are incurred and (2) an allowance for return on investment should normally be recovered in the period during which the investment is used to provide services to customers. Any departure from those norms requires an arbitrary decision about the appropriate time for recovery. The very existence of a phase-in plan indicates an inability to fully recover currently the allowable costs of delivering services to customers. Further, it represents a failure to realize normal expectations that return on prudent investments in operating plants would be recovered currently and that prudently incurred construction costs would begin to be recovered on a normal (usually straight-line) basis as soon as a plant was put in service. Although those departures from the norms of individual cost-of-service regulation are an adaptation to exceptional circumstances, they are such major departures that, if not tightly bounded, they could undermine the credibility of specialized accounting for regulated enterprises.

60. Some phase-in plans provided for deferral of extremely large amounts, such that phasing in those amounts and providing recovery of deferrals within 10 years was asserted to be not practicable. Board members are concerned that those costs might not be recoverable at all, and the phase-in plan might be nothing more than a means of delaying recognition of the fact that rates based on full cost of service cannot be charged to and collected from customers.

61. Board members were also concerned about changes that have occurred in the underlying environment of the electric utility industry. Cogeneration appears to be growing, some wholesale customers have changed suppliers, and the significant amounts of unused capacity presently in existence indicate that considerable competition, at least at the wholesale level, is possible. Also, some local regulators have not been inclined to support local franchise rights

when the possibility of electric utility customers relocating is present. These uncertainties in the electric utility industry reinforced the Board's view that extraordinary solutions to temporary problems should themselves be temporary and that the 10-year criterion was appropriate.

62. Many respondents to the Exposure Draft urged the Board, if it concluded that the 10-year criterion was necessary, to permit partial application of that criterion. Under that approach, a utility with a phase-in plan that met all of the other criteria but extended beyond 10 years would capitalize the portion of the deferrals under the plan that would be recoverable under the plan within 10 years.

63. The Board considered and rejected partial application of and several alternatives to the 10-year criterion. Alternatives included other qualitative criteria and other quantitative criteria that specified different deferral periods and different methods and periods for recoveries. The Board concluded that it was important to specify a time period in which *all* deferred amounts must be recovered rather than a time period in which only *some* deferred amounts must be recovered. The Board concluded that the 10-year criterion, when considered with the other criteria of paragraph 5, was the maximum acceptable time that met the objective of a set of criteria that is sufficiently stringent that the credibility of financial reporting under Statement 71 would not be compromised. Because the Board views those criteria as an interrelated set, it believes that it should not permit partial application for a phase-in plan that fails to meet one of those criteria.

64. Letters received before the Exposure Draft was issued and comments received on the Exposure Draft recommended that the regulator's selection of a specific allowable cost for deferral should not be important to accountants because any allowable cost can be selected with equal economic effect. The Board agrees that the regulator does have considerable discretion in identifying costs to be deferred under some phase-in plans because those plans merely defer a predetermined amount of allowable costs for a predetermined period of time. Since the Board decided to permit any allowable cost that is deferred for rate-making purposes under a qualifying phase-in plan to be capitalized for financial reporting, this issue became moot.

Limitation on Use of Accounting for Phase-in Plans

65. Some Board members agreed to permit the capitalization of allowable costs for plans meeting the specified criteria even though they believe that deferral of costs in those circumstances is not consistent with the premises that underlie the accounting provisions of Statement 71. Some viewed the regulators' decisions to approve phase-in plans as being driven more by market factors or competition than by the cost of the current services provided to customers. The Board concluded, however, that capitalization for financial reporting of amounts deferred pursuant to certain phase-in plans should be permitted because of the combination of circumstances experienced by electric utilities in recent years as set forth in paragraph 49. The Board views those circumstances as unusual and agreed to the accounting specified in this Statement as a means of addressing those unusual circumstances. On the other hand, the Board

believes that the provisions of this Statement can be viewed as a departure from the premises of Statement 71. Accordingly, the Board decided to limit application of this Statement to phase-in plans adopted in connection with plants on which there was significant physical construction before January 1, 1988. The Board concluded that this limitation on the use of phase-in plans is appropriate because the provisions of this Statement are intended to apply in specific, known circumstances. One cannot predict the extent of future competition and deregulation in the electric utility industry or in other utility industries.

Distinction between Phase-in Plans and Disallowances

66. Some existing phase-in plans have deferred allowable costs for recovery in future periods for rate-making purposes and have not provided return on the investment in those deferred costs during the deferral period. The Board considered that type of phase-in plan and concluded that it is, in substance, partially a deferral and partially a disallowance. The environment of individual cost-of-service regulation provides an enterprise an opportunity to earn a fair return on capital invested for the benefit of the enterprise's customers. If no return is provided, the regulator has indirectly disallowed part of the cost of the related plant and the accounting should reflect that disallowance.

Allowance for Earnings on Shareholders' Investment Capitalized for Rate-making Purposes

67. An AICPA Issues Paper, *Application of Concepts in FASB Statement of Financial Accounting Standards No. 71 to Emerging Issues in the Public Utility Industry*, received by the Board in November 1984, recommended that the Board amend paragraph 9 of Statement 71 to require capitalization of any allowable cost when the criteria of that paragraph are met. Many respondents to the Exposure Draft made the same recommendation. Paragraph 9 requires capitalization only of "an incurred cost that would otherwise be charged to expense." Thus, paragraph 9 does not permit capitalization of an allowance for earnings on shareholders' investment—an allowable cost but not an incurred cost that would otherwise be charged to expense. An allowance for earnings on shareholders' investment provided by a regulator is an imputed cost. Capitalization of that cost would increase currently reported income, a result which some Board members believe is inappropriate. The Board believes that income related to an allowance for earnings on shareholders' investment generally should result from revenue realization, not from capitalization.

68. In the Exposure Draft, the Board proposed to require capitalization of the cost of equity funds (an allowance for earnings on shareholders' investment) in one other limited situation—when that allowance is deferred by the regulator in connection with a short-term cost deferral and recovery is expected either through an automatic rate adjustment clause or in the rates provided in the next rate case. Even though the situation was defined carefully, comments received about that provision of the Exposure Draft indicated that any such requirement would be interpreted broadly. For example, some respondents interpreted the provision in question as

contemplating a situation in which the regulator had ordered capitalization of the net cost of operating a newly completed plant during the period from the date of completion of the plant to the date of a later rate order placing the plant into rates even though recovery, if any, will be provided over the life of the newly completed plant rather than through rates provided in the next rate case.

69. After considering comments received, the Board agreed that recognition of a deferred allowance for earnings on shareholders' investment as income in other situations that were specifically mentioned in comment letters was not warranted. The Board decided that it was more appropriate to restrict capitalization, for financial reporting, of an allowance for earnings on shareholders' investment to construction and qualifying phase-in plans than to attempt to define limited other areas for which it would be permitted. That decision reflects both the Board's reluctance to permit premature recognition of income and the practical difficulties of defining situations that would warrant such capitalization. Accordingly, the Board decided not to amend Statement 71 to permit capitalization of an allowance for earnings on shareholders' investment for financial reporting in instances other than during construction or as part of a phase-in plan.

Effective Date and Transition

70. The Board considered whether this Statement should be applied only to phase-in plans ordered after the effective date or to all phase-in plans. Applying this Statement only to phase-in plans ordered after the effective date would diminish both the comparability of the resulting financial statements among enterprises and the year-to-year consistency of financial results of an enterprise that had phase-in plans ordered both before and after the effective date. Phase-in plans extend over a number of years. Applying the Statement only to phase-in plans ordered after the effective date would also permit financial-reporting recognition of phase-in plans that the Board believes could undermine the credibility of financial reporting under Statement 71. Accordingly, the Board decided that this Statement should be applied to all phase-in plans, regardless of whether they were ordered before or after the effective date.

71. In the Exposure Draft, the Board asked whether regulators would be likely to modify existing plans in order to meet the criteria of the final Statement. Comment letters received in response to the Exposure Draft indicated that such changes may well occur. Some respondents noted that their existing phase-in plans call for automatic reconsideration in the event that they do not meet the criteria of this Statement. In view of that response, this Statement provides special transition relief for certain existing phase-in plans. The Board decided that if the regulated enterprise has requested that its regulator amend the phase-in plan in order to meet the criteria of this Statement or intends to do so as soon as practicable and it is reasonably possible that the regulator will change the terms of the plan so that it will meet the criteria of this Statement, this Statement generally would not be applied to that plan until an order is received from the regulator, either revising or refusing to revise the plan. The Board also decided that the criteria of paragraph 5 should be modified for plans that are revised to meet the criteria of this

Statement. For those plans, the 10-year limitation and the prohibition against increasing percentage rate increases would be measured from the date of the revision.

72. The Board also considered whether the provision in this Statement, that an allowance for earnings on shareholders' investment should not be capitalized for financial reporting other than during construction or as part of a phase-in plan, should be applied only to amounts accrued for rate-making purposes after the effective date or also to amounts previously capitalized for financial reporting. The Board concluded that although capitalization in circumstances other than construction and phase-in plans can result in questionable income recognition, retroactive restatement would be burdensome and would not be warranted in view of the relatively limited amounts or time periods involved in past practices. Also, the practice is not one that would be likely to undermine the credibility of financial reporting under Statement 71. Accordingly, the Board decided that this Statement should be applied to allowances for earnings on shareholders' investment deferred for rate-making purposes after initial application of the Statement. Retroactive application is not permitted for that item.

Appendix C: BACKGROUND INFORMATION

73. Statement 71 was issued in December 1982, effective for financial statements for fiscal years beginning after December 15, 1983. In early 1984, several different circumstances caused the Board to question whether the application of Statement 71 in practice was what the Board had intended.

74. Subsequent to issuing Statement 71, the Board became aware of several phase-in plans that involved capitalization of an allowance for earnings on shareholders' investment in an operating plant. The Board considered issuing an Interpretation or permitting issuance of a Technical Bulletin to point out that capitalization of such an allowance was not permitted by Statement 71. However, after discussing the nature of phase-in plans and the reasons for their adoption with an affected company and its auditor, the Board decided to explore the use of phase-in plans in more depth before addressing the accounting for those plans.

75. During 1984, rate problems related to new nuclear electric generating plants of several utilities were widely discussed in the financial press. Comments credited to executives of those utilities indicated considerable question whether the utilities could bill rates based on the cost of those plants to their customers without losing a major part of their customer base. Some articles indicated that phase-in plans were likely for certain of those utilities, but they raised significant questions about the assurance of recovery of costs that would be deferred.

76. As a result of Board member concerns, the Board asked the staff to investigate whether guidance about the application of Statement 71 was needed in practice. The staff met several times with committees of the Edison Electric Institute (EEI), the National Association of

Regulatory Utility Commissioners, and the Public Utilities Subcommittee of the American Institute of Certified Public Accountants (the AICPA Subcommittee). The Board also met with representatives of those groups and the Federal Energy Regulatory Commission.

77. In November 1984, the Board received an AICPA Issues Paper on emerging issues in the public utility industry. That paper listed 17 specific issues related to current problems in the electric utility industry identified by the AICPA Subcommittee. The Board also received a comment letter from the EEI on the issues raised in the AICPA Issues Paper.

78. The Board issued an Exposure Draft on accounting for phase-in plans, abandonments, and disallowances in December 1985. More than 1,400 organizations and individuals responded to that Exposure Draft.

79. In June 1986, the Board held a public hearing on the proposals in the Exposure Draft. Sixty-six individuals and firms presented their views at the four-day public hearing.

80. After considering comments received in comment letters and at the public hearing, the Board concluded that additional consideration was necessary to resolve the accounting issues related to phase-in plans. In December 1986, the Board issued Statement 90 to address accounting for plant abandonments and disallowances of plant costs. Subsequently, the Board continued its deliberations on accounting for phase-in plans.

81. In March 1987, the Board met in an open meeting with representatives of the EEI and four public accounting firms that audit large numbers of electric utilities. Subsequent to that meeting, the Board decided to issue this Statement to address accounting for phase-in plans and capitalization of an allowance for earnings on shareholders' investment other than during construction or as part of a phase-in plan.

Footnotes

FAS92, Footnote 1--The term *allowable costs* is used throughout this Statement to refer to all costs for which revenue is intended to provide recovery. Those costs can be actual or estimated. In that context, allowable costs include interest costs and an allowance for earnings on shareholders' investment.

FAS92, Footnote 2--"Allowable costs that are deferred for future recovery by the regulator under the plan" consist of all allowable costs deferred for rate-making purposes under the plan beyond the period in which those allowable costs would be charged to expense under generally accepted accounting principles applicable to enterprises in general.

FAS92, Footnote 3--Refer to footnote 2.

FAS92, Footnote 4--The phrase "an allowance for earnings on shareholders' investment," as used in this Statement, is intended to have the same meaning as the phrase "a designated cost of equity funds," used in paragraph 15 of Statement 71.

FAS92, Footnote 5--Refer to footnote 2.

FAS92, Appendix A, Footnote 6--*Regulatory lag* is the delay between a change in a regulated enterprise's costs and a change in rates ordered by a regulator as a result of that change in costs. A shortfall in a utility's net income can occur when regulators set rates prospectively and the estimated or test-period costs on which those rates were based are less than the actual costs that are incurred during the period covered by those rates. Regulators' actions that are designed to protect a utility from the effects of regulatory lag can occur during a rate case but before a rate order is issued, as in this example, and when no rate case is under active consideration. An accounting order to a utility to capitalize the cost of repairing storm damage would be an example of the latter situation. Those actions can also be a part of a rate order. An example of that type of action would be a fuel adjustment clause that is intended to protect the utility from the effects of unanticipated changes in fuel costs.