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Florida Power
A **Progress Energy** Company

JAMES A. MCGEE

September 4, 2002

Ms. Blanco S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, Florida 32399-0850

Re: Undocketed Workshop

Dear Ms. Bayo:

Enclosed are Florida Power Corporation's Responses to Staff's Questions Regarding Statement of Financial Accounting Standards 143 Accounting for Asset Retirement Obligations.

If you have any questions, please contact me at 727-820-5184.

Very truly yours,

James A. McGee
Associate General Counsel

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Before the Florida Public Service Commission

Florida Power Response to Staff's Questions Regarding Statement of Financial Accounting Standards No. 143 Accounting for Asset Retirement Obligations

As requested by the Florida Public Service Commission staff in its letter of August 6, 2002, Florida Power Corporation, hereby submit responses to the questions regarding accounting, reporting and ratemaking implications related to recognizing asset retirement obligations pursuant to the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 143 – Accounting for Asset Retirement Obligations (SFAS 143).

1. **Should SFAS 143 be adopted for regulatory accounting purposes?**

   RESPONSE: Yes

2. **What categories of existing fixed assets are likely to have asset retirement obligations that would be recognized and measured under SFAS 143?**

   RESPONSE: The potential exists for all asset categories to have asset retirement obligations if the criteria of a legal obligation exists. Nuclear radiated assets have been identified as having asset retirement obligations; all other assets are still being evaluated.

3. **Should legal obligations related to asset retirement obligations be recognized in Commission Annual Reports? If not, what is the authoritative support for this position? Please explain.**

   RESPONSES: Legal obligations related to asset retirement obligations should be recognized in all Commission filings. The FPSC should support the creation of new sub-

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accounts to accommodate the effects of SFAS 143 on both the balance sheet and income statement.

Florida Power recommends the following new sub-accounts be used: On the balance sheet, for the ARO liability – Account 253.xx, Other Deferred Credits, or, optionally, use Reserved Account 228.xx; for the Regulatory Liability – Account 254.xx, Other Regulatory Liabilities; for the ARO asset – Account 303.xx, Miscellaneous Intangible Plant; and for the amortization of the ARO asset – Account 111.xx, Accumulated Provision for Amortization of Electric Utility Plant. On the income statement, for Amortization Expense to record ARO Asset Amortization – Account 404.xx, Amortization of Limited-Term Electric Plant; and for the ARO accretion expense and amortization of the non-ARO regulatory liability/asset created in response to SFAS 143 – sub-accounts of Account 405, Amortization of Other Electric Plant.

4. **If legal obligations related to asset retirements should be recognized for regulatory financial accounting and reporting purposes, should they be recognized on the same basis and in the same manner as required for external and Securities and Exchange Commission financial reporting? If not, please explain the reasons for any different accounting treatment? What specific categories of existing fixed assets have asset retirement obligations that would be recognized and measured under such requirements? Please provide an approximation of the additional asset retirement obligation liability that would be recognized under this requirement, the net income effect, and other related financial consequences. Please explain and provide the workpapers supporting the estimate.**

RESPONSE: Legal obligations related to asset retirements should be recognized for regulatory financial accounting and reporting on the same basis as the obligations are recognized for external financial accounting and reporting. Florida Power believes that the objective of the revisions to the USOA should be to facilitate the elimination of any affect of the application of SFAS 143 in regulatory accounting for ratemaking/cost of service purposes. To accomplish this revenue neutrality, the difference between amounts included in rates and expense recorded for asset retirement obligations should be recognized as a regulatory asset/liability.

For ratemaking purposes, the objective is to spread all asset related costs over the life of the asset so that customers receiving the benefit of the asset pay for those costs. The use of the regulatory asset/liability and the related expense meets this objective , while at the same time providing the correct financial reporting under SFAS 143.

It is important to realize that estimates of asset retirement obligation will be dependent on each company's specific fact pattern. The most obvious existing fixed assets having asset retirement obligations that would be recognized and measured under such requirements would be nuclear generating units, whose owners have the legal obligation to decommission the contaminated portions of the units at the end of those units' operating lives. However, determination of the remaining asset retirement obligations will be an entity-specific and time-intensive process, and the companies are only in the first phase of this process.

5. **SFAS 143 requires companies to write-up the book value of tangible long-lived assets to include the present value of the retirement obligation. Should these amounts be recorded in the specific long-lived tangible asset accounts or should the amounts be separately maintained in regulatory asset accounts? If so, discuss how property taxes will be affected.**

RESPONSE: SFAS 143 requires the asset retirement costs (ARC's) to be reported as part of the long-lived asset. Therefore, we recommend recording the ARC in FERC account 303 in order to maintain its integrity for disclosure and tracking purposes. This account will roll up to property accounts for financial reporting, as required.

One aspect of the requirements of SFAS 143 that may have an impact on property taxes is the reclassification of asset retirement obligations from account 108 to a liability account. Some property tax calculations are based on net book value, which would increase as a result of reclassifying those amounts. This impact is still being reviewed.

6. **Under the Uniform Systems of Accounts, what existing or new balance sheet accounts should be used to record the capitalized asset retirement costs? Also, what existing or new primary plant account(s) should be used to record the capitalized asset retirement costs? Please explain.**

RESPONSE: The capitalized asset retirement costs should be accounted for in Account 303, Miscellaneous Intangible Plant. These costs should be placed in a separate sub-account that would roll into Account 101, Electric Plant in Service.

7. **What records should be maintained to support the capitalized asset retirement costs and related liability for the asset retirement obligations? Please explain.**

RESPONSE: Florida Power urges the FPSC to allow utilities flexibility in the methodologies used to develop and track the estimated costs associated with the capitalized asset retirement obligations and related liabilities. SFAS 143 has some provisions that are subject to various interpretations relating to the measurement of the asset retirement obligations. As implementation of SFAS 143 occurs, changes and revisions in assumptions, methods and procedures are likely to occur over a period of years.

Florida Power believes the FPSC does not need to specifically address record keeping requirements at this time, except to require companies to keep records at a sufficient, detailed level to satisfy the requirements of ongoing compliance with Rule 25-6.014, Florida Administrative Code, Records and Reports in General.

8. Under the Uniform Systems of Accounts, what existing or new accounts for depreciation expense and accumulated depreciation should be used to record depreciation on the capitalized asset retirement costs? Please explain.

RESPONSE: The accounts that should be used are Account 404 – Amortization of Limited-Term Electric Plant and Account 111 – Accumulated Provision for Amortization of Electric Utility Plant. New sub-accounts should be created within Accounts 404 and 111 to track these costs.

9. What detailed depreciation records are needed for the capitalized asset retirement costs? Please explain.

RESPONSE: See response to Question # 7.

10. Under the Uniform Systems of Accounts, what existing or new accounts should be used to record liabilities for asset retirement obligations and the related time value of money (accretion expense)? Please explain.

RESPONSE: The liability should be recorded in Account 253, Other Deferred Credits. This account will keep the ARO liability segregated from liabilities used in calculating ongoing debt ratios and would not require utilities to unnecessarily track these as current and non-current liabilities.

Accretion expense should be recorded in Account 405 – Amortization of Other Electric Plant. Recording accretion expense in Account 405 would prevent users of the information from confusing accretion expense with interest expense. A separate sub-account could be used to segregate accretion from other Account 405 expenses.

11. What records should be maintained to support the entries and the amounts included in the liability account so that companies can furnish complete information for each specific liability related to each property that gives rise to a liability for an asset retirement obligation? Please explain.

RESPONSE: The answer given for Question #7 above also applies to maintaining records to support the entries and amounts included in the liability account. Companies should be allowed flexibility in record keeping. The FPSC does not need to specifically address record keeping requirements at this time.

12. How does the accounting for asset retirement obligations impact the Uniform Systems of Accounts' and FPSC definitions for Depreciation, Service Value, Net Salvage, Salvage Value, Cost of Removal and Service Life? Please explain.

RESPONSE: There should be no change in the existing definitions provided in the USOA or by the FPSC related to depreciation, salvage and removal costs as used by rate-regulated entities. SFAS 143 should not affect the meaning or calculation of depreciation for regulated entities. Current practices should continue with the exception that portions of the depreciation expense, and reserve, should be separated on the books of the utility to reflect the existence of asset retirement obligations.

13. What revisions should be made to the Commission's definitions for Depreciation, Service Value, Net Salvage, Salvage Value, Cost of Removal and Service Life as a result the accounting for asset retirement to differentiate between the cost of removal that is not recognized as a liability for cost of removal versus the cost of removal recognized as a liability for an asset retirement obligation? Please explain.

RESPONSE: There is no need for revisions to the current definitions in the USOA or by the FPSC as they apply to the definitions of Depreciation, Service Value, Net Salvage, Salvage Value, Cost of Removal and Service Life as a result of SFAS 143. The only segregation that should occur is at the expense and reserve account number level. However, it may be appropriate to add definitions to the USOA to define Asset Retirement Obligation and Accretion Expense.

14. What are the implications of the accounting for asset retirement obligations on current depreciation rules, practices, and procedures (group method versus component method)? Please explain. How should a regulated entity account for the transition adjustment related to the adoption of accounting for asset retirement obligations? Please explain.

RESPONSE: Depreciation procedures currently employed by regulated entities should not change as a result of SFAS 143, except to the extent necessary to segregate the elements of depreciation related to the capitalized cost resulting from the recognition of asset retirement obligations in order to comply with the requirements of the Commission's USOA and cost-of-service study requirements. Otherwise, an asset retirement obligation should be recognized and recorded in the same manner, whether the entities are employing group or component depreciation. Group depreciation has been successfully used by utilities for many years. It accomplishes the overall goal of charging customers the appropriate cost of service through rate base and depreciation expense. Any requirements to change this as a result of SFAS 143 would be premature, at this time.

Electric utilities subject to SFAS 71 would record a transition adjustment in accordance with paragraph 20 of SFAS 143, which reads, "a regulated entity also shall recognize a regulatory asset or liability for differences in the timing of recognition of the period costs associated with asset retirement obligations for financial reporting pursuant to this Statement and ratemaking purposes." Therefore, assuming SFAS 71 criteria are satisfied, a cumulative adjustment to a regulatory asset or liability will be made for differences in the timing of expense recognition for ratemaking purposes that are different from, or not covered, under SFAS 143.

15. **At the date of adoption of the accounting pronouncement, how would a jurisdictional entity account for asset retirement obligations associated with plant or facilities that have been closed or abandoned (i.e. retired but not physically removed)? Please explain.**

RESPONSE: Asset retirement obligations related to retired assets, not yet physically removed, must be factored into the cash flows and calculated in the same fashion as the asset retirement obligations related to existing plant. Thus, the asset retirement obligation would be included in the entity's accounting at the date of adoption and would continue to be included until the asset retirement obligation has been satisfied. The offset to an asset retirement obligation would depend on meeting the criteria for establishment of a regulatory asset or liability under SFAS 71.

16. **If an existing component part of a larger system asset has a legal obligation associated with its retirement, and the component's useful life is shorter than the life of the larger system asset of which it is a part, must a liability for the asset retirement obligation be recognized for the component and the asset retirement costs be depreciated over the component useful life? At the date of adoption will there be sufficient information and records related to such components to recognize and measure the related asset retirement obligations? Please explain.**

An existing component part of a larger system asset that has a legal obligation associated with its retirement and that has a shorter life than the larger system asset, will have a liability and depreciable life that is expensed over a shorter period than the larger system. Utilities will need to determine if AROs related to these "interim retirements" exist based on a review of federal, state, and local laws, and specific contractual arrangements. Each utility should make this determination after performing such reviews.

17. **How should any balances remaining at the date of settlement of liabilities for asset retirement obligations be accounted for? Please explain.**

RESPONSE: As noted earlier, differences between costs recovered in rates and those recognized under FAS 143 would be recognized as regulatory assets or liabilities. Assuming that a balance remains after the settlement of the ARO, the adjustment to eliminate the remaining ARO balance should be accompanied by the reversal of any specific regulatory asset/liability established to accumulate the difference between the ARO liability in question and the traditional cost of removal.

18. **How will the recognition of asset retirement obligations affect the current accounting for capital and operating leases? Under the Uniform Systems of Accounts, what new or existing balance sheet and income statement accounts should be used by a lessor and lessee to account for asset retirement obligations associated with either capital leases or operating leases? Please explain.**

RESPONSE: Under current Commission rules, a sub-division of Account 101 – Electric Plant in Service is to be maintained to segregate owned property from property accounted for as a capital lease (Account 101.1 – Property Under Capital Leases). This requirement is sufficient in conjunction with the recommendation to record the newly capitalized asset in Account 303 – Miscellaneous Intangible Plant, which will roll into Account 101.1 for leased property. If an asset retirement obligation exists for a capitalized leasehold improvement that is made for a lease that is accounted for as an operating lease, the recommended accounting for the ARO asset would be the same as for capitalized leases.

19. **For electric utilities, does "spent nuclear fuel" and "storage casks used for interim storage of spent fuel" result in legal asset retirement obligations? If so, under the**

Uniform Systems of Accounts, what new or existing balance sheet and income statement accounts should be used to record the amounts related to the asset retirement obligations for "spent nuclear fuel" and the "storage cask used for interim storage of spent fuel"? Please explain.

RESPONSE: The liability associated with removal of spent fuel currently resides with the Department of Energy (DOE). Owners of nuclear facilities make payments to DOE for the final disposal of spent nuclear fuel. Florida Power will continue to evaluate this issue, but believes, subject to further legal review, that spent nuclear fuel should be excluded from being reflected as a liability.

However, "storage casks used for interim storage of spent fuel" may result in legal asset retirement obligations and should not require treatment that is any different from any other asset retirement obligations. For regulatory expense recognition, any differences between the timing of expenses for regulatory purposes and the future timing of expenses under SFAS 143 should be considered in regulatory asset and liability accounting, if SFAS 71 criteria are satisfied.

20. What are the issues involved in reconciling the new accounting requirements for asset retirement obligations with existing rate practices which may recover asset retirement obligations, all or in part, through general customer rates, depreciation, or negative salvage (or decommissioning) allowances? How should the transition to the new rule reflect that such costs (i.e., negative salvage) may have already been recovered in existing customer rates and existing depreciation rates?

RESPONSE: Regulated utilities will need to identify and quantify the extent to which retirement obligations have been recovered through rates in prior periods and on an ongoing basis. Such information will be necessary to record regulatory assets and liabilities as discussed in response to Questions #4, 14 and 17.

21. **What are the implications of the asset retirement obligations accounting model that may result in higher total expenses in the later years of an asset's life than in earlier years because of compounding interest effect?**

    RESPONSE: See Questions #4 and 14. Any differences between amounts included in rates and expenses recorded for asset retirement obligations should be recorded as regulatory assets or liabilities.

22. **For rate making purposes, how can interim events involving system components, such as asset retirements or sales be properly reflected if the asset retirement obligations were not recognized for the components?**

    RESPONSE: A legal obligation must exist for replacement of the component part on an interim basis to meet the SFAS 143 liability definition. If no legal obligation exists, current accounting practices involving system components will continue.

23. **How will Asset Retirement Obligations under 143 meet the definition of incurred cost under FAS 71?**

    RESPONSE: FAS 71 refers to "-- an incurred cost that would otherwise be charged to expense --." The general definition of incurred cost that is referenced includes the wording "—from cash paid out or obligation to pay --- ." Florida Power believes that any expense that must be recognized under GAAP meets the definition of an incurred cost.

24. **What are the estimated revenue requirements for each year over the next five years resulting from implementing SFAS 143? Please provide the detailed calculations.**

RESPONSE: Until the regulatory treatment of SFAS 143 is determined, the revenue requirement impact cannot be calculated. Although it cannot be calculated it is assumed that there will be no revenue requirement impact under the assumption that asset retirement costs continue to be collected in rates on the current basis and that the Commission approves the regulatory asset or liability accounting for the difference between that recognized under SFAS 143 and that recovered in rates.

25. Is rulemaking needed to provide accounting guidance for implementing SFAS 143? Please explain.

RESPONSE: Florida Power does not believe that any specific rulemaking is necessary at this time. The FERC is considering changes necessary to the USOA to accommodate the unique accounting imposed by SFAS 143. It may be necessary for the FPSC to amend Rule 25-6.014, Florida Administrative Code, Records and Reports in General, to officially adopt the changes to the USOA implemented by the FERC. These changes are consistent with the changes proposed in the responses to these questions.