

Statement of Financial Accounting Standards No. 90

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Regulated Enterprises—Accounting for
Abandonments and Disallowances of Plant Costs

(an amendment of FASB Statement No. 71)

December 1986



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 90: Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs

an amendment of FASB Statement No. 71

FAS 90 Summary

This Statement amends FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, for two types of events that recently have occurred in the electric utility industry—abandonments of plants and disallowances of costs of recently completed plants.

This Statement amends Statement 71 to require the future revenue that is expected to result from the regulator's inclusion of the cost of an abandoned plant in allowable costs for rate-making purposes to be reported at its present value when the abandonment becomes probable. If the carrying amount of the abandoned plant exceeds that present value, a loss would be recognized. Statement 71 previously required that asset to be reported at the lesser of the cost of the abandoned plant or the probable gross revenue.

This Statement also amends Statement 71 to require any disallowed costs of a recently completed plant to be recognized as a loss. Statement 71 previously required asset impairments to be recognized but did not specify what constitutes an impairment or provide specific guidance about how impairments should be measured.

Finally, this Statement amends Statement 71 to specify that an allowance for funds used during construction should be capitalized only if its subsequent inclusion in allowable costs for rate-making purposes is probable.

This Statement is effective for fiscal years beginning after December 15, 1987 unless (a) application of the Statement would cause a violation or probable future violation of a restrictive clause in an existing loan indenture or other agreement and (b) the enterprise is actively seeking to obtain modification of that restrictive clause. In that case, this Statement is effective for fiscal years beginning after December 15, 1988.

This Statement applies to the recorded costs of previously abandoned assets, the recorded costs of assets for which future abandonment is probable or becomes probable in the future, previously disallowed plant costs, and disallowances of plant costs that are probable or become probable in the future. Restatement of financial statements for prior fiscal years is encouraged but not required.

INTRODUCTION

1. FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, was issued in December 1982. Shortly after that 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 considering the application of the Statement, the Board decided to amend Statement 71 to provide more specific guidance for some of those events and to change the accounting for others.

2. This Statement amends Statement 71 to specify accounting for plant abandonments and disallowances of costs of recently completed plants. It also provides guidance for the capitalization of an allowance for funds used during construction (AFUDC).

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Accounting for Abandonments

3. When it becomes probable ¹ that an operating asset or an asset under construction will be abandoned, the cost of that asset shall be removed from construction work-in-process or plant-in-service. The enterprise shall determine whether recovery of any allowed cost is likely to be provided with (a) full return on investment during the period from the time when abandonment becomes probable to the time when recovery is completed or (b) partial or no return on investment during that period. That determination should focus on the facts and circumstances related to the specific abandonment and should also consider the past practice and current policies of the applicable regulatory jurisdiction on abandonment situations. Based on that determination, the enterprise shall account for the cost of the abandoned plant as follows:

- a. *Full return on investment is likely to be provided.* Any disallowance of all or part of the cost of the abandoned plant that is both *probable* and *reasonably estimable*, as those terms are used in FASB Statement No. 5, *Accounting for Contingencies*, and the related FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, shall be recognized as a loss, and the carrying basis of the recorded asset shall be correspondingly reduced. The remainder of the cost of the abandoned plant shall be reported as a separate new asset.
- b. *Partial or no return on investment is likely to be provided.* Any disallowance of all or part of the cost of the abandoned plant that is both *probable* and *reasonably estimable*, as those terms are used in Statement 5 and Interpretation 14, shall be recognized as a loss. The present value of the future revenues expected to be provided to recover the allowable cost of that abandoned plant and return on investment, if any, shall be reported as a separate new

asset. Any excess of the remainder of the cost of the abandoned plant over that present value also shall be recognized as a loss. The discount rate used to compute the present value shall be the enterprise's incremental borrowing rate, that is, the rate that the enterprise would have to pay to borrow an equivalent amount for a period equal to the expected recovery period. In determining the present value of expected future revenues, the enterprise shall consider such matters as (1) the probable time period before such recovery is expected to begin and (2) the probable time period over which recovery is expected to be provided. If the estimate of either period is a range, the guidance of Interpretation 14 shall be applied to determine the loss to be recognized. Accordingly, the most likely period within that range shall be used to compute the present value. If no period within that range is a better estimate than any other, the present value shall be based on the minimum time period within that range.

4. The recorded amount of the new asset shall be adjusted from time to time as necessary if new information indicates that the estimates used to record the separate new asset have changed. Those estimates include (a) the determination of whether full return on investment will be provided and, if not, the probable time period before recovery is expected to begin and the probable time period over which recovery is expected to be provided and (b) the amount of any probable and reasonably estimable disallowance of recorded costs of the abandoned plant. The amount of the adjustment shall be recognized in income as a loss or gain. Paragraphs 21, 22, and 24 of Appendix A illustrate how this paragraph applies to changes in the estimated time period before recovery begins and the time period over which recovery is expected to be provided. The recorded carrying amount of the new asset shall not be adjusted for changes in the enterprise's incremental borrowing rate.

5. During the period between the date on which the new asset is recognized and the date on which recovery begins, the carrying amount shall be increased by accruing a carrying charge. The rate used to accrue that carrying charge shall be as follows:

- a. If full return on investment is likely to be provided, a rate equal to the allowed overall cost of capital in the jurisdiction in which recovery is expected to be provided shall be used.
- b. If partial or no return on investment is likely to be provided, the rate that was used to compute the present value shall be used. Paragraphs 20 and 23 and Schedules 1 and 2 of Appendix A illustrate that procedure.

6. During the recovery period, the new asset shall be amortized as follows:

- a. If full return on investment is likely to be provided, the asset shall be amortized in the same manner as that used for rate-making purposes.
- b. If partial or no return on investment is likely to be provided, the asset shall be amortized in a manner that will produce a constant return on the unamortized investment in the new asset equal to the rate at which the expected revenues were discounted. Paragraph 25 and Schedule 3 of Appendix A illustrate that procedure.

Disallowances of Costs of Recently Completed Plants

7. When it becomes probable that part of the cost of a recently completed plant will be disallowed for rate-making purposes and a reasonable estimate of the amount of the disallowance can be made,² the estimated amount of the probable disallowance shall be deducted from the reported cost of the plant and recognized as a loss. If part of the cost is explicitly, but indirectly, disallowed (for example, by an explicit disallowance of return on investment on a portion of the plant), an equivalent amount of cost shall be deducted from the reported cost of the plant and recognized as a loss.

Allowance for Funds Used during Construction

8. Paragraph 15 of Statement 71 requires an allowance for funds used during construction, including a designated cost of equity funds, to be capitalized in specified circumstances as part of the acquisition cost of the related asset. That cost shall be capitalized under those circumstances only if its subsequent inclusion in allowable costs for rate-making purposes is probable.

Amendments to Statement 71

9. Statement 71 is amended as follows:

a. Footnote 6 to paragraph 9 is superseded by the following:

⁶The term *probable* is used in this Statement consistent with its use in FASB Statement No. 5, *Accounting for Contingencies*. Statement 5 defines *probable* as an area within a range of the likelihood that a future event or events will occur. That range is from probable to remote, as follows:

Probable. The future event or events are likely to occur.

Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.

Remote. The chance of the future event or events occurring is slight.

b. The following footnote is added at the end of the first sentence of paragraph 9:

*Costs of abandoned plants shall be accounted for in accordance with paragraphs 3-6 of FASB Statement No. 90, *Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs*.

c. The following footnote is added to the end of paragraph 10:

†Disallowances of costs of recently completed plants, whether direct or indirect, shall be accounted for in accordance with paragraph 7 of Statement 90.

- d. Paragraph 13 is superseded by the following:

Appendix B and Statement 90 illustrate the application of the general standards of accounting for the effects of regulation.

- e. The following sentence is added preceding the last sentence of paragraph 15:

Those amounts shall be capitalized only if their subsequent inclusion in allowable costs for rate-making purposes is probable.

- f. The following footnote is added to the end of the third sentence of paragraph 34:

‡An exception to this general rule is provided for costs of abandoned plants. Paragraphs 16-25 of Statement 90 illustrate accounting for future revenues expected to result from the cost of an abandoned plant with a partial return or no return on investment during the recovery period.

Effective Date and Transition

10. Except as provided in paragraph 13, the provisions of this Statement shall be effective for fiscal years beginning after December 15, 1987 and interim periods within those fiscal years. Earlier application is encouraged. Retroactive application of this Statement in fiscal years for which financial statements have previously been issued is encouraged, in which case the financial statements of all prior periods presented shall be restated. In addition, the 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.

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

12. Initial application of this Statement will require the following adjustments to previously recorded assets with corresponding adjustments to reported net income of prior years or to the cumulative effect of an accounting change in the year of the change:

- a. Amounts that were recorded in prior years for recoverable costs of abandoned plants shall be adjusted as indicated in paragraph 3. If partial or no return on investment is likely to be provided, the discount rate used to compute the present value shall be the regulated enterprise's incremental borrowing rate at the date on which the abandonment became probable.
- b. Disallowed plant costs of the types described in paragraph 7 shall be deducted from the reported cost of the related asset.

13. If application of this Statement would cause a violation or probable future violation of a restrictive clause in an existing loan indenture or other agreement and the enterprise is actively seeking to obtain modification of that restrictive clause, that enterprise may delay application of this Statement for one additional year. In that case, the enterprise shall disclose, in its financial statements for the first fiscal year beginning after December 15, 1987 and interim periods within that fiscal year, (a) the effects that application of this Statement would have had on assets, retained earnings at the end of that fiscal year or interim period, income before extraordinary items, net income, and related per share amounts, (b) the nature of the violation or probable future violation that would result from application of the Statement, and (c) the steps that the company is taking to eliminate the restrictions. That enterprise shall apply this Statement, as indicated in paragraphs 10-12 above, for fiscal years beginning after December 15, 1988 and interim periods within those fiscal years.

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

This Statement was adopted by the affirmative votes of four members of the Financial Accounting Standards Board. Messrs. Brown, Kirk and Northrop dissented.

Messrs. Brown and Northrop dissent to this Statement's provisions concerning accounting for abandonments and disallowances of plant costs. They see no reason to modify the applicability of generally accepted accounting principles to regulated enterprises beyond those departures specifically called for by Statement 71.

Messrs. Brown and Northrop disagree with the requirement to record recoverable costs of abandoned plants at their present value and subsequently to accrue the discount resulting from this present value computation. They would record the costs associated with abandoned plants at the lower of cost or gross recoverable amount (the undiscounted amount of such costs that will be allowed in future rates). They would amortize these costs over the period during which they will be allowed for rate-making purposes. In their view, this cost recovery approach, now specified by Statement, should not be changed because it (1) conforms with accounting for enterprises in general and (2) is consistent with the Board's conclusion not to require recoverable costs of other regulator-created assets, such as storm damage costs, to be recorded at their present value. Further, they believe that recording recoverable costs at their present value results in inappropriate understatement of current period net income and overstatements of net income

in subsequent periods.

Messrs. Brown, Kirk and Northrop object to the requirement to recognize disallowances of costs of newly completed operating plants as losses in all cases. In their view, a regulator's disallowance of part of the cost of a fixed asset is an event warranting disclosure but not accounting recognition, except to the extent that the asset has been impaired. They believe that, barring impairment, reflecting a disallowance as a loss inappropriately recognizes reduced future revenues as reductions in current period net income. This results in overstatement of net income in subsequent periods.

Members of the Financial Accounting Standards Board:

Donald J. Kirk, *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

14. 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 the examples assume that the enterprise meets the criteria in paragraph 5 of Statement 71 for the application of Statement 71 by the enterprise. Cases similar to those illustrated in this appendix may involve income tax effects that could accrue to the utility in question. Some of those tax effects may be recognized currently under the applicable authoritative literature (presently APB Opinion No. 11, *Accounting for Income Taxes*); others may not be recognized currently. Under Opinion 11, the tax effects of timing differences are measured by the differential between income taxes computed with and without inclusion of the transaction creating the difference between taxable income and pretax accounting income. For simplicity, the examples base the income tax effects on a 34 percent tax rate and assume that those effects may be recognized.

15. Specific situations discussed in this appendix are:

	Paragraph Numbers
Accounting for an abandonment	16-25
Accounting for a disallowance of plant cost	26-27
Accounting for a disallowance of plant cost resulting from a "cost cap"	28-31
Accounting for an explicit, but indirect, disallowance	32-34

Accounting for an Abandonment

16. Assume that Utility A operates solely in a single-state jurisdiction that, in the past, has permitted recovery of amounts prudently invested in abandoned plants over an extended period of time without a return on unrecovered investment during the recovery period. Utility A decides to abandon a plant that has been under construction for some time. Although the possibility of abandoning the plant has been under consideration, abandonment was not considered probable before the actual decision was made. The recorded cost of the plant is \$728 million; and the company estimates that it will incur additional contract cancellation penalties of approximately \$22.5 million, which will be paid in approximately 6 months. Utility A's incremental borrowing rate at the date of the decision to abandon the plant is 14 percent, compounded monthly.

17. In view of the accumulated cost of the abandoned plant, Utility A believes that it is probable that recovery of cost without return on investment during the recovery period will be

granted over a period that will not be less than 5 years nor more than 10 years, but it has no basis for estimating the exact time period that will be selected by the regulator. In view of the rate-making process in Utility B's jurisdiction, it will take approximately 18 months to obtain a rate order covering the abandoned plant.

18. For income tax purposes, the abandoned plant has a basis of \$500 million, including the contract cancellation penalties of \$22.5 million. Utility A will deduct the cost of the abandoned plant as a loss on its income tax return in the year of the abandonment and will receive a tax benefit of 34 percent. All of the benefit of that loss will be recognized in the current year, partially through a reduction of current taxable income and carryback to prior years, the balance through offset of existing deferred taxes that will reverse during the carryforward period. Existing deferred taxes on timing differences relating to the abandoned plant total \$35 million. For regulatory purposes, the tax benefit of the abandonment will be reflected as recovery of part of the cost of the abandoned plant.

19. When the abandonment becomes probable (in this case, at the date of the decision to abandon), Utility A would remove the plant from construction work-in-process. Any disallowance of the recorded cost that is probable and can be reasonably estimated would be recorded as a loss. This example assumes that no disallowance of recorded cost is anticipated. Utility A would record a separate new asset, representing the future revenues expected to result from the regulator's treatment of the cost of the abandoned plant, at the present value of those expected future revenues. The computation of the amount to be recovered would be as follows:

Recorded cost of abandoned plant		\$728,000,000
Cancellation charges payable		<u>22,500,000</u>
Total		750,500,000
Less reduction of cost in an amount equal to the amounts designated by the regulator for current recovery:		
Current tax benefit of abandonment	\$170,000,000	
Deferred taxes reversed	<u>35,000,000</u>	<u>205,000,000</u>
Net amount to be recovered in future rates		<u>\$545,500,000</u>

The probable future revenues would be estimated at \$9,091,667 per month for 5 years (based on an assumed straight-line recovery over the 5-year minimum period within the range), and those cash flows would be estimated to begin in 19 months. The computation of the amount to be recorded for the new asset and of the loss resulting from the abandonment would be as follows:

Present value of \$9,091,667 per month at 14% for 60 months, starting at the end of the 19th month (amount to be recorded as new asset)		\$317,107,016
Cost of abandoned plant:		
Net amount to be recovered in future rates for regulatory purposes (per table above)	\$545,500,000	
Discount to reduce cancellation charges to present value (\$22,500,000 discounted at 14% for 6 months)	<u>(1,512,637)</u>	<u>543,987,363</u>
Loss to be recognized at time of abandonment		226,980,347
Deferred tax benefit at 34%		<u>77,139,318*</u>
Net loss to be recognized at time of decision to abandon the plant		<u>\$149,741,029</u>

The deferred tax benefit of the recovery would reverse in relation to the earnings on the unamortized asset. The deferred tax on the imputed interest on the cancellation charges would reverse as interest expense is accrued.

20. Pending receipt of a rate order, Utility A would accrue carrying charges on the recorded asset at a 14 percent annual rate. Schedule 1 shows that computation.

Schedule 1

Utility A

Accrual of Carrying Charges on Asset Resulting from Abandoned Plant

Month	Recorded Amount Beginning of Month	Carrying Charges Accrued*	Recorded Amount End of Month
1	\$317,107,016	\$3,699,582	\$320,806,598
2	320,806,598	3,742,743	324,549,341
3	324,549,341	3,786,409	328,335,750
4	328,335,750	3,830,584	332,166,334
5	332,166,334	3,875,274	336,041,608
6	336,041,608	3,920,486	339,962,094
7	339,962,094	3,966,224	343,928,318
8	343,928,318	4,012,497	347,940,815
9	347,940,815	4,059,310	352,000,125
10	352,000,125	4,106,668	356,106,793
11	356,106,793	4,154,579	360,261,372
12	360,261,372	4,203,049	364,464,421

*As carrying charges are accrued, deferred income tax benefits would be reversed and income tax expense recognized in accordance with Opinion 11.

21. Assume that at the end of the 12th month Utility A determines that it is now probable, based on discussions with the regulator, that recovery of cost without return on investment will be granted over a period that will not be less than 7 years nor more than 15 years, but it still has no basis for estimating the exact time period that will be selected by the regulator. Utility A also estimates that it will take approximately another 12 months (that is, 24 months after the date of the decision to abandon rather than the 18 months previously assumed) to obtain a rate order.

22. When new evidence makes it possible to refine a previous estimate, Utility A would adjust the recorded amount of the asset to reflect its revised estimate. The probable future revenues now would be estimated at \$6,494,048 per month for 7 years (based on an assumed straight-line recovery over the 7-year minimum period within the range), and those cash flows would be estimated to begin 25 months after the date of the decision to abandon. The computation of the adjustment to the carrying amount of the asset that results from the new estimate would be as follows:

Present value of \$6,494,048 per month at 14% for 84 months, starting at the end of the 25th month, which is 13 months in the future (adjusted carrying amount of asset)	\$301,506,272
Carrying amount of asset at end of 12th month (Schedule 1)	<u>364,464,421</u>
Pretax loss to be recognized at end of 12th month	62,958,149
Deferred tax benefit of loss at 34%	<u>21,405,771</u>
Net loss to be recognized at end of 12th month	<u>\$ 41,552,378</u>

The discount rate would not be adjusted to reflect Utility A's current incremental borrowing rate. That new rate reflects current conditions rather than the conditions that prevailed at the time of the decision to abandon.

23. Pending receipt of a rate order, Utility A would continue to accrue carrying charges on the adjusted recorded asset at a 14 percent annual rate. Schedule 2 shows that revised computation.

Schedule 2

Utility A

**Accrual of Carrying Charges on Asset Resulting from
Abandoned Plant Revised to Reflect a Change in Estimate**

<u>Month</u>	<u>Recorded Amount Beginning of Month</u>	<u>Carrying Charges Accrued*</u>	<u>Recorded Amount End of Month</u>
13	\$301,506,272	\$3,517,573	\$305,023,845
14	305,023,845	3,558,612	308,582,457
15	308,582,457	3,600,128	312,182,585
16	312,182,585	3,642,131	315,824,716
17	315,824,716	3,684,621	319,509,337
18	319,509,337	3,727,609	323,236,946
19	323,236,946	3,771,098	327,008,044
20	327,008,044	3,815,094	330,823,138
21	330,823,138	3,859,603	334,682,741
22	334,682,741	3,904,632	338,587,373
23	338,587,373	3,950,186	342,537,559
24	342,537,559	3,996,271	346,533,830

*As carrying charges are accrued, deferred income tax benefits would be reversed and income tax expense recognized in accordance with Opinion 11.

24. Assume that the rate order is received at the end of the 24th month and specifies a recovery period of 8 years; the resulting revenues will start approximately 1 month after the rate order is received. The probable future revenues now would be estimated at \$5,682,292 per month for 8 years (based on the regulator's decision to allow straight-line recovery over an 8-year period), and those cash flows would be estimated to begin 25 months after the abandonment occurred (1 month after the rate order is received). Utility A would reflect that change by recognizing an additional loss, as follows:

Present value of \$5,682,292 per month at 14% for 96 months (adjusted carrying amount of asset)	\$327,104,260
Carrying amount of asset at end of 24th month (Schedule 2)	<u>346,533,830</u>
Pretax loss to be recognized at time of rate order	19,429,570
Deferred tax benefit of loss at 34%	<u>6,606,054</u>
Net loss to be recognized at time of rate order	<u>\$ 12,823,516</u>

The discount rate would not be adjusted to reflect Utility A's current incremental borrowing rate. That new rate reflects current conditions rather than the conditions that prevailed at the time of

the abandonment.

25. As recovery occurs, the recorded asset would be amortized so as to reflect earnings on the unamortized asset at the 14 percent rate used to determine the present value of the asset. Schedule 3 shows the details of that computation.

Schedule 3

Utility A

Computation of Amortization of Asset Resulting from Abandoned Plant

	(1)	(2)	(3)	(4)	(5)
<u>Month</u>	<u>Unamortized Balance Beg. of Month</u>	<u>Return* at 14.00%</u>	<u>Revenues</u>	<u>Amortization of Cost (Col 3 – Col 2)</u>	<u>Unamortized Balance End of Month (Col 1 – Col 4)</u>
25	\$327,104,260	\$3,816,217	\$5,682,292	\$1,866,075	\$325,238,185
26	325,238,185	3,794,445	5,682,292	1,887,847	323,350,338
27	323,350,338	3,772,421	5,682,292	1,909,871	321,440,467
28	321,440,467	3,750,139	5,682,292	1,932,153	319,508,314
29	319,508,314	3,727,597	5,682,292	1,954,695	317,553,619
30	317,553,619	3,704,792	5,682,292	1,977,500	315,576,119
31	315,576,119	3,681,721	5,682,292	2,000,571	313,575,548
32	313,575,548	3,658,382	5,682,292	2,023,910	311,551,638
33	311,551,638	3,634,769	5,682,292	2,047,523	309,504,115
34	309,504,115	3,610,881	5,682,292	2,071,411	307,432,704
35	307,432,704	3,586,715	5,682,292	2,095,577	305,337,127
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110	58,342,320	680,661	5,682,292	5,001,631	53,340,689
111	53,340,689	622,308	5,682,292	5,059,984	48,280,705
112	48,280,705	563,275	5,682,292	5,119,017	43,161,688
113	43,161,688	503,553	5,682,292	5,178,739	37,982,949
114	37,982,949	443,134	5,682,292	5,239,158	32,743,791
115	32,743,791	382,011	5,682,292	5,300,281	27,443,510
116	27,443,510	320,174	5,682,292	5,362,118	22,081,392
117	22,081,392	257,617	5,682,292	5,424,675	16,656,717
118	16,656,717	194,328	5,682,292	5,487,964	11,168,753
119	11,168,753	130,302	5,682,292	5,551,990	5,616,763
120	5,616,763	65,529	5,682,292	5,616,763	0

*As earnings on the unamortized asset are recognized, deferred income tax benefits would be reversed and income tax expense recognized in accordance with Opinion 11.

Accounting for a Disallowance of Plant Cost

26. Assume that Utility B operates in two state jurisdictions. After an extensive "prudence investigation," the regulator in one of those state jurisdictions disallows \$865 million of the \$3.6 billion total cost of Utility B's recently completed nuclear generating plant. That state jurisdiction represents approximately 50 percent of Utility B's operations, and approximately 50 percent of the output of the recently completed plant is expected to be used in that state. The tax basis of the plant is \$2.4 billion. The regulator indicates that the tax benefit from a ratable portion of depreciation will be given to the shareholders as a result of the disallowance. After consultation with counsel, Utility B decides that it should not appeal the regulator's disallowance. The regulator in Utility B's other state jurisdiction has not participated in the "prudence investigation," and there is no indication that a similar disallowance is likely in that jurisdiction.

27. Utility B should recognize the effective disallowance as a loss. Because only 50 percent of the plant's cost will be recoverable from customers in the state, the effective disallowance is 50 percent of the amount disallowed, or \$432.5 million. The disallowance should be recognized when the disallowance is probable and the amount of the disallowance can be reasonably estimated, and those conditions are met in this case. The tax benefit of the loss will be realized as future depreciation is taken for income tax purposes. Since the tax benefit of the plant is based on \$2.4 billion and the cost of the plant prior to the disallowance is \$3.6 billion, only two-thirds of the loss is available for tax benefit. A deferred tax benefit, based on two-thirds of the loss, can be recognized when the loss is recognized providing that benefit meets the criteria of Opinion 11 for recognition.

Accounting for a Disallowance of Plant Cost Resulting from a "Cost Cap"

28. Assume that Utility C, which operates solely in one state jurisdiction, is constructing a new electric generating plant. Completion is expected to take approximately one year. The cost of the plant, which was originally expected to be \$1.25 billion, is now estimated to be as follows:

Costs capitalized to date	\$2,700,000,000
AFUDC on above for 1 year at 11.25%	303,750,000
Remaining labor, materials, etc., to complete, expected to be spent ratably over the year	469,822,500
AFUDC on above for 1/2 year at 11.25%	<u>26,427,500</u>
Total estimated cost at completion	<u>\$3,500,000,000</u>

Various parties have charged that certain cost increases were a result of imprudent management of the construction.

29. To avoid the cost and time delay that would be involved in a full-scale "prudence investigation" of the construction of the plant, Utility C and its regulator agree that the total cost of the plant that will be allowable in determining depreciation and that will be allowed in Utility C's rate base will be \$3.4 billion. If the eventual cost of the plant exceeds that "cap," a ratable portion of the tax benefit of depreciation will accrue to the benefit of the shareholders. For tax purposes, the plant is expected to have a net depreciable basis of \$2.0 billion.

30. The loss that results from the disallowance inherent in the "cost cap" would be computed as follows:

Total estimated cost at completion	\$3,500,000,000
Maximum allowable cost	<u>3,400,000,000</u>
Difference	<u>\$ 100,000,000</u>
Loss to be recognized (present value of difference at 11.25% AFUDC rate, based on 1 year to complete)	\$ 89,887,600
Deferred tax benefit of loss ($2.0/3.5 \times \$100,000,000 \times 34\%$)	<u>19,428,600</u>
Net loss to be recognized when "cost cap" is agreed to	<u>\$ 70,459,000</u>

After the loss is recognized, AFUDC would continue to be recorded based on the remaining recorded costs. Subsequently, if additional increases in the cost of the plant become probable and those costs are not allowable under the agreed "cost cap," those increases would also be recognized as losses from disallowances when they become probable.

31. If the regulator ordered a "cost cap" that Utility C did not agree to, Utility C would have to assess whether the criteria of Statement 5 for loss recognition are met. If those criteria are met, the accounting would be as indicated above. Otherwise, no loss would be recognized until that loss was probable and could be reasonably estimated. Because of the possible disallowance inherent in the "cost cap," it may no longer be probable that some amount of AFUDC will be included in allowable costs in the future, and that amount may be reasonably estimable. In that case, that amount of AFUDC would not be capitalized.

Accounting for an Explicit, but Indirect, Disallowance

32. Assume that Utility D operates solely in a single-state jurisdiction. On January 1, 19X1, Utility D's new electric generating plant becomes operational. The cost of that plant is \$1 billion.

33. Utility D's regulator concludes that part of the cost of the recently completed plant was imprudently incurred. However, rather than disallow the specific costs that were imprudent, the regulator instead excludes 10 percent (\$100 million) of the plant from the rate base, thereby providing no return on investment on that portion of the plant. The regulator does not intend any part of the tax benefit of depreciation to accrue to the benefit of Utility D's shareholders. The

regulator indicates that the exclusion of 10 percent of the plant's cost from the rate base is intended to be permanent. The utility concludes that it will not appeal the disallowance after considering the likely outcome of an appeal.

34. Utility D should record the indirect disallowance as a loss and should estimate the amount of that loss using the best available information. If the regulator specifies the amount of cost that was imprudent, that amount may be the best estimate of the loss. Otherwise, Utility D would have to estimate the future cash flows that have been disallowed as a result of the order and determine the effective disallowance by computing the present value of those disallowed future cash flows. Since both the disallowed future cash flows and the appropriate discount rate to compute the present value would be estimates, those estimates should be calculated on a consistent basis. Accordingly, if the future cash flows are estimated based on the current weighted-average overall cost of Utility D's capital, that weighted-average overall cost of capital should also be used as the discount rate. The loss has no tax benefit to Utility D.

Appendix B

BASIS FOR CONCLUSIONS

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Appendix B: BASIS FOR CONCLUSIONS

Introduction

35. 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.

General Considerations

36. Many letters received as the Board was developing the conclusions in this Statement objected to the Board's conclusions about accounting for abandonments and disallowances of costs of recently completed plants on the basis that those decisions departed from the historical cost model of accounting for enterprises generally. The Board provided its view of the current accounting model in paragraphs 66-70 of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*. Paragraph 66 acknowledges that the current model is not a pure "historical cost" model, as follows:

Items currently reported in financial statements are measured by different attributes, depending on the nature of the item and the relevance and reliability of the attribute measured. The Board expects the use of different attributes to continue.

37. The Board also noted that much of the accounting specified by Statement 71 is itself a departure from the accounting framework applied by nonregulated enterprises generally. That Statement recognizes that rate actions of a regulator can have economic effects and requires certain items that would be charged to expense by nonregulated enterprises to be capitalized by regulated enterprises solely because the regulator's rate actions can provide reasonable assurance of future revenue.

38. The accounting set forth in Statement 71 requires certain regulated enterprises to recognize probable increases in future revenues due to a regulator's actions as assets by capitalizing incurred costs that would otherwise be charged to expense. The Board believes those regulated enterprises should also recognize probable decreases in future revenues due to a regulator's actions as reductions of assets. General purpose financial statements that recognize asset enhancements but not asset decrements would lack representational faithfulness—a critical qualitative characteristic if financial statements are to be reliable. After reviewing the frequency and magnitude of recent plant abandonments and disallowances of plant costs in the electric

utility industry, the Board concluded that it should require the resulting probable decreases in future revenues to be recognized as reductions in assets if financial statements are to be representationally faithful.

39. The Board also believes that the accounting for plant abandonments required by this Statement is consistent with the accounting followed by companies in general for monetary assets under APB Opinion No. 21, *Interest on Receivables and Payables*. Whatever asset remains after a utility plant is abandoned is essentially monetary in nature.

40. Many respondents to the Exposure Draft, *Regulated Enterprises—Accounting for Phase-in Plans, Abandonments, and Disallowances of Plant Costs*, urged the Board not to adopt some of the provisions in this Statement because they would reduce some companies' retained earnings to the extent that payment of dividends, future financing on favorable terms, or both would be precluded. When a company incurs a loss, significant consequences may occur, and the Board is aware that some of the effects of the issues addressed in this Statement are major. The Board believes that those consequences result from the event that is being accounted for, not from the accounting itself. The Board believes that accounting should reflect major adverse occurrences that affect an enterprise even though the consequences of those major adverse occurrences may be significant.

41. Many respondents also urged the Board not to adopt certain provisions of this Statement because the regulated rates might decrease as a result of the accounting requirements. Others indicated that the regulated rates would increase if the accounting specified by this Statement were required. The Board believes that regulators will provide whatever rates they believe are justified; general-purpose financial reporting should not be designed to encourage or to discourage specific actions of regulators, and regulators can be expected to understand accounting that reflects the effects of their actions.

Accounting for Abandonments

42. Historically, utilities have usually abandoned plants in early stages of construction, rather than after incurring major construction costs. Prior to Statement 71, most regulated enterprises accounted for the costs of abandoned plants on a cost recovery basis; that is, no loss was recorded if revenues promised by a regulator were expected to recover the recorded costs. Statement 71 did not change that practice.

43. Recently, abandonments of plants under construction have become more common, and some utilities have abandoned plants during the later stages of construction. In many cases, the cost of abandoned plants is much greater than in the past.

44. Many respondents to the Exposure Draft indicated that the essential nature of the asset does not change when a plant is abandoned. In their view, cost-based regulation treats all assets the same; a plant under construction and an abandoned plant are both accumulated costs that will

be recovered through revenues. The Board does not agree with that view and has concluded that an abandonment changes the nature of the asset. A plant under construction is expected to produce utility services that have value. An abandoned plant can produce no services. Any value that results from the abandoned plant is limited to the revenues that will be furnished through the sales of services provided by other plants.

45. Other respondents to the Exposure Draft urged the Board not to require loss recognition until the loss is probable. That is the basis for loss recognition that is provided by one of the criteria of Statement 5. The Board agrees that loss recognition should not occur until the loss is probable and reasonably estimable, consistent with Statement 5. However, some of those respondents equated *probable* with *certain*. The Board notes that the term *probable* is defined in Statement 5 and is used in the same sense in this Statement. That definition is not synonymous with *certain*, a term that connotes a much higher level of assurance than *probable*.

46. Regulators in many jurisdictions have provided recovery of the cost of abandoned plants without return on investment during the recovery period. That procedure has been described as a means of sharing the loss between customers and shareholders. A cost-recovery approach for accounting for abandonments was based on the view that the regulator was disallowing future earnings, rather than disallowing a portion of the cost of the abandoned plant. In reconsidering that issue in the context of today's environment, the Board concluded that a cost-recovery approach, in effect, delays recognition of losses that are known to have been incurred. Although that approach might have little significance when applied to relatively immaterial items, the significance of the amounts involved in recent cases indicates that recognition of losses resulting from abandonments should not be delayed beyond the date when they are probable and reasonably estimable.

47. The Board also concluded that the future revenue that will result from inclusion of the cost of an abandoned plant in allowable costs for rate-making purposes is essentially a monetary asset. In the Board's view, an abandoned plant should be written off when abandonment is probable. Unless it is probable that the cost of an abandoned plant will be entirely disallowed by the regulator, a new asset that is essentially a monetary asset should be recognized. That asset most closely resembles a long-term receivable that is recognized on the basis of (a) its cost, if the stated interest rate is reasonable, or (b) its present value, if the interest rate is not stated or if the stated rate is unreasonable. The Board believes that a similar measurement basis is appropriate for expected future revenue that will result from a regulator's treatment of the cost of an abandoned plant.

48. In the Exposure Draft, the Board proposed that the overall rate of return allowed in the regulated enterprise's last rate case in the jurisdiction in which recovery is expected to be received be used to measure the present value of the future revenue that will result from an abandoned plant. Respondents to the Exposure Draft pointed out that the actual disallowance is the overall rate of return in the future rate cases covering the period during which recovery will occur. That rate is not known at the time of the abandonment. The Board agreed that a surrogate

rate should be used to compute the present value of the remaining future revenues, and it decided to require the enterprise to use its incremental borrowing rate at the date the abandonment becomes probable.

49. Some respondents suggested that the interest rate used should be changed whenever the allowed overall rate of return changes during the recovery period. The Board views that approach as a means of maintaining the asset in question at its fair value. Fair value often is used in accounting to measure a newly acquired asset when that fair value is more clearly evident than the value of the asset given up. However, with the exception of certain assets that are readily marketable, the present accounting model does not adjust the carrying basis of an existing asset when the fair value of that asset changes.

50. Some respondents to the Exposure Draft indicated that the rate used to value an abandonment should be a net-of-tax rate. Other respondents asked that the Board address the tax effects of the proposed accounting for abandonments. APB Opinion No. 11, *Accounting for Income Taxes*, does not permit accounting for items with tax effects on a net-of-tax basis. Rather, deferred income taxes are provided for timing differences when they occur, and those deferred taxes are reversed when the related timing differences reverse. Opinion 11 applies to taxable enterprises that apply Statement 71 except in the limited circumstances outlined in paragraph 18 of Statement 71. Accordingly, the loss recognized to reduce the asset resulting from an abandonment to its present value and the subsequent profit that results comprise a timing difference. The tax effects of that timing difference would be recognized when the timing difference originates if appropriate under the provisions of Opinion 11.

51. The Board concluded that accruing a carrying charge on, or recognizing accretion of, the present value of the expected future revenue related to an abandonment is appropriate for two reasons. First, the basis used to record that asset recognizes the effect of the regulator's disallowance of future return on investment as a loss in the period in which the loss becomes probable and the amount can be reasonably estimated. The disallowance that already has been recognized should not reduce the reported level of return on investment in later years, and accrual of a carrying charge has the effect of maintaining the level of return on investment similar to what it would have been if there had been no disallowance. Second, the nature of the resulting asset is similar to a long-term receivable, even though Board members acknowledge that it lacks some of the characteristics of a receivable. Accordingly, they concluded that (a) the subsequent reporting should be consistent with that afforded a long-term receivable and (b) accrual of a carrying charge is consistent with accounting for a long-term receivable initially recognized at its present value.

52. A number of respondents to the Exposure Draft objected to the requirement that the amount recorded for the probable future revenue that would result from an abandonment be adjusted when a rate order is received. They indicated that the real process of regulation in some jurisdictions occurs in the courts. The Board viewed the rate order as the confirming event, permitting an estimate of the loss to be refined at that time, and it believes that will usually be

the case. However, the Board agrees that a loss should not be recognized unless it is probable that a loss has occurred and the amount can be reasonably estimated. If those criteria are not met at the time of an initial rate order, the loss should not be recognized at that time.

53. The Board considered adopting a requirement that all assets representing solely the probable future revenue resulting from a regulator's actions be recorded at the present value of the future cash flows and decided not to adopt such a requirement at this time. Some Board members noted that the requirement of Statement 71 to recognize those other assets on a cost-recovery basis, which was a continuation of prior practice, does not seem to have caused major problems in practice. Other Board members noted that the rate treatment anticipated during construction, prior to abandonment of the asset under construction, was full recovery of both cost and return on investment, whereas the cost of repairing storm damage, which is sometimes afforded recovery over a period of time without return on investment, represents a cash outlay usually made with the anticipation of that rate treatment. Thus, if the Board were to conclude that recording that asset at the amount of the consideration paid is not appropriate, that conclusion would be based on considerations somewhat different from those that the Board applied to abandonments.

Disallowances of Costs of Recently Completed Plants

54. Paragraph 10 of Statement 71 addresses disallowances by a regulator. That paragraph indicates that when a disallowance occurs, "the carrying amount of any related asset shall be reduced to the extent that the asset has been impaired. Whether the asset has been impaired shall be judged the same as for enterprises in general."

55. Recently, several disallowances of major amounts of cost on recently completed plants have been well publicized. The AICPA Issues Paper, "Application of Concepts in FASB Statement of Financial Accounting Standards No. 71 to Emerging Issues in the Public Utility Industry," concludes that "the measure of whether an asset has been impaired [when part of the cost of that asset is disallowed for rate-making purposes] is whether net cash inflows (revenues less applicable expenses) are sufficient to cover the cost of the asset. In measuring expenses, interest applicable to the unit should be included, but equity return would not be included."

56. The Board concluded that the view described in the AICPA Issues Paper, which appears to describe some, but not all, of existing practice, is a narrower interpretation of an "impairment," as referred to in paragraph 10 of Statement 71, than is appropriate for the events in question. The Board believes that an impairment evaluation includes the estimation of losses in value that become determinable as a result of an identifiable event, and it concluded that a regulator's disallowance of part of the cost of a recently completed plant creates an impairment that warrants recognition.

57. Some Board members also believe that the stated reason for certain recent disallowances of plant costs—that the costs were not productive or were not necessary for the completion of the

plant—indicates that those costs should not be included in the carrying amount of the related plant. Nonregulated enterprises do not continue to carry identified nonproductive costs as part of the cost of their fixed assets, and regulated enterprises also should not do so.

58. Many respondents to the Exposure Draft objected to what they considered to be a unique impairment evaluation. The Board believes that the event in question, disallowance of part of the cost of an operating plant by a regulator, is itself unique. Other enterprises do not have disallowances of their plant costs resulting from actions of a regulator.

59. The Board believes that the credibility of financial reporting in general would be diminished by the failure to recognize a diminution in value and a corresponding loss that is generally agreed to have occurred. When a regulator disallows a significant part of the cost of a recently completed plant, financial statements that do not report that disallowance as a loss reflect adversely on the representational faithfulness of those financial statements and of financial statements generally. Accordingly, the Board decided to amend Statement 71 to require loss recognition for such a disallowance.

60. Some respondents to the Exposure Draft requested that the Board address "excess capacity" disallowances. Those disallowances relate to part of the cost of service of a recently completed plant and are based on a finding that the utility's reserve capacity exceeds an amount deemed to be reasonable. If an "excess capacity" disallowance is ordered by a regulator *without* a specific finding that the enterprise should not have constructed that capacity or should have delayed the construction of that capacity, the rate order raises questions about whether the enterprise meets the criteria for application of Statement 71, in that it is not being regulated based on its own cost of service. However, because such a rate order itself is neither a direct disallowance nor an explicit, but indirect, disallowance of part of the cost of the plant, this Statement does not specify the accounting for it. If an "excess capacity" disallowance is ordered by a regulator *with* a specific finding that the enterprise should not have constructed that capacity or should have delayed the construction of that capacity, the rate order may be an explicit, but indirect, disallowance of part of the cost of the plant, and the enterprise should account for the substance of that order as set forth in paragraph 7 of this Statement.

61. In a few recent cases, a regulator has included a recently completed plant in rates based on the assumed cost of another plant rather than based on the cost of the plant that exists. In those cases, the enterprise is not being regulated based on its own cost, and the criteria of application of Statement 71 do not appear to be met. If the rate order is based on a finding that, based on factors that were known during the construction, the utility should not have constructed the plant that it did construct, the order may be an explicit, but indirect, disallowance, and it should be accounted for as set forth in paragraph 7 of this Statement. Otherwise, unless the order is being appealed, the enterprise should consider discontinuing application of Statement 71.

62. A number of respondents indicated that it would often be impossible to determine whether an indirect disallowance had been made. They noted that regulators have considerable discretion

in selecting a rate that represents a fair return on equity investment, and that specific matters included in a settlement agreement might not be apparent. The Board intends that explicit, but indirect, disallowances be reported as disallowances; it does not intend to require that an enterprise determine whether the terms of a settlement agreement or rate order contained a hidden, indirect disallowance. Accordingly, paragraph 7 of this Statement was modified to indicate the Board's intent.

63. The Board considered making a more sweeping amendment of Statement 71, to require loss recognition for all cost disallowances by a regulator, whether related to a recently completed plant or otherwise. For example, regulators in some jurisdictions disallow costs of acquired companies in excess of the acquired company's book value and a variety of other types of costs. After consideration, the Board decided to limit this Statement to the relatively narrow issues that caused the Board to add a project on regulated enterprises to its agenda.

Criteria for Capitalization of AFUDC

64. Paragraph 15 of Statement 71 requires an allowance for funds used during construction, including an allowance for equity funds, to be capitalized in lieu of capitalizing interest in accordance with FASB Statement No. 34, *Capitalization of Interest Cost*, if certain criteria are met. The AICPA Issues Paper cited a need for guidance on whether AFUDC should be capitalized in a number of different situations.

65. After considering the cases in which capitalization of AFUDC is controversial, the Board concluded that AFUDC should be capitalized only if subsequent inclusion of that AFUDC in plant cost for rate-making purposes is probable. That conclusion was based on paragraph 15 of Statement 71, which is derived from the general standards in paragraphs 9-12 of that Statement. Under those general standards, a cost may not be capitalized unless it is probable that the cost will be included in allowable cost in the future, and the Board concluded that the same criteria should apply to capitalization of AFUDC.

66. Some respondents to the Exposure Draft indicated that AFUDC is a cost, and it warrants capitalization whenever the general criteria of Statement 34, that interest cost is being incurred and construction is in progress, are met. The Board disagreed with this view of AFUDC. Statement 71 concluded that, if specific criteria in paragraph 15 are met, the AFUDC that will be the basis for future rates should be capitalized instead of interest computed in accordance with Statement 34. As noted above, that provision of Statement 71 was derived from the general standards in paragraphs 9-12 of that Statement. Those general standards require that inclusion of an amount in allowable cost in the future be probable for that amount to be capitalized. The Board believes that the intent of Statement 71, in accepting the amount of AFUDC that will be the basis for future rates instead of the usual capitalization of interest, was not solely to accept a surrogate computation, but also to accept a computation that was a better indicator of future cash flows for enterprises that meet both the criteria for application of Statement 71 and the criteria of paragraph 15 of the Statement for capitalization of AFUDC. The Board concluded that allowing

capitalization of amounts for which future inclusion in allowable cost for rate-making purposes was not probable would make the resulting capitalized amounts poorer indicators of the future cash flows expected to result from utility plants. Accordingly, the Board concluded that if inclusion of that AFUDC in the cost that will become the basis for future rates is not probable, the enterprise should not capitalize it. The Board also concluded that, if the specific criteria in paragraph 15 of Statement 71 are met but AFUDC is not capitalized because its inclusion in the cost that will become the basis for future rates is not probable, the regulated enterprise may not alternatively capitalize interest cost in accordance with Statement 34.

67. The Board believes that the criteria for capitalization of AFUDC are particularly relevant to two situations that have occurred in practice. In the first situation, completion of a plant under construction is reasonably possible but no longer probable, and the regulator in the governing jurisdiction routinely disallows accumulated AFUDC on abandoned plants. In that situation, the criteria required to write off previously recognized AFUDC are not met since disallowance is not probable; thus, previously capitalized AFUDC should not be written off. However, because inclusion of AFUDC in the cost allowed for future rates is no longer probable, further capitalization of AFUDC is not warranted.

68. In the second situation, a prudence investigation is in process or has taken place, and a disallowance of cost (including subsequent AFUDC on those costs) is reasonably possible. The range of such disallowance is from zero to some maximum amount, and no point within the range is more likely than any other. In that situation, because a disallowance of the maximum amount in the range is reasonably possible and thus inclusion of that amount in rates is no longer probable, subsequent capitalization of AFUDC should be discontinued for an amount of costs equal to the maximum amount that is within the range.

Definition of Probable

69. The term *probable* was defined in Statement 71 differently from how it has been defined in other authoritative literature. The Board used a definition based on the definition used in FASB Concepts Statement No. 3, *Elements of Financial Statements of Business Enterprises*, because that definition was one of the criteria of an asset in Concepts Statement 3.

70. The AICPA Issues Paper questioned whether that definition was intended to be significantly different from the definition used in Statement 5 and indicated that the use of different definitions had caused some confusion in practice. The Board considered the concern expressed in the AICPA Issues Paper and decided to change the definition in Statement 71 to the definition in Statement 5.

71. Some respondents to the Exposure Draft indicated their belief that the definition included in this Statement was a more stringent one than that contained in FASB Concepts Statement No. 6, *Elements of Financial Statements*, and in Statement 71. In their view, the definition in this Statement is appropriate for loss recognition, but the definition that was originally included in

Statement 71 was more appropriate for asset recognition. The Board believes that a single concept is involved, and one definition can be applied in practice more easily than two. Thus, the Board concluded that the change in definition in this Statement is appropriate.

Accounting for Phase-in Plans

72. The Exposure Draft proposed specific accounting for phase-in plans. After considering comments received, both in comment letters and during the public hearing, the Board concluded that additional consideration is necessary to resolve the accounting issues related to phase-in plans. Accordingly, the Board decided to issue this Statement on plant abandonments and disallowances of plant costs and to consider further how to address accounting for phase-in plans.

Effective Date and Transition

73. The Board considered whether this Statement should be applied only to events occurring after the effective date or to all events of the types addressed. Applying this Statement only to events occurring after the effective date would diminish both comparability of the resulting financial statements among enterprises and consistency within an enterprise that had experienced such events both before and after the effective date. The events addressed by this Statement tend to have long-lasting effects on financial statements. For example, a decision whether to recognize a disallowance of plant cost as a loss affects reported depreciation and net income for the life of the related plant. Accordingly, the Board decided that this Statement should be applied to all abandoned plants and disallowed plant costs, regardless of whether those events occurred before or will occur after the effective date.

74. The Exposure Draft was proposed to be effective for fiscal years beginning after December 15, 1986. The Board requested respondents who believed that additional delay in that proposed effective date was warranted for their specific situations to describe their existing circumstances in detail and explain why a delay would be appropriate and what it would accomplish.

75. Most of the respondents who requested a delay in application of the proposed Statement cited phase-in plans that might be modified if this Statement were to address accounting for phase-in plans. Few respondents indicated that a regulator's disallowance might be reconsidered or that a regulator's decision about recovery on an abandoned plant might be reconsidered.

76. Many respondents to the Exposure Draft indicated that this Statement should not be applied to regulatory actions that occurred before the effective date. They indicated that covenants, entered into without knowledge of the accounting requirements of this Statement, may now result in unintended restrictions on companies' actions. The Board recognizes that creditors may be willing to modify existing covenants for some enterprises that will be affected by this Statement. Although the Board decided to make this Statement effective for fiscal years

beginning after December 15, 1987, it also decided to permit enterprises to delay application of this Statement until fiscal years beginning after December 15, 1988 if (a) application of this Statement would cause a violation or probable future violation of a restrictive clause in an existing loan indenture or other agreement and (b) the enterprise is actively seeking to obtain modification of that restrictive clause.

Appendix C: BACKGROUND INFORMATION

77. 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.

78. During 1984, representatives of some regulatory commissions began to question the cost of certain new plants and to discuss possible major disallowances. Also, several plants in advanced stages of construction were abandoned. In a few states, courts ruled that utilities could not recover the costs of those abandoned plants from customers.

79. As a result of Board member concerns, the Board asked the staff to investigate whether guidance on the application of Statement 71 was needed in practice. The staff met several times with committees of 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 staff members of the Federal Energy Regulatory Commission.

80. 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 EEI on the issues raised in the AICPA Issues Paper.

81. In April 1985, the Board's Task Force on Regulated Enterprises met and discussed a staff draft of a possible Exposure Draft that encompassed most of the conclusions included in this Statement.

82. Subsequent to the April 1985 task force meeting, the Board received 51 letters from 39 affected enterprises and other interested parties commenting on the positions proposed in the staff draft discussed at the task force meeting and on the Board's tentative conclusions reached at its public meetings subsequent to that task force meeting.

83. The Board issued an Exposure Draft in December 1985. More than 1,400 organizations

and individuals responded to that Exposure Draft, many with multiple letters.

84. 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.

85. After considering comments received in comment letters and at the public hearing, the Board concluded that additional consideration is necessary to resolve the accounting issues related to phase-in plans. After consideration, the Board decided to issue this Statement to address accounting for plant abandonments and disallowances of plant costs. The Board will consider accounting for phase-in plans further at a later date.

Footnotes

FAS90, Footnote 1--The term probable is used in this Statement consistent with its use in FASB Statement No. 5, *Accounting for Contingencies*, to mean that a transaction or event is likely to occur.

FAS90, Footnote 2--Interpretation 14 provides guidance for making a reasonable estimate of the amount of a loss.

FAS90, Par. 19, Footnote * – This amount consists of the following:

Deferred tax benefit of discount to reduce the expected recovery of abandonment to present value	\$ 77,653,615
Deferred tax on discount to reduce cancellation charges to present value	<u>(514,297)</u>
Total	<u>\$77,139,318</u> =====