

# Statement of Financial Accounting Standards No. 71

FAS71 Status Page  
FAS71 Summary

Accounting for the Effects  
of Certain Types of Regulation

December 1982

**FILED**

DEC 28 2004

Missouri Public  
~~Service Commissioner~~



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

OPC Exhibit No. 132  
Case No(s) ER-2004-0570  
Date 12-15-04 Rptr JL

respect to that contract, this Statement shall apply.

### General Standards of Accounting for the Effects of Regulation

9. Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An enterprise shall capitalize all or part of an incurred cost <sup>5</sup> that would otherwise be charged to expense if both of the following criteria are met:

- a. It is probable <sup>6</sup> that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.
- b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

10. Rate actions of a regulator can reduce or eliminate the value of an asset. If a regulator excludes all or part of a cost from allowable costs and it is not probable that the cost will be included as an allowable cost in a future period, the cost cannot be expected to result in future revenue through the rate-making process. Accordingly, 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.

11. Rate actions of a regulator can impose a liability on a regulated enterprise. Such liabilities are usually obligations to the enterprise's customers. The following are the usual ways in which liabilities can be imposed and the resulting accounting:

- a. A regulator may require refunds to customers.<sup>7</sup> Refunds that meet the criteria of paragraph 8 (accrual of loss contingencies) of FASB Statement No. 5, *Accounting for Contingencies*, shall be recorded as liabilities and as reductions of revenue or as expenses of the regulated enterprise.
- b. A regulator can provide current rates intended to recover costs that are expected to be incurred in the future with the understanding that if those costs are not incurred future rates will be reduced by corresponding amounts. If current rates are intended to recover such costs and the regulator requires the enterprise to remain accountable for any amounts charged pursuant to such rates and not yet expended for the intended purpose,<sup>8</sup> the enterprise shall not recognize as revenues amounts charged pursuant to such rates. Those amounts shall be recognized as liabilities and taken to income only when the associated costs are incurred.
- c. A regulator can require that a gain or other reduction of net allowable costs be given to customers over future periods. That would be accomplished, for rate-making purposes, by

amortizing the gain or other reduction of net allowable costs over those future periods and reducing rates to reduce revenues in approximately the amount of the amortization. If a gain or other reduction of net allowable costs is to be amortized over future periods for rate-making purposes, the regulated enterprise shall not recognize that gain or other reduction of net allowable costs in income of the current period. Instead, it shall record it as a liability for future reductions of charges to customers that are expected to result.

12. Actions of a regulator can eliminate a liability only if the liability was imposed by actions of the regulator.

13. Appendix B illustrates the application of the general standards of accounting for the effects of regulation.

#### **Specific Standards Derived from the General Standards**

14. The following specific standards are derived from the general standards in paragraphs 9-12. The specific standards shall not be used as guidance for other applications of those general standards.

#### **Allowance for Funds Used during Construction**

15. In some cases, a regulator requires an enterprise subject to its authority to capitalize, as part of the cost of plant and equipment, the cost of financing construction as financed partially by borrowings and partially by equity. A computed interest cost and a designated cost of equity funds are capitalized, and net income for the current period is increased by a corresponding amount. After the construction is completed, the resulting capitalized cost is the basis for depreciation and unrecovered investment for rate-making purposes. In such cases, the amounts capitalized for rate-making purposes as part of the cost of acquiring the assets shall be capitalized for financial reporting purposes instead of the amount of interest that would be capitalized in accordance with FASB Statement No. 34, *Capitalization of Interest Cost*.<sup>2</sup> The income statement shall include an item of other income, a reduction of interest expense, or both, in a manner that indicates the basis for the amount capitalized.

#### **Intercompany Profit <sup>10</sup>**

16. Profit on sales to regulated affiliates shall not be eliminated in general-purpose financial statements <sup>11</sup> if both of the following criteria are met:

- a. The sales price is reasonable.
- b. It is probable that, through the rate-making process, future revenue approximately equal to the sales price will result from the regulated affiliate's use of the products.

17. The sales price usually shall be considered reasonable if the price is accepted or not challenged by the regulator that governs the regulated affiliate. Otherwise, reasonableness shall

# Statement of Financial Accounting Standards No. 71

FAS71 Status Page  
FAS71 Summary

Accounting for the Effects  
of Certain Types of Regulation

December 1982



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

respect to that contract, this Statement shall apply.

### General Standards of Accounting for the Effects of Regulation

9. Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An enterprise shall capitalize all or part of an incurred cost <sup>5</sup> that would otherwise be charged to expense if both of the following criteria are met:

- a. It is probable <sup>6</sup> that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.
- b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

10. Rate actions of a regulator can reduce or eliminate the value of an asset. If a regulator excludes all or part of a cost from allowable costs and it is not probable that the cost will be included as an allowable cost in a future period, the cost cannot be expected to result in future revenue through the rate-making process. Accordingly, 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.

11. Rate actions of a regulator can impose a liability on a regulated enterprise. Such liabilities are usually obligations to the enterprise's customers. The following are the usual ways in which liabilities can be imposed and the resulting accounting:

- a. A regulator may require refunds to customers.<sup>7</sup> Refunds that meet the criteria of paragraph 8 (accrual of loss contingencies) of FASB Statement No. 5, *Accounting for Contingencies*, shall be recorded as liabilities and as reductions of revenue or as expenses of the regulated enterprise.
- b. A regulator can provide current rates intended to recover costs that are expected to be incurred in the future with the understanding that if those costs are not incurred future rates will be reduced by corresponding amounts. If current rates are intended to recover such costs and the regulator requires the enterprise to remain accountable for any amounts charged pursuant to such rates and not yet expended for the intended purpose,<sup>8</sup> the enterprise shall not recognize as revenues amounts charged pursuant to such rates. Those amounts shall be recognized as liabilities and taken to income only when the associated costs are incurred.
- c. A regulator can require that a gain or other reduction of net allowable costs be given to customers over future periods. That would be accomplished, for rate-making purposes, by

amortizing the gain or other reduction of net allowable costs over those future periods and reducing rates to reduce revenues in approximately the amount of the amortization. If a gain or other reduction of net allowable costs is to be amortized over future periods for rate-making purposes, the regulated enterprise shall not recognize that gain or other reduction of net allowable costs in income of the current period. Instead, it shall record it as a liability for future reductions of charges to customers that are expected to result.

12. Actions of a regulator can eliminate a liability only if the liability was imposed by actions of the regulator.

13. Appendix B illustrates the application of the general standards of accounting for the effects of regulation.

#### **Specific Standards Derived from the General Standards**

14. The following specific standards are derived from the general standards in paragraphs 9-12. The specific standards shall not be used as guidance for other applications of those general standards.

#### **Allowance for Funds Used during Construction**

15. In some cases, a regulator requires an enterprise subject to its authority to capitalize, as part of the cost of plant and equipment, the cost of financing construction as financed partially by borrowings and partially by equity. A computed interest cost and a designated cost of equity funds are capitalized, and net income for the current period is increased by a corresponding amount. After the construction is completed, the resulting capitalized cost is the basis for depreciation and unrecovered investment for rate-making purposes. In such cases, the amounts capitalized for rate-making purposes as part of the cost of acquiring the assets shall be capitalized for financial reporting purposes instead of the amount of interest that would be capitalized in accordance with FASB Statement No. 34, *Capitalization of Interest Cost*.<sup>3</sup> The income statement shall include an item of other income, a reduction of interest expense, or both, in a manner that indicates the basis for the amount capitalized.

#### **Intercompany Profit <sup>10</sup>**

16. Profit on sales to regulated affiliates shall not be eliminated in general-purpose financial statements <sup>11</sup> if both of the following criteria are met:

- a. The sales price is reasonable.
- b. It is probable that, through the rate-making process, future revenue approximately equal to the sales price will result from the regulated affiliate's use of the products.

17. The sales price usually shall be considered reasonable if the price is accepted or not challenged by the regulator that governs the regulated affiliate. Otherwise, reasonableness shall