Goss • Samford PLLC
Attorneys at Law

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COMMISSION

May 11, 2015

VIA HAND DELIVERY

Mr. Jeff Derouen
Executive Director
Kentucky Public Service Commission
P.O. Box 615
211 Sower Boulevard
Frankfort, KY 40602

Re: PSC Case No. 2014-00432

Dear Mr. Derouen:

Please find enclosed for filing with the Commission in the above-referenced case an original and eight copies of the responses of East Kentucky Power Cooperative, Inc. ("EKPC"), to the Staff's Rehearing Request for Information dated April 27, 2015.

Due to the complexity of the ARO accounting, EKPC would be willing to participate in an informal conference with the Commission Staff if such a conference would be of assistance.

Very truly yours,

David Samford by D.

David S. Samford

Enclosures

2365 Harrodsburg Road, Suite B-325 | Lexington, Kentucky 40504

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF EAST KENTUCKY POWER COOPERATIVE, INC. FOR AN ORDER APPROVING THE ESTABLISHMENT OF REGULATORY ASSETS FOR THE DEPRECIATION AND ACCRETION EXPENSES ASSOCIATED WITH ASSET RETIREMENT OBLIGATIONS	))))))	**CASE NO. 2014-00432**

RESPONSES TO COMMISSION STAFF'S

REHEARING REQUEST FOR INFORMATION

TO EAST KENTUCKY POWER COOPERATIVE, INC.,

DATED APRIL 27, 2015

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

THE APPLICATION OF EAST KENTUCKY POWER COOPERATIVE, INC. FOR AN ORDER APPROVING THE ESTABLISHMENT OF REGULATORY ASSETS FOR THE DEPRECIATION AND ACCRETION EXPENSES ASSOCIATED WITH ASSET RETIREMENT OBLIGATIONS	))))))	**CASE NO. 2014-00432**

CERTIFICATE

STATE OF KENTUCKY)
)
COUNTY OF CLARK)

Michelle K. Carpenter, being duly sworn, states that she has supervised the preparation of the responses of East Kentucky Power Cooperative, Inc. to the Public Service Commission Staff's Rehearing Request for Information in the above-referenced case dated April 27, 2015, and that the matters and things set forth therein are true and accurate to the best of her knowledge, information and belief, formed after reasonable inquiry.

Michelle K. Carpenter

Subscribed and sworn before me on this 11th day of May 2015.

Gwyn M. Willoughby #500144
Notary Public

GWYN M. WILLOUGHBY
Notary Public
State at Large
Kentucky
My Commission Expires Nov 30, 2017

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

THE APPLICATION OF EAST KENTUCKY POWER COOPERATIVE, INC. FOR AN ORDER APPROVING THE ESTABLISHMENT OF REGULATORY ASSETS FOR THE DEPRECIATION AND ACCRETION EXPENSES ASSOCIATED WITH ASSET RETIREMENT OBLIGATIONS	))))))	CASE NO. 2014-00432

CERTIFICATE

STATE OF KENTUCKY)
)
COUNTY OF CLARK)

Isaac S. Scott, being duly sworn, states that he has supervised the preparation of the responses of East Kentucky Power Cooperative, Inc. to the Public Service Commission Staff's Rehearing Request for Information in the above-referenced case dated April 27, 2015, and that the matters and things set forth therein are true and accurate to the best of his knowledge, information and belief, formed after reasonable inquiry.

Isaac S. Scott

Subscribed and sworn before me on this 11th day of May 2015.

Gwyn M. Willoughby #508448
Notary Public

GWYN M. WILLOUGHBY
Notary Public
State at Large
Kentucky
My Commission Expires Nov 30, 2017

EAST KENTUCKY POWER COOPERATIVE, INC.

PSC CASE NO. 2014-00432

RESPONSE TO INFORMATION REQUEST

COMMISSION STAFF'S REHEARING REQUEST FOR INFORMATION DATED 04/27/15

REQUEST 1

RESPONSIBLE PARTY: Michelle K. Carpenter and Isaac S. Scott

Request 1. Refer to EKPC's Petition for Rehearing ("Petition"), pages 7-8, specifically, the first sentence of the second full paragraph on page 7 and the last sentence of the partial paragraph which ends on the top of page 8.

Request 1a. To paraphrase, the sentence on page 7 states that the ARO-related depreciation and accretion expenses are separate from the accounting and ratemaking treatments authorized by the Commission in Case No. 2014-00252[1] for the project identified as Project 15. The sentence on page 8 reads, "The prescribed accounting treatment would not be impacted by the discretionary rate-making treatment ordered by the Commission in Case No. 2014-00252...." Aside from the results, explain why EKPC believes that the accounting treatment for the ARO-related depreciation and accretion expenses should not be impacted by the ratemaking treatment ordered by the Commission in Case No. 2014-00252.

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[1] Case No. 2014-00252, *Application of East Kentucky Power Cooperative, Inc. for a Certificate of Public Convenience and Necessity for Construction of an Ash Landfill at J.K. Smith Station, the Removal of Impounded Ash from William C. Dale Station for Transport to J.K. Smith and Approval of a Compliance Plan Amendment for Environmental Surcharge Recovery* (Ky. PSC Mar. 6, 2015).

<u>Response 1a.</u> EKPC believes its position reflects the appropriate accounting for two separate and distinct transactions. Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") Topic 410-20 prescribes that accretion and depreciation be systematically recognized over the life of the applicable asset associated with the ARO. The cumulative accretion and depreciation combined, at the end of the life of the asset, should theoretically equal the Asset Retirement Obligation ("ARO"). The actual costs incurred to settle the ARO have been approved by the Commission for recovery through the environmental surcharge mechanism as the costs are incurred. However, such costs cannot be expensed as incurred for accounting purposes because they are already included in the amounts currently being accreted and depreciated on the applicable ARO. An illustration may be helpful to explain the uniqueness of the ARO accounting and demonstrate why applying the rate-making treatments ordered in Case No. 2014-00252 to the ARO regulatory assets is not appropriate.

Hypothetical Example: On January 1, 2015 EKPC recognized an ARO for a plant set to retire on December 31, 2025. The engineering estimate for the retirement obligation is $10,000,000. EKPC records an ARO asset of the present value of the estimated future obligation and an ARO liability of $6,516,457. It should be remembered that the ARO accounting is based upon the best estimates of the cost that will be incurred to settle the future legal obligations; it is not based on nor does it represent any actual costs to settle the future legal obligations. During 2015 and each subsequent year until 2025 EKPC records annual ARO-related accretion expense. This expense begins at $258,703 in 2015 and increases each year through 2025, when the accreted liability balance reaches $10,000,000. At the same time, EKPC begins depreciating the ARO asset, with $592,405 recorded each year from 2015 through 2025, bringing the ending net balance of the ARO asset to zero. At 2025 all that remains on the books is a $10,000,000 ARO liability. Please see page 7 of 17 to this response for the calculation of the present value of the estimated future obligation, the ARO asset and liability, the accretion expense, and depreciation expense.

Without regulatory asset treatment of the accretion and depreciation associated with the ARO, expenses are recorded each year from 2015 through 2025, depressing margins. In 2026 EKPC begins work on the remediation project, which had previously been granted a CPCN by the Commission. The project was still estimated to cost $10,000,000 at the time the CPCN was issued; however, EKPC engineering identified cost saving opportunities while working on the project. Actual costs incurred are $6,000,000 in 2026 and $3,500,000 in 2027, for a total cost of $9,500,000. This is recovered through the environmental surcharge contemporaneously, but the expenses have already been recognized so the incurred costs simply relieve the ARO liability account. The ARO liability has an ending balance of $500,000 after the project is completed, representing the amount by which the actual project costs were lower than the estimates. This amount is recognized as income (margin) in 2027, the year the project is closed, thus bringing the ARO liability account to zero. Margins are understated from 2015 through 2025, but are overstated by $6,000,000 in 2026 and $4,000,000 in 2027 as a result of not having regulatory asset treatment of accretion and depreciation associated with the ARO. Please see page 8 of 17 to this response for the ARO asset, ARO liability, and margin impacts as described above.

In the illustration above, EKPC's accounting was consistent with the requirements of the Rural Utilities Service Uniform System of Accounts ("RUS USoA") and FASB ASC Topic 410-20. In this proceeding, EKPC requested that the ARO-related accretion and depreciation expenses be deferred via a regulatory asset so that those expenses could be properly matched with the actual project revenue, thereby eliminating the period of depressed margins followed by the period of inflated margins. Had the Commission granted EKPC's request as submitted, using the same assumptions as the hypothetical example above, would have produced the results shown on page 9 of 17 to this response. In this spreadsheet all ARO-related accretion and depreciation expenses are recorded to the regulatory asset account, which is settled when the actual project is undertaken by expensing its balance and then truing up any remainder – in this example the $500,000. The true-up is a debit to the ARO liability and a credit to the regulatory asset account. This methodology perfectly matches the expenses with the revenues, resulting in no distortion of the financial statements.

The Commission's order in this case required the accounting and rate-making treatments authorized in Case No. 2014-00252, specifically the expensing of ash hauling costs associated with an actual project, to be applied to the ARO accounting. As previously stated, FASB ASC Topic 410-20 and the RUS USoA requires that accretion and depreciation to be charged to expense over the life of the asset associated with the ARO. Granting of a regulatory asset is actually the only way that expense will ultimately be recognized when the actual project costs are incurred and would also match the revenue generated through the environmental surcharge mechanism. Comparing the spreadsheets shown on pages 8 and 9 of 17 to this response, one can readily see that this would again result in a mismatch of revenue and expense, just as shown on page 8 of 17 to this response, but in a smaller amount. The expense treatment of those costs would appropriately occur as the project is underway in 2026 and 2027. Whether the actual project costs were treated as capital or expense for the purposes of environmental surcharge recovery would have no bearing on the ARO accounting.

Request 1b. Provide any accounting literature, regulatory commission orders, court orders, correspondence with auditors, etc., that support the response to part a. of this request.

Response 1b. The following documents support the response to part a. above and are attached to this response:

- RUS USoA, 7 CFR 1767, Section 1767.15, General Instructions, subpart (y), Accounting for asset retirement obligations. See pages 10 and 11 of 17 of this response.
- RUS USoA, 7 CFR 1767, Section 1767.10, Definitions – Regulatory Assets and Liabilities. See page 12 of 17 of this response.

- FASB ASC Topic 980-410-25-2 – Costs from Asset Retirement Obligations. See pages 13 and 14 of 17 of this response.
- FASB ASC Topic 980-410-20-35 – Asset Retirement Obligations, Subsequent Measurement. See pages 15 through 17 of 17 of this response.

EKPC is willing to meet with Commission Staff in an informal conference to address any additional questions which Staff might have regarding the proposed accounting treatment.

EAST KENTUCKY POWER COOPERATIVE
PSC--ARO Example

PSC Example--estimated closure December 31, 2025

	Retirement Cost Jan 1	Inflation Rate	Inflation	Retirement w/ Inflation December 31	
2015	7,621,447.82	2.50%	190,536.20	7,811,984.02	
2016	7,811,984.02	2.50%	195,299.60	8,007,283.62	
2017	8,007,283.62	2.50%	200,182.09	8,207,465.71	
2018	8,207,465.71	2.50%	205,186.64	8,412,652.35	
2019	8,412,652.35	2.50%	210,316.31	8,622,968.66	
2020	8,622,968.66	2.50%	215,574.22	8,838,542.87	
2021	8,838,542.87	2.50%	220,963.57	9,059,506.45	
2022	9,059,506.45	2.50%	226,487.66	9,285,994.11	
2023	9,285,994.11	2.50%	232,149.85	9,518,143.96	
2024	9,518,143.96	2.50%	237,953.60	9,756,097.56	
2025	9,756,097.56	2.50%	243,902.44	10,000,000.00	Cost for inflation through December 2025
				6,516,456.74	PV at 3.97%
				11	YEARS (132 months)

	Liability Balance Jan 1	Interest Rate	Accretion	Liability Balance December 31
2015	6,516,456.74	3.97%	258,703.33	6,775,160.07
2016	6,775,160.07	3.97%	268,973.85	7,044,133.93
2017	7,044,133.93	3.97%	279,652.12	7,323,786.04
2018	7,323,786.04	3.97%	290,754.31	7,614,540.35
2019	7,614,540.35	3.97%	302,297.25	7,916,837.60
2020	7,916,837.60	3.97%	314,298.45	8,231,136.06
2021	8,231,136.06	3.97%	326,776.10	8,557,912.16
2022	8,557,912.16	3.97%	339,749.11	8,897,661.27
2023	8,897,661.27	3.97%	353,237.15	9,250,898.42
2024	9,250,898.42	3.97%	367,260.67	9,618,159.09
2025	9,618,159.09	3.97%	381,840.92	10,000,000.00

	Estimated Annual Depreciation	Accretion from above	Estimated Annual Depreciation & Accretion
2015	592,405.16	258,703.33	851,108.49
2016	592,405.16	268,973.85	861,379.01
2017	592,405.16	279,652.12	872,057.28
2018	592,405.16	290,754.31	883,159.47
2019	592,405.16	302,297.25	894,702.41
2020	592,405.16	314,298.45	906,703.61
2021	592,405.16	326,776.10	919,181.26
2022	592,405.16	339,749.11	932,154.27
2023	592,405.16	353,237.15	945,642.31
2024	592,405.16	367,260.67	959,665.83
2025	592,405.14	381,840.92	974,246.06
	6,516,456.74	3,483,543.26	10,000,000.00

established January 1, 2015

rates:	credit adj:	final disc rate:
5 year U.S. Treasury 1.65%	1.7	3.35
7 year U.S. Treasury 1.97%	1.7	3.67
10 year U.S. Treasury 2.17%	1.8	3.97
20 year U.S. Treasury 2.47%	1.9	4.37
30 year U.S. Treasury 2.75%	1.9	4.65

ARO Estimate	$6,516,457
ARO Est. Date	1/1/2015
Retirement Date	12/31/2025
ARO Est. 2025	$10,000,000
Project Inception	2026
Project Duration	2 Years
Project Cost	$9,500,000
Approved Recovery through ES	

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Balance Sheet													
ARO Asset	$ 6,516,457	$ 5,924,052	$ 5,331,647	$ 4,739,242	$ 4,146,836	$ 3,554,431	$ 2,962,026	$ 2,369,621	$ 1,777,216	$ 1,184,811	$ 592,405		
Accum Depr.	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ -	$ -
Net ARO Asset	$ 5,924,052	$ 5,331,647	$ 4,739,242	$ 4,146,836	$ 3,554,431	$ 2,962,026	$ 2,369,621	$ 1,777,216	$ 1,184,811	$ 592,405	$ 0	$ 0	$ 0
Total Assets	$ 5,924,052	$ 5,331,647	$ 4,739,242	$ 4,146,836	$ 3,554,431	$ 2,962,026	$ 2,369,621	$ 1,777,216	$ 1,184,811	$ 592,405	$ 0	$ 0	$ 0
ARO Liability Beg of Yr	$ 6,516,457	$ 6,775,160	$ 7,044,134	$ 7,323,786	$ 7,614,541	$ 7,916,838	$ 8,231,136	$ 8,557,912	$ 8,897,662	$ 9,250,899	$ 9,618,159	$ 10,000,000	$ 4,000,000
Accum Accretion	$ 258,703	$ 268,974	$ 279,652	$ 290,754	$ 302,297	$ 314,298	$ 326,776	$ 339,749	$ 353,237	$ 367,261	$ 381,841	$ -	$ -
Actual Project Costs												$ (6,000,000)	$ (3,500,000)
Gain/loss on Settlement													$ (500,000)
ARO Liability End of Yr	$ 6,775,160	$ 7,044,134	$ 7,323,786	$ 7,614,541	$ 7,916,838	$ 8,231,136	$ 8,557,912	$ 8,897,662	$ 9,250,899	$ 9,618,159	$ 10,000,000	$ 4,000,000	$ 0
Total Liabilities	$ 6,775,160	$ 7,044,134	$ 7,323,786	$ 7,614,541	$ 7,916,838	$ 8,231,136	$ 8,557,912	$ 8,897,662	$ 9,250,899	$ 9,618,159	$ 10,000,000	$ 4,000,000	$ 0
Income Statement													
Revenue - ES												$ 6,000,000	$ 3,500,000
ARO Depreciation	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405		
ARO Accretion	$ 258,703	$ 268,974	$ 279,652	$ 290,754	$ 302,297	$ 314,298	$ 326,776	$ 339,749	$ 353,237	$ 367,261	$ 381,841		
Total ARO Expenses	$ 851,108	$ 861,379	$ 872,057	$ 883,159	$ 894,702	$ 906,704	$ 919,181	$ 932,154	$ 945,642	$ 959,666	$ 974,246	$ -	$ -
ARO Settlement True-up Gain	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 500,000
Margin Impact	$ (851,108)	$ (861,379)	$ (872,057)	$ (883,159)	$ (894,702)	$ (906,704)	$ (919,181)	$ (932,154)	$ (945,642)	$ (959,666)	$ (974,246)	$ 6,000,000	$ 4,000,000
Actual Project Costs												$ 6,000,000	$ 3,500,000

ARO Estimate	$6,516,457
ARO Est. Date	1/1/2015
Retirement Date	12/31/2025
ARO Est. at 2025	$10,000,000
Project Inception	2026
Project Duration	2 Years
Project Cost	$9,500,000
Approved Recovery through ES	

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Balance Sheet													
ARO Asset	$ 6,516,457	$ 5,924,052	$ 5,331,647	$ 4,739,242	$ 4,146,836	$ 3,554,431	$ 2,962,026	$ 2,369,621	$ 1,777,216	$ 1,184,811	$ 592,405		
Accum Depr.	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ -	$ -
Net ARO Asset	$ 5,924,052	$ 5,331,647	$ 4,739,242	$ 4,146,836	$ 3,554,431	$ 2,962,026	$ 2,369,621	$ 1,777,216	$ 1,184,811	$ 592,405	$ 0	$ 0	$ 0
Regulatory Asset													
ARO expense transfer	$ 851,108	$ 861,379	$ 872,057	$ 883,159	$ 894,702	$ 906,704	$ 919,181	$ 932,154	$ 945,642	$ 959,666	$ 974,246	$ -	$ -
Total Reg Asset	$ 851,108	$ 1,712,488	$ 2,584,545	$ 3,467,704	$ 4,362,407	$ 5,269,110	$ 6,188,292	$ 7,120,446	$ 8,066,088	$ 9,025,754	$ 10,000,000	$ 10,000,000	$ 10,000,000
Reg Asset Amort.													
Amort. Expense	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ (6,000,000)	$ (3,500,000)
True-Up to Actual (Gain/Loss)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ (500,000)
Net Accum Amort	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ (6,000,000)	$ (10,000,000)
Total Assets	$ 6,775,160	$ 7,044,134	$ 7,323,786	$ 7,614,541	$ 7,916,838	$ 8,231,136	$ 8,557,912	$ 8,897,662	$ 9,250,899	$ 9,618,159	$ 10,000,000	$ 4,000,000	$ 0
ARO Liability Beg of Yr	$ 6,516,457	$ 6,775,160	$ 7,044,134	$ 7,323,786	$ 7,614,541	$ 7,916,838	$ 8,231,136	$ 8,557,912	$ 8,897,662	$ 9,250,899	$ 9,618,159	$ 10,000,000	$ 4,000,000
Accum Accretion	$ 258,703	$ 268,974	$ 279,652	$ 290,754	$ 302,297	$ 314,298	$ 326,776	$ 339,749	$ 353,237	$ 367,261	$ 381,841	$ -	$ -
Actual Project Costs												$ (6,000,000)	$ (3,500,000)
Gain/loss on Settlement													$ (500,000)
ARO Liability End of Yr	$ 6,775,160	$ 7,044,134	$ 7,323,786	$ 7,614,541	$ 7,916,838	$ 8,231,136	$ 8,557,912	$ 8,897,662	$ 9,250,899	$ 9,618,159	$ 10,000,000	$ 4,000,000	$ 0
Total Liabilities	$ 6,775,160	$ 7,044,134	$ 7,323,786	$ 7,614,541	$ 7,916,838	$ 8,231,136	$ 8,557,912	$ 8,897,662	$ 9,250,899	$ 9,618,159	$ 10,000,000	$ 4,000,000	$ 0
Income Statement													
Revenue - ES												$ 6,000,000	$ 3,500,000
ARO Depreciation	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405	$ 592,405		
ARO Accretion	$ 258,703	$ 268,974	$ 279,652	$ 290,754	$ 302,297	$ 314,298	$ 326,776	$ 339,749	$ 353,237	$ 367,261	$ 381,841		
Total ARO Expenses	$ 851,108	$ 861,379	$ 872,057	$ 883,159	$ 894,702	$ 906,704	$ 919,181	$ 932,154	$ 945,642	$ 959,666	$ 974,246	$ -	$ -
ARO to Reg Asset	$ (851,108)	$ (861,379)	$ (872,057)	$ (883,159)	$ (894,702)	$ (906,704)	$ (919,181)	$ (932,154)	$ (945,642)	$ (959,666)	$ (974,246)		
Net ARO Expenses	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Reg. Assset True-up	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Reg Asset Amortization	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 6,000,000	$ 3,500,000
Margin Impact	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Actual Project Costs												$ 6,000,000	$ 3,500,000

RUS USoA

7 CFR 1767, Section 1767.15
General Instructions, subpart (y), Accounting for asset retirement obligations

(1) An asset retirement obligation represents a liability for the legal obligation associated with the retirement of a tangible long-lived asset that a company is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel. An asset retirement cost represents the amount capitalized when the liability is recognized for the long-lived asset that gives rise to the legal obligation. The amount recognized for the liability and an associated asset retirement cost shall be stated at the fair value of the asset retirement obligation in the period in which the obligation is incurred.

(2) The utility shall initially record a liability for an asset retirement obligation in account 230, Asset retirement obligations, and charge the associated asset retirement costs to electric utility plant (including accounts 101.1 and 120.6), and nonutility plant, as appropriate, related to the plant that gives rise to the legal obligation. The asset retirement cost shall be depreciated over the useful life of the related asset that gives rise to the obligation. For periods subsequent to the initial recording of the asset retirement obligation, a utility shall recognize the period to period changes of the asset retirement obligation that result from the passage of time due to the accretion of the liability and any subsequent measurement changes to the initial liability for the legal obligation recorded in account 230, Asset retirement obligations, as follows:

> (i) The utility shall record the accretion of the liability by debiting account 411.10, Accretion expense, for electric utility plant, account 413, Expenses of electric plant leased to others, for electric plant leased to others, and account 421, Miscellaneous nonoperating income, for nonutility plant and crediting account 230, Asset retirement obligations; and
>
> (ii) The utility shall recognize any subsequent measurement changes of the liability initially recorded in account 230, Asset retirement obligation, for each specific asset retirement obligation as an adjustment of that liability in account 230 with the corresponding adjustment to electric utility plant, electric plant leased to others, and nonutility plant, as appropriate. The utility shall on a timely basis monitor any measurement changes of the asset retirement obligations.

(3) Gains or losses resulting from the settlement of asset retirement obligations associated with utility plant resulting from the difference between the amount of the liability for the asset retirement obligation included in account 230, Asset retirement obligations, and the actual amount paid to settle the obligation shall be accounted for as follows:

(i) Gains shall be credited to account 411.6, Gains from disposition of utility plant, and;

(ii) Losses shall be charged to account 411.7, Losses from disposition of utility plant.

(4) Gains or losses on the settlement of asset retirement obligations associated with nonutility plant resulting from the difference between the amount of the liability for the asset retirement obligation in account 230, Asset retirement obligations, and the amount paid to settle the obligation, shall be accounted for as follows:

(i) Gains shall be credited to account 421, Miscellaneous nonoperating income, and;

(ii) Losses shall be charged to account 426.5, Other deductions.

(5) Separate subsidiary records shall be maintained for each asset retirement obligation showing the initial liability and associated asset retirement cost, any incremental amounts of the liability incurred in subsequent reporting periods for additional layers of the original liability and related asset retirement cost, the accretion of the liability, the subsequent measurement changes to the asset retirement obligation, the depreciation and amortization of the asset retirement costs and related accumulated depreciation, and the settlement date and actual amount paid to settle the obligation. For purposes of analyses a utility shall maintain supporting documentation so as to be able to furnish accurately and expeditiously with respect to each asset retirement obligation the full details of the identity and nature of the legal obligation, the year incurred, the identity of the plant giving rise to the obligation, the full particulars relating to each component and supporting computations related to the measurement of the asset retirement obligation.

RUS USoA

7 CFR 1767, Section 1767.10
Definitions, Regulatory Assets and Liabilities

Regulatory Assets and Liabilities are assets and liabilities that result from rate actions of regulatory agencies. Regulatory assets and liabilities arise from specific revenues, expenses, gains, or losses that would have been included in net income determinations in one period under the general requirements of the Uniform System of Accounts but for it being probable:

(1) That such items will be included in a different period(s) for purposes of developing the rates the utility is authorized to charge for its utility services; or

(2) In the case of regulatory liabilities, that refunds to customers, not provided for in the other accounts, will be required.

980-410-25 Recognition

Click here to link to 980-410-S25.

General Note: The Recognition Section provides guidance on the required criteria, timing, and location (within the financial statements) for recording a particular item in the financial statements. Disclosure is not recognition.

General Note for Fair Value Option: Some of the items subject to the guidance in this Subtopic may qualify for application of the Fair Value Option Subsections of Subtopic 825-10. Those Subsections (see paragraph 825-10-05-5) address circumstances in which entities may choose, at specified election dates, to measure eligible items at fair value (the fair value option). See Section 825-10-15 for guidance on the scope of the Fair Value Option Subsections of the Financial Instruments Topic.

General

> Decommissioning Costs

25-1 Nuclear plant decommissioning costs are incurred costs in the current accounting framework. Those costs and the related liabilities are imposed by regulation or statute, similar to the liability to restore the land after strip mining. Accordingly, paragraph 980-405-25-1(b) does not address those costs.

> Costs from Asset Retirement Obligations

25-2 Many rate-regulated entities currently provide for the costs related to the retirement of certain long-lived assets in their financial statements and recover those amounts in rates charged to their customers. Some of those costs result from asset retirement obligations within the scope of Subtopic 410-20; others result from costs that are not within the scope of that Subtopic. The amounts charged to customers for the costs related to the retirement of long-lived assets may differ from the period costs recognized in accordance with that Subtopic and, therefore, may result in a difference in the timing of recognition of period costs for financial reporting and rate-making purposes. An additional recognition timing difference may exist when the costs related to the retirement of long-lived assets are included in amounts charged to customers but liabilities are not recognized in the financial statements. If the requirements of this Topic are met, 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 that Subtopic and rate-making purposes.

410-20-35 Subsequent Measurement

General Note: The Subsequent Measurement Section provides guidance on an entity's subsequent measurement and subsequent recognition of an item. Situations that may result in subsequent changes to carrying amount include impairment, fair value adjustments, depreciation and amortization, and so forth.

General

> Allocation of Asset Retirement Cost

35-1 A liability for an **asset retirement obligation** may be incurred over more than one reporting period if the events that create the obligation occur over more than one reporting period. Any incremental liability incurred in a subsequent reporting period shall be considered to be an additional layer of the original liability. Each layer shall be initially measured at fair value. For example, the liability for decommissioning a nuclear power plant is incurred as contamination occurs. Each period, as contamination increases, a separate layer shall be measured and recognized. Paragraph 410-20-30-1 provides guidance on using that technique.

35-2 An entity shall subsequently allocate that **asset retirement cost** to expense using a systematic and rational method over its useful life. Application of a systematic and rational allocation method does not preclude an entity from capitalizing an amount of asset retirement cost and allocating an equal amount to expense in the same accounting period. For example, assume an entity acquires a long-lived asset with an estimated life of 10 years. As that asset is operated, the entity incurs one-tenth of the liability for an asset retirement obligation each year. Application of a systematic and rational allocation method would not preclude that entity from capitalizing and then expensing one-tenth of the asset retirement costs each year.

35-3 In periods subsequent to initial measurement, an entity shall recognize period-to-period changes in the liability for an asset retirement obligation resulting from the following:

a. The passage of time

b. Revisions to either the timing or the amount of the original estimate of undiscounted cash flows.

35-4 An entity shall measure and incorporate changes due to the passage of time into the carrying amount of the liability before measuring changes resulting from a revision to either the timing or the amount of estimated cash flows.

35-5 An entity shall measure changes in the liability for an asset retirement obligation due to passage of time by applying an interest method of allocation to the amount of the liability at the beginning of the period. The interest rate used to measure that change shall be the credit-adjusted risk-free rate that existed when the liability, or portion thereof, was initially measured. That amount shall be recognized as an increase in the carrying amount of the liability and as an expense classified as **accretion expense**. Paragraph 835-20-15-7 states that accretion expense related to exit costs and asset retirement obligations shall not be considered to be interest cost for purposes of applying Subtopic 835-20.

35-6 The subsequent measurement provisions require an entity to identify undiscounted estimated cash flows associated with the initial measurement of a liability. Therefore, an entity that obtains an initial measurement of fair value from a market price or from a technique other than an expected present value technique must determine the undiscounted cash flows and estimated timing of those cash flows that are embodied in that fair value amount for purposes of applying the subsequent measurement provisions. Example 1 (see paragraph 410-20-55-31) provides an illustration of the subsequent measurement of a liability that is initially obtained from a market price. (See paragraph 410-20-25-14 for a discussion on conditional outcomes.)

35-7 Paragraph 410-20-25-14 explains how uncertainty surrounding conditional performance of a retirement obligation is factored into its measurement by assessing the likelihood that performance will be required. As the time for notification approaches, more information and a better perspective about the ultimate outcome will likely be obtained. Consequently, reassessment of the timing, amount, and probabilities associated with the expected cash flows may change the amount of the liability recognized. See paragraphs 410-20-55-18 through 55-19.

> Change in Estimate

35-8 Changes resulting from revisions to the timing or the amount of the original estimate of undiscounted cash flows shall be recognized as an increase or a decrease in the carrying amount of the liability for an asset retirement obligation and the related asset retirement cost capitalized as part of the carrying amount of the related long-lived asset. Upward revisions in the amount of undiscounted estimated cash flows shall be discounted using the current credit-adjusted risk-free rate. Downward revisions in the amount of undiscounted estimated cash flows shall be discounted using the credit-adjusted risk-free rate that existed when the original liability was recognized. If an entity cannot identify the prior period to which the downward revision relates, it may use a weighted-average credit-adjusted risk-free rate to discount the downward revision to estimated future cash flows. When asset retirement costs change as a result of a revision to estimated cash flows, an entity shall adjust the amount of asset retirement cost allocated to expense in the period of change if the change affects that period only or in the period of change and future periods if the change affects more than one period as required by paragraphs 250-10-45-17 through 45-20 for a change in estimate.

> Effects of Funding and Assurance Provisions

35-9 Methods of providing assurance include surety bonds, insurance policies, letters of credit, guarantees by other entities, and establishment of trust funds or identification of other assets dedicated to satisfy the asset retirement obligation. The existence of funding and assurance provisions may affect the determination of the credit-adjusted risk-free rate. For a previously recognized asset retirement obligation, changes in funding and assurance provisions have no effect on the initial measurement or accretion of that liability, but may affect the credit-adjusted risk-free rate used to discount upward revisions in undiscounted cash flows for that obligation.

EAST KENTUCKY POWER COOPERATIVE, INC.

PSC CASE NO. 2014-00432

RESPONSE TO INFORMATION REQUEST

COMMISSION STAFF'S REHEARING REQUEST FOR INFORMATION DATED 04/27/15

REQUEST 2

RESPONSIBLE PARTY: Michelle K. Carpenter and Isaac S. Scott

Request 2. Refer to EKPC's Petition, pages 12-13, regarding its concerns about the 10 percent threshold for increases in its Asset Retirement Obligation ("ARO") balances.

Request 2a. State what EKPC believes to be a reasonable threshold and the basis for that belief.

Response 2a. EKPC respectfully submits that it believes no threshold is appropriate or reasonable concerning increases in the ARO balances. EKPC has attempted to demonstrate throughout this case the dynamic nature of ARO accounting. As shown in the hypothetical example provided in the response to Request 1a, a 10 percent threshold would be exceeded within three years of the establishment of the ARO simply from the normal accretion entries. If there had been any updating of the ARO estimates, that adjustment coupled with the accretion entries could easily exceed a 10 percent threshold as well. EKPC respectfully submits it needs certainty concerning the authorization for the regulatory asset treatment of certain ARO-related depreciation and accretion expenses rather than having to return to the Commission seeking reauthorization for the regulatory asset treatment simply because the RUS USoA required accounting for AROs causes EKPC to exceed a threshold limit.

EKPC did not request a blanket authorization permitting regulatory asset treatment for all ARO-related depreciation and accretion expenses for all AROs established in 2013 and going forward. EKPC requested and the Commission appeared to approve the request to reclassify as regulatory assets the 2014 ARO-related depreciation and accretion expenses and all subsequent ARO-related depreciation and accretion expenses associated with the ARO balances by type and location as of December 31, 2013. The types referenced were for asbestos abatement and ash disposal sites and the locations were for the Spurlock, Dale, and Cooper generating stations.

EKPC believes that the annual reporting requirements for the ARO calculations established in ordering paragraph 4 of the March 6, 2015 Order, with the modifications proposed by EKPC in its March 20, 2015 Petition for Rehearing, will provide the Commission the ability to monitor changes in the ARO balances originally recorded at December 31, 2013. The annual reporting will allow the Commission to follow the changes in the specific ARO balances that are associated with the regulatory assets.

Request 2b. Clarify what EKPC believes the circumstances should be before it must seek further Commission approval regarding the ARO balances and potential changes thereto.

Response 2b. As noted in the response to the Commission Staff's Initial Request for Information dated December 24, 2014, Request 7a, EKPC will file new applications requesting authorization to establish regulatory assets for the ARO-related depreciation and accretion expenses for any ARO that is not associated with asbestos abatement or ash disposal sites at any EKPC location. In addition, EKPC will file similar applications for AROs associated with asbestos abatement or ash disposal sites that are not located at Spurlock, Dale, or Cooper generating stations. For example, if it is determined there are legal obligations associated with ammonia facilities at Spurlock and an ARO is established, EKPC would file an application if it desired the regulatory asset treatment for the depreciation and accretion expenses associated with this ARO. Likewise, if it is determined there are legal obligations associated with asbestos abatement at EKPC's headquarters or the Smith generating station and an ARO is established, EKPC would file an application if it desired the regulatory asset treatment.