

# Chelan County PUD

## Regulatory Accounting

July 12, 2010

# Purpose

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- ▶ **Regulatory Accounting**
  - ▶ What is it?
  - ▶ Requirements
  - ▶ Who uses it?
  - ▶ Benefits
  - ▶ How could it be used at the District
- ▶ **Derivative Fair Value Adjustments**
- ▶ **Contributions in Aid of Construction**
- ▶ **Policy considerations**
- ▶ **Sample Financial Statements/Disclosures**

# What is it?

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- ▶ Permits an entity with cost-based rates to defer certain costs or income that would otherwise be recognized when incurred to the extent that the rate-regulated entity is recovering or expects to recover such amount in rates charged to its customers.
- ▶ Regulatory assets or liabilities are recorded when it is probable that future rates (or rate reductions) will permit recovery of such costs (or revenues).
- ▶ *A.k.a. Statement of Financial Accounting Standards (SFAS) No. 71 or FASB Accounting Standards Codification (ASC) 980.*

# Regulatory Accounting Requirements

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- ▶ Rates charged to customers are established or approved by a regulator or governing board empowered by statute,
- ▶ Rates are designed to recover specific costs of providing service, and
- ▶ Based on demand and competition, rates set at levels that will recover costs can be charged to and collected from customers.
- ▶ Board approval obtained prior to the costs or revenue being deferred.
- ▶ Have a plan on how deferred items will be included in rates.

# Who uses it?

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- ▶ Snohomish PUD
- ▶ Clark PUD
- ▶ Benton PUD
- ▶ Grant PUD
- ▶ Seattle City Light
- ▶ Tacoma Power
- ▶ Eugene Water Electric Board
- ▶ BC Hydro
- ▶ Lower Colorado River Authority
- ▶ Sacramento Municipal Utility District
- ▶ Platte River Power
- ▶ Omaha Public Power
- ▶ Long Island Power
- ▶ Salt River Project
- ▶ Santee Cooper

# Other District Accounting Deferrals

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- ▶ Relicensing
- ▶ Bond Issuance Costs
- ▶ Some Fish Protection Costs (prior to 1995)
- ▶ Capacity Reservation Payments

# Benefits of implementing regulatory deferrals at the District

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- ▶ Consistent with many other utilities and rate regulated entities.
- ▶ Smooths financial results when unanticipated events occur.
- ▶ Supports compliance with bond (Debt Service Coverage) covenants.
- ▶ Reduces rate volatility and hardship on customer-owners.

# Potential Application at the District

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- ▶ **Defer Certain Expenses - Regulatory Assets**
  - ▶ Conservation
  - ▶ Storm Damage
  - ▶ Contract termination payments
  - ▶ Excess wholesale market purchases
  - ▶ Fair market value adjustments (Investments/Derivatives)
- ▶ **Defer Certain Revenues - Regulatory Liabilities**
  - ▶ Fair market value adjustments (Investments/Derivatives)
  - ▶ Contributions in Aid of Construction (CIAC)
  - ▶ Excess wholesale revenues – Revenue Stabilization Account

# Derivative Fair Value Adjustments

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- ▶ **Governmental Accounting Standards Board Statement 53 (GASB 53)**
  - ▶ Effective in 2010
  - ▶ Requires changes in fair value of certain contracts to be recognized in Statement of Revenues, Expenses and Changes in Net Assets (“Income Statement”)
  - ▶ Can have significant impact on reported income/loss
  - ▶ No direct effect on District’s cash flows or rates
  - ▶ Gains and losses offset over life of contract
  - ▶ Requires restatement of prior year results

# GASB53 Application at District

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- ▶ Forward Purchase and Sale of Energy – Current energy contracts excluded from requirements under “normal purchase/sale” exemption.
- ▶ Forward Purchase and Sale of Investments – The District has two forward purchase agreements subject to GASB53 requirements. The agreements meet the effectiveness criteria, therefore any change in fair value will be deferred on the Balance Sheet.
- ▶ Interest Rate SWAPs (IRSA) – The District has six IRSA that are subject to GASB53 requirements. Both of the District’s Series 2007 (2008A) swaps met the effectiveness criteria, therefore any change in fair value will be deferred on the Balance Sheet. The 2009 swap, swap reversal and forward starting swaps do **not** meet the effectiveness criteria so the change in fair value must be recognized in the Statement of Revenues, Expenses and Changes in Net Assets.
- ▶ Other Potential Derivative Transactions that may require fair value accounting: financial forward energy transactions, energy options, environmental attributes, variable rate commodity pricing, etc.

# Accounting for Derivatives

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- ▶ **Prior to 2010**
  - ▶ Disclosure only
- ▶ **Beginning in 2010**
  - ▶ Implementation of GASB53 results in financial statement performance which is inconsistent with rate setting process.
  - ▶ Fluctuating market prices have no long term impact on District's earnings, cash flow or rates.
  - ▶ Recommend adopting Regulatory Accounting for contracts requiring fair value adjustments under GASB53.
  - ▶ Record Regulatory Assets or Liabilities simultaneously when booking GASB53 entries to result in no impact on District's Statement of Revenues, Expenses and Changes in Net Assets.

# 2009 District Condensed Statements of Revenue, Expenses and Changes in Net Assets

(in \$000s)

	Annual Report	GASB53	Reg. Acctg.
Operating Revenue	202,760	202,760	202,760
Operating Expenses	(176,053)	(176,053)	(176,053)
Operating Income	26,707	26,707	26,707
Non-Op Exp (Inc)	(44,712)	(50,805)	(44,712)
<b>Change in Net Assets before CIAC</b>	<b>(18,005)</b>	<b>(24,098)</b>	<b>(18,005)</b>
Capital Contributions	2,886	2,886	2,886
Change in Net Assets	(15,119)	(21,212)	(15,119)

# 2009 District Condensed Balance Sheets

(in \$000s)

	Annual Report	GASB53	Reg. Acctg.
Current Assets	324,541	324,541	324,541
Net Utility Plant	1,096,518	1,096,518	1,096,518
Deferred Charges & Other Assets	171,710	<i>181,564</i>	<i>187,657</i>
Total Assets	1,592,769	1,602,623	1,608,716
Current Liabilities	76,579	76,579	76,579
Long-term Debt	1,010,158	1,010,158	1,010,158
Deferred Credits & Other Liabilities	121,637	<i>137,584</i>	<i>137,584</i>
Total Liabilities	1,208,374	1,224,321	1,224,321
Total Net Assets	384,395	<i>378,302</i>	<i>384,395</i>

# Contributions In Aid of Construction (CIAC)

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- ▶ A government receives value from another party without directly giving equal value in return.
- ▶ CIAC are considered to be non-exchange transactions as defined by GASB33.

# CIAC Examples at District

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## ▶ Distribution

- ▶ Line Extensions
- ▶ Connection Fees
- ▶ Alcoa/BPA Valhalla Substation
- ▶ Alcoa-McKenzie Substation capital

## ▶ Water/Wastewater

- ▶ Grants
- ▶ LUDs
- ▶ Line Extensions/Meter Installations
- ▶ System Development Charges

## ▶ Hydros

- ▶ Softball field lighting (Apple Valley Softball Assoc)
- ▶ Docks (Wenatchee Row & Paddle Club)

# Accounting for CIAC

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## ▶ Current

- ▶ GASB 33 requires income recognition in the period the resources are received and to expense the value over the expected life of the asset acquired.
- ▶ Timing of reported income does not match with related expense.
- ▶ Can have significant impact on reported income.

## ▶ Recommend

- ▶ Adopt Regulatory Accounting for significant capital contributions (i.e. over \$1M in Distribution and \$500k in Water/Wastewater)
- ▶ Defer recognition of income as a Regulatory Liability and recognize income over life of asset
- ▶ Better match of income and expense for financial reporting and rate setting purposes.
- ▶ Results in same net impact to financial statements at end of asset's useful life.

# Water Statements of Revenue, Expenses and Changes in Net Assets

(in \$000s)

	2009	2008	Reg. Acctg.
Operating Revenue	4,417	3,923	3,923
Operating Expenses	4,543	4,572	4,572
Operating Loss	(126)	(649)	(649)
Non-Op Exp (Inc)	301	134	134
<b>Change in Net Assets before CIAC</b>	<b>(427)</b>	<b>(535)</b>	<b>(535)</b>
Capital Contributions	567	4,896	1,109
Change in Net Assets	141	4,361	574

# Proposed Implementation Plan

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## ▶ Board approval

- ▶ Derivative Fair Value Adjustments – July 26
- ▶ Contributions in Aid of Construction – July 26
- ▶ Conservation – 2011 Budget
- ▶ Significant Unanticipated Costs/Revenues – as needed
- ▶ Revenue Stabilization Account – revenue exceed targets

## ▶ Transparency in Financial Statements

- ▶ New line items - Regulatory Assets and Liabilities
- ▶ Management Discussion & Analysis – results before and after
- ▶ Disclosure
  - ▶ Items and amounts deferred
  - ▶ Amounts amortized (reflected in rates)

# Sample Balance Sheet Components

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- ▶ **CURRENT ASSETS**

- ▶ Regulatory costs to be recovered within one year

- ▶ **DEFERRED CHARGES & OTHER ASSETS**

- ▶ Regulatory costs for future recovery

- ▶ **CURRENT LIABILITIES**

- ▶ Regulatory credits to be recognized within one year

- ▶ **DEFERRED CREDITS & OTHER LIABILITIES**

- ▶ Regulatory credits

# Sample Income Statement Components

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## ▶ **OPERATING REVENUES**

- ▶ Rate stabilization fund transfers
- ▶ Recognition of previously deferred Regulatory credits

## ▶ **OPERATING EXPENSES**

- ▶ Regulatory deferrals collected in rates

# Sample Management Discussion & Analysis (MD&A)

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- ▶ Total Deferred Charges & Other Assets increased by \$xx million due to higher Regulatory Costs for future recovery. This increase is mainly due to deferred costs for the change in value of Derivative Financial Instruments resulting from significant changes in interest rates.
- ▶ Regulatory Credits decreased by \$xx million reflecting the recognition of previously deferred CIAC revenue.
- ▶ Change in Net Assets before Regulatory Accounting was \$xx million. After Regulatory deferrals, Change in Net Assets was \$xx million.

# Sample Disclosure - Derivatives

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## ▶ **Deferred Regulatory Assets and Liabilities**

- ▶ *Governmental accounting standards require that the fair value of all derivative financial instruments be recognized as either assets or liabilities on the balance sheet, with a corresponding charge or credit to operations. The PUD has reviewed its various contractual arrangements and concluded that the majority of the contracts for the purchase, sale, transportation and exchange of power constitute normal purchases and sales under existing accounting standards.*
- ▶ *The Board of Commissioners establishes rates for the PUD that are designed to recover the costs of providing services. As a result, the PUD qualifies for the application of FASB Accounting Standards Codification (ASC) 980, Regulated Operations, which allows for the deferral of certain unrecognized gains and losses. The PUD entered into floating-to-fixed interest rate swap agreements to hedge the effect of interest rate changes on variable rate bonds. These contracts meet the definition of derivative assets or liabilities and as such, the fair value of these derivatives has been recorded on the balance sheet. The Board has approved resolutions that allow the change during the period in the fair value of these contracts to be deferred and recorded as regulatory charges and/or liabilities, which have no impact on operating results. The District has deferred \$xx and \$xx at December 31, 2010 and 2009, respectively.*

# Sample Disclosure - CIAC

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## ▶ Regulatory Liabilities (Credits)

- ▶ *CIAC. In 2010 and 2009 the District capitalized CIAC totaling \$xx million and \$xx million, respectively, in Plant in Service in the Balance Sheets and recorded \$xx million and \$xx million, respectively, of Depreciation Expense in the Statements of Revenues, Expenses and Changes in Net Assets. The District's regulatory credit relating to CIAC is intended to offset the revenue and expense associated with this accounting treatment. Thus, this regulatory credit is being amortized into rates over the depreciable lives of the related contributed distribution plant assets in order to offset the earnings effect of these nonexchange transactions.*

# Regulatory Accounting Considerations

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- ▶ Requires additional effort to track, report, review and audit.
- ▶ Introduces additional complexity to financial statements.
- ▶ Regulatory Accounting alone does not address deteriorating cash reserves (unless raise rates).
- ▶ Rating Agencies remove regulatory adjustments from their analysis.
- ▶ Discontinuation of Regulatory Accounting could have a material impact on the District's financial statements.

# Questions?

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