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Accounting for Public Utilities

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HIGHLIGHTS

Accounting for Public Utilities is a must-have for anyone involved in utility accounting, finance, ratemaking, and de-regulation. This publication brings into focus all the special types of accounting rules, situations, and adaptations that are essential in this highly specialized industry. The volume includes:

- discussions of ratemaking concepts, including styles of ratemaking, determining utility rate base, cost allocations and normalization;
- analyses of regulatory accounting and reporting requirements; and
- explanations of accounting for taxes, public utility regulation, management accounting systems, pricing and depreciation.

Federal Regulation of Public Utilities. The Securities Exchange Commission (SEC) has promulgated numerous rules and regulations pertaining to the accounting, reporting, and public financing requirements imposed on utilities and other companies. The SEC's authority to regulate reporting requirements

greatly expanded when Congress enacted the Sarbanes-Oxley Act of 2002. The Act directed the SEC to establish the Public Company Accounting Oversight Board. The Board's duties are to oversee the audit of public companies that are subject to the securities laws. For detailed analysis of the Sarbanes-Oxley Act of 2002, see § 2.07[7].

Utility Financial Statements. Financial statements for public utility companies differ in certain respects from those for non-regulated business enterprises. The differences are in format, contents, and footnote disclosures. Chapter 13 has been completely revised to highlight the unique features of utility financial statements.

Accounting for Taxes. Federal income tax and other taxes constitute a major component of a utility's operating expenses and cost of service for ratemaking purposes. The concepts governing the allocation and accounting of taxes are complicated. Chapter 17 has been substantially revised to depict a clear picture of the effect of taxes on a utility's financial health and economic viability.

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PUBLIC UTILITY DEPRECIATION

§ 6.03[1]

the Financial Accounting Standards Board (FASB)'s Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations," changes the basis for depreciation accounting for financial reporting purposes. (For further discussion, see § 12.08.)

Future salvage and cost of removal amounts are perceived to be difficult to estimate. A good example of this difficulty, and of the regulatory response to it, is nuclear power plant decommissioning. Not only must the utility estimate the decommissioning cost at today's price levels, but it must also predict the timing of the expenditures and the price levels that will exist at that time. Recognition of future costs in current rates is controversial because it makes the burden on present ratepayers appear much greater than it actually is, and the method of considering cost escalation has a significant impact on the amount of that burden. The regulator must confront these considerations when addressing depreciation in the ratemaking process. Regulators tend to emphasize history when deciding upon the net salvage factors to be incorporated into depreciation rates. History, however, may not be an appropriate indicator and may not produce rates that adequately reflect the obligation to safely remove or abandon depreciable property at the end of its life.

In the case of utility depreciation, because of the rate base approach to ratemaking, payment now saves a larger payment later. In the end, the distribution of the various components of depreciation costs to the different generations of ratepayers is controlled by the manner in which utilities and their regulators respond to the politics of regulation. Without rate base regulation, appropriate cost allocation should still be addressed. Depreciation should be recorded to match consumption of an asset. To ensure that the results of operations are appropriately reflected in financial statements, it is essential to understand accounting policy and practices and the causes of depreciation.

§ 6.03 Purpose of Book Depreciation Accounting

[1] Overview

In simple terms, book depreciation is merely the recognition in financial statements that physical assets are consumed in the process of providing a service or a product. It should be remembered that book depreciation is provided for the purpose of recovering the original investment in the assets concerned, and not for providing for their replacement. Thus, book depreciation is often referred to as capital recovery.

The most widely recognized definition of depreciation accounting is that of the American Institute of Certified Public Accountants (AICPA), which states:

(Rel. 13-11) (AICPA Pub. 516)