ORDER NO. 03-455

ENTERED JUL 24 2003

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1088

In the Matter of PACIFIC POWER & LIGHT (dba PACIFICORP) Application for an Accounting Order Regarding Treatment of Certain Asset Retirement Obligations.	))))))))	ORDER

DISPOSITION: APPLICATION APPROVED WITH CONDITION

On May 27, 2003, Pacific Power & Light (PacifiCorp) filed an application with the Public Utility Commission (Commission) requesting an accounting order authorizing PacifiCorp to 1) record, as a regulatory asset or a regulatory liability, the cumulative financial statement impact resulting from PacifiCorp's implementation of Statement of Financial Accounting Standards (SFAS) 143; and 2) record on an ongoing basis, as a regulatory asset or regulatory liability, an amount equal to the difference between the annual SFAS accretion and depreciation expenses and the annual depreciation expenses based on Commission-approved depreciation expense.

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS 143, *Accounting for Asset Retirement Obligations*, effective for fiscal years after June 15, 2002. Under SFAS 143, entities are required to recognize and account for certain asset retirement obligations in a manner different from the way that PacifiCorp has traditionally recognized and accounted for such costs. Staff's recommendation is attached as Appendix A and is incorporated by reference.

At its Public Meeting on June 15, 2003, the Commission adopted Staff's Recommendations and approved PacifiCorp's current request with one condition.

ORDER

IT IS ORDERED that:

1) Pacific Power & Light Company's accounting application is approved, subject to one condition.

2) At any time Pacific Power & Light Company files a results of operations report or general rate change, for a period of five years, Pacific Power & Light Company must provide the Public Utility Commission with all journal entries made under the requirements of SFAS 143 and any adjustments necessary to remove rate impacts of this accounting treatment.

Made, entered and effective ____________________________________.

BY THE COMMISSION:

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Becky Beier
Commission Secretary

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A party may appeal this order to a court pursuant to ORS 756.580.

ITEM NO. CA4

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: July 15, 2003

REGULAR ____ **CONSENT** __X__ **EFFECTIVE DATE** ________ **April 1, 2003** ________

DATE: June 17, 2003

TO: John Savage through Lee Sparling and Ed Busch

FROM: Judy Johnson

SUBJECT: PACIFIC POWER & LIGHT: (Docket No. UM 1088) Requests Accounting Order Regarding Treatment of Certain Asset Retirement Obligations

SUMMARY RECOMMENDATION:

I recommend the Commission approve Pacific Power & Light Company's accounting application, with one condition.

DISCUSSION:

On May 27, 2003, Pacific Power & Light Company (PacifiCorp or company) filed an application requesting an accounting order authorizing the company to 1) record, as a regulatory asset or a regulatory liability, the cumulative financial statement impact resulting from the company's implementation of Statement of Financial Accounting Standards (SFAS) 143; and 2) record on an ongoing basis, as a regulatory asset or regulatory liability, an amount equal to the difference between the annual SFAS accretion and depreciation expenses and the annual depreciation expensed based on Commission-approved depreciation expense.

On June 2001, the Financial Accounting Standards Board (FASB) issued SFAS 143, *Accounting for Asset Retirement Obligations*, effective for fiscal years after June 15, 2002. Under SFAS 143, entities are required to recognize and account for certain asset retirement obligations in a manner different from the way that PacifiCorp has traditionally recognized and accounted for such costs.

Specifically, if a legally enforceable asset retirement obligation (ARO), as defined by SFAS 143, is deemed to exist, an entity must measure and record the liability for the ARO on its books at fair market value in the period during which the liability is incurred. At the time the liability is recorded, a corresponding and equivalent ARO asset is also recorded on the entity's books as part of the cost of the associated tangible asset. The ARO asset is then depreciated over the life of the associated tangible asset. In addition, accretion is added to the ARO liability annually to account for the time value of money, so that at the time of retirement the recorded ARO liability will be sufficient to provide the cash required to meet the legal obligation.

In addition to the forward-looking requirements of SFAS 143, entities are required to recognize the cumulative impact on their financial statements resulting from the implementation of SFAS 143. This cumulative impact amounts to a transition entry on the entity's books, so that in future years the financial statements will appear as if the requirements of SFAS 143 had always been followed. Neither the SFAS 143 transition entries nor the annual accounting entries will change the level of costs included in rates.

PacifiCorp is required to implement SFAS 143 in order to comply with Generally Accepted Accounting Principles. The company has determined that it will need to record AROs under SFAS 143 for certain generation and mining assets. The company has also identified AROs for transmission and distribution assets. However, the timing of those obligations is indeterminate and the liability cannot be measured and recorded at this time. There were no material AROs for general plant assets.

The company's proposed accounting treatment will use SFAS 143 for reporting on its financial statements, but retain its current methodology for ratemaking purposes. SFAS 143 recognizes that differences may exist between its requirements and the treatment of ARO costs for regulatory purposes and provides that a regulated entity subject to SFAS 71, *Accounting for the Effects of Certain Types of Regulation*, can recognize any differences between the two approaches as a regulatory asset or a regulatory liability, subject to the requirements of SFAS 71.

Under the accounting method currently used by the company for both financial reporting and ratemaking purposes, the cost of removing a tangible long-lived asset at retirement is included in the calculation of depreciation rates as negative salvage and is recovered over the useful life of the asset. Under this method, the accrued removal cost is included in Account 108, Accumulated Depreciation.

PacifiCorp believes, and Staff agrees, that it is not appropriate to apply the requirements of SFAS 143 in determining AROs for ratemaking purposes. Rather, the company believes, and Staff agrees, that AROs should continue to be established through traditional depreciation studies and recovered through the application of Commission-approved depreciation rates. SFAS 143 should not be used for ratemaking for several reasons detailed in the attachment to the Staff report.

Nothing in this application requests any approval regarding future ratemaking treatment. PacifiCorp notes, however, that upon retirement of the related assets and determination of actual removal costs, such costs will be trued-up for ratemaking purposes, at which time the regulatory accounts associated with these assets will be eliminated. For regulatory reporting purposes, the effects of SFAS 143 will be removed and there should be no rate change, now or in the future, associated with the application of the requested accounting treatment.

PacifiCorp also requests confirmation by the Commission that asset removal costs, in the form of negative net salvage, are currently accrued through annual depreciation expense which is recoverable in rates; that these costs are based on estimates of the final removal cost; and that such costs are trued-up for ratemaking purposes at the time the related assets are retired and the actual removal costs are determined. Staff does not believe that this confirmation should be in a formal Commission motion for accounting approval. However, Staff acknowledges that the company's characterization of the Commission's current ratemaking practices in regard to asset removal costs is correct.

PROPOSED COMMISSION MOTION:

Pacific Power & Light Company's accounting application in UM 1088 be approved, subject to the following condition: At any time PacifiCorp files a results of operations report or general rate change, for a period of five years, the company must provide Staff with all journal entries made under the requirements of SFAS 143 and any adjustments necessary to remove rate impacts of this accounting treatment.

Attachment

PacifiCorp UM 1088

ATTACHMENT A

SFAS 143 should not be used for ratemaking for the following reasons:

1. The primary focus of SFAS 143 is on financial statement presentation rather than cost recovery.

   - The FASB provided the following two reasons for issuing FAS 143: (1) Users of financial statements indicated that the diverse accounting practices that have developed for obligations associated with the retirement of tangible long-lived assets make it difficult to compare the financial position and results of operations of companies that have similar obligations but account for them differently; and (2) Obligations that meet the definition of a liability were not being recognized when those liabilities were incurred or the recognized liability was not consistently measured or presented.
   - The provisions of FAS 143 are primarily focused on determining the appropriate amount of the ARO liability to be reflected in the financial statements.
   - For ratemaking purposes the issue with asset removal cost is not balance sheet presentation. The ratemaking issue is how to properly estimate removal costs and how to recover them in a fair and equitable manner from the utility customers being served by the assets. This process of estimation and recovery is best accomplished through traditional utility depreciation procedures that are subject to regulatory review and oversight.

2. Adoption of SFAS 143 for ratemaking would effectively transfer the determination of the appropriate amount of asset removal cost from regulators to the FASB.

   - When removal costs are determined through a depreciation study, if the Commission disagrees with the company's estimates, the estimates are simply changed and the depreciation rates adjusted accordingly.
   - If the SFAS 143 estimates of removal cost are to be used for ratemaking, then the Commission must accept whatever amount is calculated by the company and determined by its external auditors to be in compliance with SFAS 143.

3. Under the provisions of SFAS 143, the recognition of removal cost in period expense over the life of the asset is "back-end loaded".

As a result of the application of present value techniques, SFAS 143 results in removal expense that is lower in the early years of asset life and greater in the final years.

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- In contrast, for ratemaking purposes the goal of a depreciation study is to recover the cost of an asset, including removal cost, on a straight-line basis over the productive life of the asset.

4. The methods for determining the amount of removal cost required by SFAS 143 are different than those traditionally used in utility depreciation analysis and adopted for ratemaking purposes, leading to potentially higher cost estimates.

   - SFAS 143 requires that the value of the removal liability be determined based on "fair value", which would ideally be based on a market price. In other words SFAS 143 assumes that asset removal would be accomplished by a third party engaged by the utility. Use of a third party involves recognizing a profit margin in the removal cost estimate.
   - As a practical matter, utilities would normally use their own workforces to the extent possible to remove and dispose of utility assets. Thus the requirement by SFAS 143 to include a third-party profit margin could lead to higher removal cost estimates than would be included in a traditional depreciation study.

5. Use of SFAS 143 for ratemaking would create additional regulatory oversight issues.

   - Under current procedures, all changes in asset lives as well as changes in asset salvage and removal costs are contained in a single comprehensive depreciation study that is prepared and submitted for regulatory review and approval at periodic intervals (normally five years).
   - If SFAS 143 were adopted for ratemaking, it would still be necessary to prepare a depreciation study and submit it for review and approval. In addition, for assets that qualify for SFAS 143 treatment, regulators would need to conduct a separate review of ARO calculations, interest rate determinations, the calculation of annual accretion and ARO asset amortization expense, etc.
   - When the recovery of asset removal costs is approved through a depreciation study, it remains in effect until the next study is prepared, typically five years. Potentially, under the provisions of SFAS 143, new AROs could be added and the amounts of existing AROs could be updated each year; requiring virtually continuous regulatory oversight.