

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF LOUISVILLE GAS AND)	
ELECTRIC COMPANY FOR AN ORDER)	
APPROVING AN ACCOUNTING ADJUSTMENT TO)	CASE NO.
BE INCLUDED IN EARNINGS SHARING)	2003-00426
MECHANISM CALCULATIONS FOR 2003)	

AND

APPLICATION OF KENTUCKY UTILITIES)	
COMPANY FOR AN ORDER APPROVING AN)	
ACCOUNTING ADJUSTMENT TO BE INCLUDED)	CASE NO.
IN EARNINGS SHARING MECHANISM)	2003-00427
CALCULATIONS FOR 2003)	

O R D E R

On November 14, 2003, Louisville Gas and Electric Company (LG&E) and Kentucky Utilities Company (KU) (collectively the Companies) filed applications seeking approval of an accounting adjustment to their respective Earnings Sharing Mechanism (ESM) filings for calendar year 2003. The accounting adjustment is related to the Companies adoption during 2003 of Statement of Financial Accounting Standards (SFAS) No. 143, *Accounting for Asset Retirement Obligations*.

The Kentucky Industrial Utility Customers, Inc. (KIUC) sought and was granted intervention in this proceeding.

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, with an effective implementation date of January 1, 2003. In October 2002, the Federal Energy Regulatory Commission (FERC) issued a Notice of Proposed Rulemaking to

modify the Uniform System of Accounts and the FERC annual report forms. FERC issued its final rule on April 9, 2003, generally adopting the requirements of SFAS No. 143.¹

In conjunction with the adoption of SFAS No. 143, the Companies were required to recognize the cumulative effect impact on their respective financial statements, which represents the asset retirement obligation (ARO) asset depreciation and ARO liability accretion that would have been recorded had the asset and liability been recorded by the Companies when the original asset was placed into service.² The timing of cost recognition under SFAS No. 143 and differences in rate recovery methods could result in the need for the Companies to record regulatory assets or liabilities. As part of the entries to record the adoption of SFAS No. 143, LG&E and KU have each recorded a regulatory asset and a regulatory liability.³

LG&E and KU state that the accounting required in conjunction with the adoption of SFAS No. 143 results in their respective net operating incomes for calendar year 2003 being overstated for ESM calculation purposes. The overstatement occurs because the cumulative effect impact adjustments are recorded below the line while

¹ FERC Docket No. RM02-7-000, Order No. 631, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*, Final Rule Issued April 9, 2003.

² LG&E has recorded a net cumulative effect impact of \$5,281,000 while KU has recorded a net cumulative effect impact of \$9,926,000. See Application, Exhibit 1 for LG&E and KU.

³ LG&E has recorded a regulatory asset of \$5,281,000 and a regulatory liability of \$59,000 related to the adoption of SFAS No. 143. KU has recorded a regulatory asset of \$9,926,000 and a regulatory liability of \$910,000. See Response to the Commission Staff's First Data Request dated December 5, 2003, Item 4(b).

the corresponding regulatory credit is recorded above the line. The Companies request authorization to offset this above the line regulatory credit when performing their respective ESM calculations for calendar year 2003. The Companies also request Commission approval to establish the regulatory asset and liability accounts associated with the adoption of SFAS No. 143.⁴

On December 19, 2003, the Companies and KIUC filed a stipulation agreement (Stipulation) where the parties recommend the Commission issue an Order granting the applications of LG&E and KU subject to the accounting procedures described in the Stipulation. The parties request the Commission issue an Order which:

- 1) Approves the regulatory assets and liabilities associated with adopting SFAS No. 143 and going forward;
- 2) Eliminates the impact on net operating income in the 2003 ESM annual filing caused by adopting SFAS No. 143;
- 3) To the extent accumulated depreciation related to the cost of removal is recorded in regulatory assets or regulatory liabilities, such amounts will be reclassified to accumulated depreciation for rate-making purposes of calculating rate base; and
- 4) The ARO assets, related ARO asset accumulated depreciation, ARO liabilities, and remaining regulatory assets associated with the adoption of SFAS No. 143 will be excluded from rate base.⁵

A copy of the Stipulation is attached to this Order as Appendix A.

⁴ Response to the Commission Staff's First Data Request dated December 5, 2003, Item 2(c). The Companies did not previously seek approval to establish the regulatory asset and liability accounts based on the assumption that the cost of removal was covered by the Commission's previous approval of the depreciation rates currently in effect. However, the Companies stated that if the Commission did not agree with the assumption, the Companies also request the approval of the regulatory asset and liability accounts in this proceeding.

⁵ Stipulation at 5.

The Commission has reviewed the information provided by the Companies and the terms of the Stipulation, and finds that the requested accounting treatments should be approved. The cumulative effect impact reflects the restatement of account balances in accordance with the requirements of SFAS No. 143. The determination of the calendar year 2003 ESM calculations should exclude this change in accounting treatment when determining the Companies net operating income for ESM purposes.

Concerning the establishment of the regulatory asset and liability accounts, LG&E and KU are reminded that the prior approval of the Commission is required before these accounts are established. However, given the fact the regulatory asset and liability accounts established by the Companies were a direct result of the adoption of SFAS No. 143, in this case the Commission will approve the establishment of these regulatory asset and liability accounts. This approval is for accounting purposes only, and the appropriate rate-making treatment for these regulatory asset and liability accounts will be addressed in the Companies next general rate case. LG&E and KU are reminded that in the future the Commission's prior approval will be required before regulatory asset or liability accounts are established.

The Commission is not clear as to the exact meaning of Nos. 3 and 4 on page 5 of the Stipulation. When the Stipulation is read as a whole, it appears to address the accounting treatment for the adoption of SFAS No. 143 and how the associated accounting entries will be treated in the calendar year 2003 ESM calculations. However, both discuss rate-making treatments for the calculation of rate base without distinguishing whether the rate base treatments described apply only to the calendar year 2003 ESM calculations or to a general base rate proceeding. Based upon our

understanding of the provisions of the Stipulation, the Commission finds that Nos. 3 and 4 should be approved for purposes of the calendar year 2003 ESM calculations only. Consistent with our approval of the regulatory asset and liability accounts, the Commission will address the rate-making treatment for base rates in the next general rate case. The Commission will ask the Companies and KIUC to indicate their acceptance of our approval as described above.

In responses to the Commission Staff's data request, LG&E indicated that no assets associated with AROs are currently included in LG&E's environmental surcharge while KU indicated that three assets associated with AROs are currently included in KU's environmental surcharge.⁶ KU estimated the impact of SFAS No. 143 on its environmental surcharge calculations, and expressed the opinion that the asset removal costs impacted by the adoption of SFAS No. 143 should continue to be recovered through the environmental surcharge.⁷

While the Commission believes it was reasonable to determine whether the adoption of SFAS No. 143 could have an impact on the Companies' environmental surcharge, we find it is not reasonable to resolve that issue in this proceeding. The record is not sufficiently developed to support a decision addressing what changes, if any, should be made to KU's environmental surcharge due to the adoption of SFAS No. 143. Therefore, KU should address the affects the adoption of SFAS No. 143 has had on its environmental surcharge as part of its next 6-month environmental surcharge review.

⁶ Id., Item 1(b).

⁷ Id., Item 1(c).

IT IS THEREFORE ORDERED that:

1. The accounting treatment for LG&E s and KU s adoption of SFAS No. 143 and the related treatment in the calendar year 2003 ESM calculations as described in the Stipulation are approved as modified in this Order.

2. The regulatory asset and liability accounts established by the adoption of SFAS No. 143 are approved for accounting purposes only.

3. The rate base treatments discussed in Nos. 3 and 4 of page 5 of the Stipulation are adopted for calendar year 2003 ESM calculation purposes only. LG&E, KU, and KIUC shall within 10 days of the date of this Order file written statements agreeing to this interpretation of the Stipulation.

Done at Frankfort, Kentucky, this 23rd day of December, 2003.

By the Commission

ATTEST:

Deputy



Executive Director

Case No. 2003-00426
Case No. 2003-00427

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION
IN CASE NOS. 2003-00426 AND 2003-00427 DATED December 23, 2003

(see document named 200300426_12232003apx.pdf for appendix)