Power & Utilities quarterly accounting update — Year-end 2014

January 7, 2015

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Agenda

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Presenters

Bill Graf, Partner, Deloitte & Touche LLP

Bill is an audit partner in the Chicago office of Deloitte & Touche LLP and the organization's National Professional Practice Director and industry leader for power and utilities. He also serves as the advisory partner and engagement quality control reviewer on many of Deloitte's large utility clients. Bill has provided training on regulatory and accounting matters to companies, industry groups, and regulatory agencies and has published extensively on accounting for energy companies.

Tom Kilkenny, Partner, Deloitte & Touche LLP

Tom is an audit partner in the Milwaukee office of Deloitte & Touche LLP and a Deputy Professional Practice Director for the power and utilities industry. He also serves as the lead client service partner and engagement quality control reviewer for several of Deloitte's utility industry clients. Tom has more than 30 years' experience providing audit services to companies in this industry.

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Presenters (cont.)

James Barker, Partner, Deloitte & Touche LLP

James is a member of Deloitte's National Office. He is a clearing partner in Accounting Consultation where he focuses primarily on financial instrument issues and lease accounting. Prior to joining National Office, he was a partner in Deloitte's Capital Markets practice where he focused on the energy industry and served as a subject-matter expert for derivatives and hedging activities. James has advised many of Deloitte's utility clients in connection with hedging strategies for energy trading and marketing activities, as well as broader issues around derivative accounting.

Financial Statement Presentation and Disclosure—Helpful Reminders

Balance Sheet

- Consistency of accounting policies in consolidation for utility holding companies
- Presentation of liability for budget billing
- Classification of current and non-current regulatory assets and liabilities and the propriety of netting
- Regulatory liability for non-legal asset decommissioning and removal costs
- Deferred income taxes and the right level of netting
- Abandonment of PP&E not classified in Plant-In-Service

Income Statement

- Separately disclosing revenues and cost of revenues by products and services pursuant to Rules 5-03(b)(1) and (2) of Regulation S-X for your non-regulated businesses
- Gain/Loss on disposition of operating assets classified within operating income without consideration of ratemaking

Cash Flows

- Classification of Acquisition of Property, Plant, and Equipment on Account
- Presentation of AFUDC-equity
- Centralized cash management arrangements—Cash Pools
- Presentation of changes in restricted cash balances
- Presentation of bank and book overdrafts
- Costs associated with asset retirement obligations and non-ARO decommissioning
- Emission allowances and related transactions

Financial Statement Segments

Segments

- Over the past several months, a number of SEC staff members have discussed recurring practice issues in segment reporting, including issues identified in the Financial Accounting Foundation's (FAF's) Post Implementation Review (PIR) report on FASB Statement 131
- The SEC staff stated that it will renew its focus on the identification of the CODM and entity's organizational structure in determining operating segments
- The SEC staff will continue to challenge whether aggregation of operating segments is consistent with the objectives and basic principles of ASC 280 and will question how entities determined that providing more detailed segment disclosures would detract from these objectives

Segments

- Recurring Issue — Identifying the CODM
- Recurring Issue — Identifying Information Provided to and Regularly Reviewed by the CODM
- Recurring Issue — Aggregating Operating Segments

Subsequent Events

Subsequent Event & Rate-Regulated Activity

- Items to consider when determining if rate-regulated activity, such as a rate order, should be accounted for as a recognized or nonrecognized subsequent event
  - Does the rate order provide additional evidence about conditions that existed at the date of the balance sheet?
  - Does the rate order provide evidence about condition that did not exist at the date of the balance sheet but came about after the balance sheet date but before the financial statements are issued?
  - What is the regulatory timeline being followed with the Commission?
  - What precedence has been established with prior rate orders?
- Recognized subsequent events
  - An entity shall recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements.

Nonrecognized Subsequent Events

- An entity shall not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date but before financial statements are issued or are available to be issued.
- Some nonrecognized subsequent events may be of such a nature that they must be disclosed to keep the financial statements from being misleading. For such events, an entity shall disclose the following:
  - The nature of the event
  - An estimate of its financial effect, or a statement that such an estimate cannot be made
- Occasionally, a nonrecognized subsequent event may be so significant that disclosure can best be made by means of pro forma financial data. Such data shall give effect to the event as if it had occurred on the balance sheet date.

Disclosure Related to Recently Issued Accounting Standards Effective in Future Periods – Revenue Recognition

SAB Topic 11-M Relative to Revenue Recognition

- Disclosure of ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” under Staff Accounting Bulletin (SAB) Topic 11-M (SAB 74) in interim and annual filings.
- SAB Topic 11-M addresses disclosure of the impact of recently issued accounting standards will have on the financial statements of registrants when adopted in a future period.
- Companies will need time to assess the effects of Topic 606 on their financial statements. Accordingly, the initial SAB Topic 11-M disclosures about the effects may not be specific in nature.
- SEC staff has indicated it expects these disclosure to evolve over time as companies begin to better understand how Topic 606 will impact their financial statements.
- Registrants should also consider making disclosure of the potential impact of other significant matters that may result from the adoption of Topic 606.

SAB Topic 11-M Relative to Revenue Recognition, cont.

- Initial disclosure examples:
  - Company A
    - ASU 2014-09, “Revenue from Contracts with Customers” (ASU 2014-09): ASU 2014-09 provides accounting guidance for revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers. The guidance also provides a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate. This guidance must be adopted using either a full retrospective approach for all periods presented in the period of adoption or a modified retrospective approach.
    - We will adopt ASU 2014-09 on January 1, 2017 as required, and we are currently evaluating the effect of adopting it on our financial condition, results of operations and cash flows.

SAB Topic 11-M Relative to Revenue Recognition, cont.

- Initial disclosure examples:
  - Company B
    - In May 2014 the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606).” The ASU’s core principle is that “an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” The ASU details a five-step model that should be followed to achieve the core principle. ASU 2014-09 is effective for Company B for the first quarter 2017. Company B does not expect ASU 2014-09 to affect materially its results of operations, financial position, or cash flows.

SAB Topic 11-M Relative to Revenue Recognition, cont.

- Initial disclosure examples:
  - Company C
    - This accounting standard was issued to clarify the principles for recognizing revenue and to develop a common standard that would remove inconsistencies in revenue requirements; improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets; and provide improved disclosures.
    - The guidance provides a five-step model to be used for recognizing revenue for the transfer of promised goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services.
    - The update is effective for annual and interim reporting periods beginning after December 15, 2016. Early application is not permitted. We are currently analyzing the impact of this standard on our financial statements.

Disclosure Related to Unrecognized Tax Benefits

Unrecognized Tax Benefit Related Disclosures

- Basic recognition threshold
  - An entity shall initially recognize the financial statement effects of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination.
  - The determination of whether or not a tax position has met the more-likely-than-not recognition threshold shall consider the facts, circumstances, and information available at the reporting date.

Unrecognized Tax Benefit Related Disclosures

- All entities shall disclose all of the following at the end of each annual reporting period presented:
  - The total amounts of interest and penalties recognized in the statement of operations and the total amounts of interest and penalties recognized in the statement of financial position
  - For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date:
    - The nature of the uncertainty
    - The nature of the event that could occur in the next 12 months that would cause the change
    - An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made.
  - A description of tax years that remain subject to examination by major tax jurisdictions.

Unrecognized Tax Benefit Related Disclosures, cont.

- Public entities shall disclose both of the following at the end of each annual reporting period presented:
  - A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period, which shall include at a minimum:
    - The gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during a prior period
    - The gross amounts of increases and decreases in unrecognized tax benefits as a result of tax positions taken during the current period
    - The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities
    - Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations
  - The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate

Disclosures — Tabular rollforward

Example

	2014	2013	2012
Unrecognized tax benefits, opening balance	**$XX**	**$XX**	**$XX**
Gross increases – tax positions in prior periods	XX	XX	XX
Gross decreases – tax positions in prior periods	(XX)	(XX)	(XX)
Gross increases – current period tax positions	XX	XX	XX
Settlements	(XX)	(XX)	(XX)
Lapse of statute of limitations	(XX)	(XX)	(XX)
Unrecognized tax benefits, ending balance	**$XX**	**$XX**	**$XX**

Note: This annual disclosure is not required during interim periods, but quarterly MD&A disclosure of (de)recognition of material amounts may be required

Presentation of UTB when attribute DTAs exist

ASU 2013-11 issued July 18, 2013

ASU 2013-11
UTB is presented as a reduction of the tax impact of a net operating loss, a similar tax loss, or tax credit carryforward unless tax law prohibits settlement with NOL/tax credit (or tax law does not require and entity does not intend to offset)

Effective date and transition

- Prospective application to any UTBs that exist as of effective date
  - Public companies – interim and annual periods beginning after December 15, 2013
  - Non-public companies – interim and annual periods beginning after December 15, 2014
- Retrospective application permitted; early adoption permitted

Balance Sheet	Gross	Net
DTAs	**$ 1,000**	**$ 500**
Other assets	20,000	20,000
Total assets	**$21,000**	**$20,500**
UTB liability	**$ 500**	**$ 0**
Other liabilities	14,000	14,000
Equity	6,500	6,500
Total liabilities & equity	**$21,000**	**$20,500**

Disclosure Effectiveness

Disclosure Effectiveness

- In December 2013, in a report made in response to a JOBS Act mandate, the SEC staff indicated that the Commission would commence a broad effort to modernize and streamline its rules and regulations (i.e., the SEC's "disclosure effectiveness project")
- To achieve this objective, the SEC will focus not only on eliminating outdated, redundant, and overlapping disclosures but also on identifying topics about which investors may need better or more information to make educated investment decisions
- Division staff (and others) stress registrants should focus disclosures on material and relevant matters to their operations, liquidity, and financial condition to make current disclosures more effective

Disclosure Effectiveness Considerations

Disclosure Type	Disclosure Considerations
Critical accounting estimates in MD&A	• Reduce or remove from MD&A redundant information related to an accounting policy itself and instead cross-refer to the financial statement footnotes. • Focus the MD&A discussion on the nature of estimates and assumptions and any material impact on liquidity and operations.
Legal and other contingencies in Regulation S-K, Item 103, "Legal Proceedings"	• Consider that the requirements of ASC 450 and Item 103 are not identical. • Reduce or remove redundant information in complying with Item 103 and, if appropriate, cross-refer to the financial statement footnotes. • Comply with incremental requirements in Regulation S-K.

Disclosure Effectiveness Considerations, cont.

Disclosure Type	Disclosure Considerations
Disclosing the impact of recently issued accounting pronouncements under SAB Topic 11.M	• Consider whether disclosure is necessary by assessing the estimated impact of the future guidance on the entity. • Disclose the specific impact to the entity and quantify if possible. • Consider excluding discussion if the known or expected impact is immaterial.
Risk factors	• Limit risk factors to those that are relevant and material to the entity. • Tailor the discussion to registrant-specific facts and circumstances; consider how the registrant would be affected if the risk materializes. • Continually monitor and update risk factors.

Disclosure Effectiveness Considerations, cont.

Disclosure Type	Disclosure Considerations
Disclosure resulting from past SEC comment letters	• Assess disclosures resulting from previous SEC comments and provide updates on the basis of materiality and relevance. • Consider removing disclosures that are no longer relevant.
Disclosure of historical information	• Continually reassess existing disclosures for relevance. • Add, expand, or eliminate disclosures on the basis of changes in a registrant's facts and circumstances.
SEC best practices or changes in interpretive guidance	• Evaluate the nature and extent of disclosures in light of the SEC's recommendations for improvement.

Disclosure Effectiveness Considerations, cont.

Disclosure Type	Disclosure Considerations
Nature and extent of information disclosed in MD&A	• Assess disclosures on the basis of materiality and relevance. • Include analysis underlying changes from the financial statements (e.g., for liquidity disclosures, avoid only restating numerical changes from the statement of cash flows).

Agenda

- Highlights of 2014 AICPA Conference
- Update on IASB RRA Project
- Update on Work of Power & Utilities Revenue Recognition Task Force
- Update on Lease Accounting Project
- Update on EITF Consideration of NPNS Designations in Nodal Energy Markets

Highlights of 2014 AICPA Conference

2014 AICPA Conference

Highlights and Areas of Focus

- Segment reporting
  - Identifying the CODM
  - Over-reliance on CODM reporting package
  - Reminder regarding entity-wide disclosure requirements
  - Aggregation considerations
- Income tax disclosures in MD&A
  - Valuation Allowances
  - Realizability of DTAs
  - Indefinite reinvestment assertions
  - Effective tax rates that are volatile or appear unusual relative to statutory rate
- ICFR – Low number of material weaknesses in the absence of a restatement
  - Reminder to adequately consider the “could factor”

2014 AICPA Conference

Highlights and Areas of Focus

- Revenue Recognition
  - FASB to discuss possible effective date deferral in early 2015
  - Importance of initial implementation - SEC expressed view that outliers should be rare
  - Reminder of requirement to disclose material changes to ICFR
- IFRS / Convergence
  - New SEC Chief Accountant has not decided what path he will recommend
  - SEC is seeking stakeholder input on allowing domestic filers to submit supplemental IFRS-based information on a voluntary basis

2014 AICPA Conference

Highlights and Areas of Focus

- SEC staff speeches on technical accounting topics:
  - Statement of cash flows
  - Defined benefit plans – use of updated mortality tables
  - Changes to equity-classified preferred stock
  - ***Derivative novations***
  - Allocating proceeds to a bifurcated derivative liability
  - Gross versus net revenue reporting
  - Reverse spinoffs
  - Change in annual goodwill impairment testing date
  - Presentation of expenses related to pushdown accounting
  - Variable interest entities
  - Joint ventures

2014 AICPA Conference

Highlights and Areas of Focus

- PCAOB 2015 Inspection Program – Areas of Focus:
  - Controls in business processes related to business combinations
  - Income taxes
  - Valuation of hard-to-value financial instruments
  - Environmental developments including the impact of falling oil prices
  - Management and auditor considerations around statement of cash flow presentation of significant transactions
  - Cybersecurity

For additional information refer to Deloitte Heads Up issued December 15, 2014

Update on IASB Rate Regulated Activities Project

IASB RRA Project

Highlights of DP Issued in September 2014

- Part of IASB's comprehensive project on Accounting for the Effects of Rate Regulation
  - Research Phase
  - IFRS 14
- Discussion document designed to solicit input about the features of rate regulation and whether such features give rise to rights/obligations that should be reflected in general purpose financial statements
- Discusses cost-of-service schemes and incentive-based schemes
- Also discusses hybrid schemes similar to those found in the United States

IASB RRA Project

Highlights of DP Issued in September 2014

- DP does not prescribe any accounting requirements but does explore several possible alternatives, including:
  - Relying on IASB Conceptual Framework
  - Allowing regulated entities to report under regulatory requirements
  - Precluding recognition of assets/liabilities that arise due to regulatory mechanisms
  - Creating specific rules for regulatory assets/liabilities (similar to US GAAP)
  - Recognition of basket of rights/obligations as an intangible asset
- Refer to Deloitte Industry Spotlight for further information
- Comments on DP due January 15, 2015

IASB RRA Project

EEI Hosted Meeting in December 2014

- EEI held a meeting with the IASB (staff and 2 board members) designed to convey the US perspective
- Attendees included company reps, accounting firm reps, debt and equity analysts and federal and state regulators
- Key messages communicated:
  - Users want information about the effects of regulation and want it in the audited financial statements
  - Analysts are interested in the timing of cash flows associated with regulatory assets/liabilities
  - Regulatory assets are good assets
  - Encouraged further consideration of Conceptual Framework as well as IFRS 15 (the new revenue standard) to support recognition

Update on Work of Power and Utilities Revenue Recognition Task Force

Revenue Recognition

Update on Work of Industry Task Force

Areas of Focus:

- Scope clarification for tariff based sales
- Variable consideration scenarios
- Contract modifications including blend-and-extend
- Implications for bundled sales
- Sales of PP&E (including partial sales)

Next Steps:

- Submission of two issues (tariff sales and blend-and-extend modifications) in January
- Continue work on remaining issues after 10-K season

Update on Lease Accounting Project

Leasing Project Update

Staff consideration of definition of a lease continues to evolve:

- Right to direct the use of an asset has received considerable attention
- Increased emphasis on where and when the asset is used
- Decreased emphasis on performing the O&M
- Expectation that PPAs that provide the buyer with dispatch rights will meet revised definition

Other open areas:

- Dual-model for lessees – converged solution?
- Treatment of small-ticket items

Update on EITF Consideration of NPNS Designations in Nodal Energy Markets

Update on NPNS Issue

NPNS for electricity forwards in nodal markets:

- Diversity in views around application of NPNS to forward purchases that deliver to a hub
- Spot market used to "transmit" the power from hub to customer load zone
  - Spot sale at hub and spot purchase at load zone
  - LMP differential = cost of transmission
- Is spot sale at hub a net settlement of the forward contract?
  - If so, NPNS would appear to be precluded
- U.S. GAAP does not contemplate nodal markets
- Diversity in practice exists (EEI survey performed in September 2013)

Update on NPNS Issue

NPNS for electricity forwards in nodal markets:

- A working group was assembled to discuss with the SEC staff on a no-name basis
- Industry prepared a position paper that presented alternative views and asked SEC “not to object” to NPNS
- SEC notified the working group in June 2014 that they have asked the EITF to address the matter
- EITF expected to hold education session on the issue in January 2015 and commence deliberations at their March meeting
- Early indications of staff support/sympathy for industry position
- Consult your auditor regarding existing and proposed NPNS designations

Coal Ash EPA Regulation Update

Coal Ash EPA Regulation

- Disposal of Coal Combustion Residuals from Electric Utilities final rule was signed by the EPA Administrator on December 19, 2014
  – Rule establishes technical requirements for CCR landfills and surface impoundments under Subtitle D of the Resource Conservation and Recovery Act (RCRA), as anticipated
  – As of January 7, 2015 (10AM EDT) this rule had not yet been published in the Federal Register

- Timing considerations for recording an asset retirement obligation (ARO)
  – ARO accounting (ASC 410-20-15) applies to legal obligations associated with the retirement of a long lived asset
  – A question that many companies are addressing at year end 2014 is when does the EPA rule on coal ash become a legal obligation
  – EEI survey indicates most company legal departments assert that the coal ash requirements are not a legal obligation prior to the date the rule is published in the Federal Register

  Reminder:

    - Promissory estoppel considerations under ASC 410-20-55-1

EPA CCR Rule - Details

	Regulation Requirements under Rule (Subtitle D)
Effective Date	Six months after final rule is promulgated for most provision: certain provisions have a longer effective date
Enforcement	Enforcement through citizen suits; States can act as citizens.
Corrective Action	Self-implementing
Financial Assurance	Considering subsequent rule using CERCLA 108 (b) Authority
Permit Issuance	No
Requirements for Storage, Including Containers, Tanks, and Containment Buildings	No
Surface Impoundments Built Before Rule is Finalized	Must remove solids and retrofit with a composite liner or cease receiving CCRs within 5 years of effective date and close the unit
Surface Impoundments Built After Rule is Finalized	Must install composite liners. No Land Disposal Restrictions
Landfills Built Before Rule is Finalized	No liner requirements, but require groundwater monitoring
Landfills Built After Rule is Finalized	Liner requirements and groundwater monitoring
Requirements for Closure and Post-Closure Care	Yes; self-implementing

EPA CCR Rule – Details

- The final EPA ruling (subject to approval and publication in federal register) sets parameters under several criteria:
  - Location Requirements
  - Liner Design Criteria
  - Structural Integrity Requirements
  - Operating Criteria
  - Groundwater Monitoring and Corrective Action
  - Closure & Post Closure Requirements
  - Record Keeping, Notification, and Internet Posting Requirements

Defined benefit pension and postretirement plans—

Mortality assumption

Mortality Tables – AICPA Conference Update

Assumptions

- Each individual assumption under ASC 715-30 and ASC 715-60 represents management's best estimate
- Mortality is key assumption in defined benefit obligation measurement

Views on Society of Actuaries updated mortality tables and improvements scale (released October 2014)

- OCA staff expects registrants to use the updated information
- OCA staff also expects registrants to disclose any significant effect on the benefit obligation resulting from change in mortality tables
- Separate current practice issues panelist noted:
  - Importance of registrants discussing longevity assumption with their auditors early in the process
  - Updated mortality tables could result in significant increases in benefit obligation

Identifying and assessing deficiencies in internal controls

Comments from the SEC at the AICPA year end conference

Internal Control Over Financial Reporting

- Significant focus of SEC staff (reviews & enforcements)
- Control deficiencies:
  - Need to evaluate severity
    - Not limited to the size of the error identified
    - Assess whether there a reasonable possibility that a material misstatement could occur and not be detected or prevented by the entity’s ICFR?
      - Immaterial misstatements still could be indicative of a material weakness
  - Consider impact on control environment, information and communication, risk assessment, and/or monitoring components of ICFR

Internal Control Over Financial Reporting

- Most common deficiencies relate to:
  - Not obtaining a sufficient understanding of the flow of transactions in order to identify and test the controls that mitigate the risks
  - Management review controls
  - Not testing the completeness and accuracy of the data used in the performance of controls
  - Identification, evaluation, and disclosure of material weaknesses
    - Not identifying deficiencies
    - Not appropriately evaluating severity of deficiencies
      - Too much focus on the actual error and not what the error could have been
    - Relationship of deficiency with various COSO components

Year end FERC reporting reminders including formula rates

Formula rates

Many companies have formula rates for a portion of utility revenues

- Electric transmission and wholesale electric production are common
- After filing of the FERC Form 1, a final revenue requirement calculation is prepared
- Any over or under collection is billed or refunded
- The revenue recognition policy for most formula rates are to recognize revenue based on the revenue requirement calculation rather than the amount currently billed
- The year end revenue requirements calculation is typically an estimate because the FERC Form 1 and the complete calculation is normally not available at the time the books are closed

Formula rates

Formula rate considerations at year end

- Retrospective review--understand any changes from the prior year “close the books” estimate to the final “as-filed” calculation

- Internal control

- Common FERC audit findings related to formula rates
  - Rate base errors (AROs, deferred taxes, prepaid taxes, plant acquisition adjustments)
  - Equity errors (purchase accounting impacts, AOCI)
  - Cost of service errors (above vs. below the line expenses)
  - Errors in Form 1 amounts used to populate the formula rate template

FERC Year end reminders

- AFUDC calculations
- Differences in FERC and GAAP reporting
  - Numerous classification differences (such as cost of removal)
  - Netting of RTO transactions (wholesale revenue and power purchase expense)
  - Regulatory asset criteria

FERC – upcoming webcast

- EEI, AGA, and Deloitte will present a webcast in mid March 2015 for EEI and AGA members

The webcast will cover FERC audit findings, things to focus on for 2014 FERC Form 1 and Form 2 preparation, and resources for researching FERC accounting issues

Questions

?

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