

# *Stay informed*

## 2013 spotlight on financial reporting

Power and utilities industry  
current areas of SEC focus

December 2013

The content of this publication is based on developments at the Securities and Exchange Commission through December 16, 2013 and comment letters publicly available as of October 31, 2013. Accordingly, certain aspects of this publication may be superseded as new guidance or interpretations emerge. Financial statement preparers and other users of this publication are therefore cautioned to stay abreast of and carefully evaluate subsequent authoritative and interpretive guidance that is issued.

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Clients and friends:

Changes in key positions at the Securities and Exchange Commission (SEC or the Commission) in the wake of the U.S. presidential election have prompted questions about the direction of its rulemaking and future policy decisions. Mary Jo White became the chair of the SEC in April 2013 – the first former prosecutor to serve in this role in its history. Chair White has indicated that she plans to support the SEC's key priorities, such as rulemaking required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and the Jumpstart Our Business Startups (JOBS) Act while continuing to strengthen the efficacy of the enforcement division. For example, in August 2013, the Commission proposed rules requiring disclosure of CEO-to-employee pay ratio and in October 2013, it proposed rules to permit companies to offer and sell securities through crowdfunding. Much of the rulemaking required by Dodd-Frank and the JOBS Act is pending and will undoubtedly be a key priority of the SEC for years to come.

PwC's Power and Utilities Industry Group has developed this publication to assist management teams in understanding some of the SEC's current focus areas as well as other financial reporting hot topics. The document includes:

- Recent SEC matters of relevance to industry registrants
- Information summarized from SEC staff comment letters issued to electric, natural gas, water, and co-generation registrants, including highlights of the areas in which power and utilities registrants received the most comments as well as relevant example comments
- Our views on key considerations in the preparation of the Form 10-K
- Benchmarks and data from our survey of financial reporting trends in the power and utilities industry including discussion of accounting policies and significant accounting estimates

Our goal in providing this publication is to provide controllers and financial reporting specialists with relevant information for the upcoming financial reporting season. The information is meant to aid in ensuring that disclosures are robust and consistent with the relevant guidance while also facilitating discussion with audit committees, senior management, and others on certain aspects of industry reporting. We hope you find the insights and examples in this report to be both informative and useful as you navigate your year-end reporting process. Please feel free to contact your PwC engagement team to discuss the information in this publication or to address any questions you may have.

Best wishes,

A handwritten signature in black ink, appearing to read 'Cary H. Hays'.

U.S. Power and Utilities Leader  
December 2013



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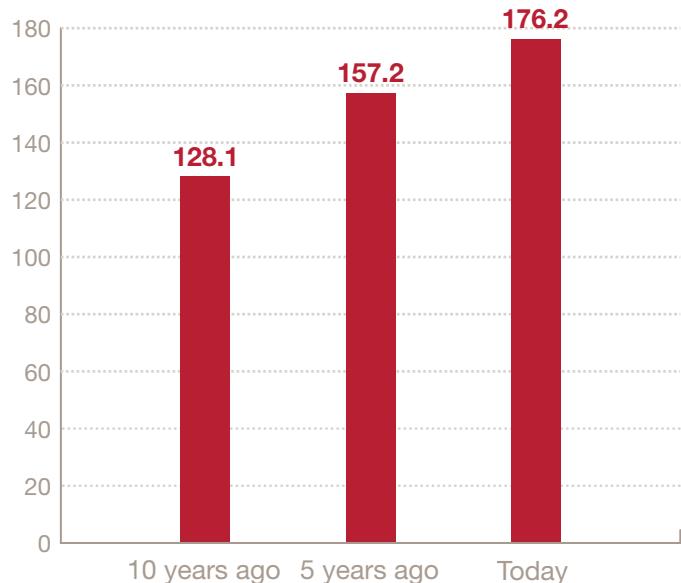
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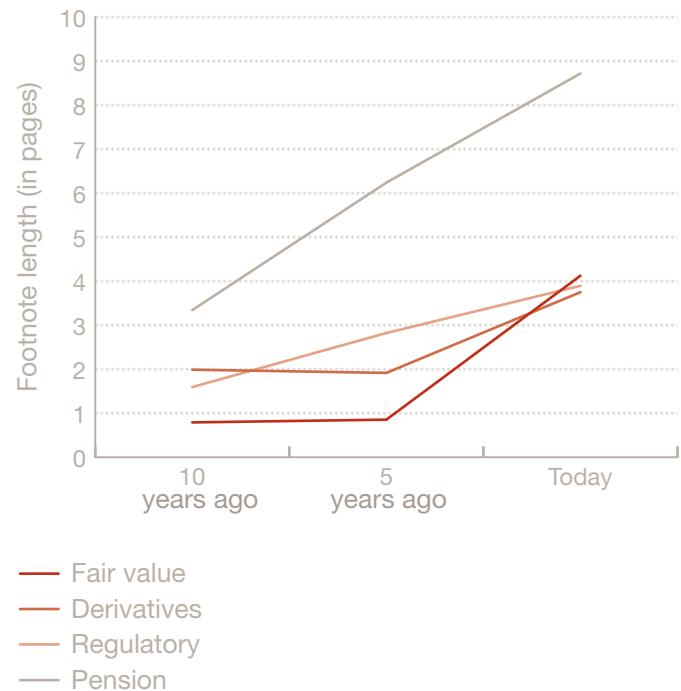
# Overview

This document provides a focus on the Form 10-K, including our views on relevant considerations in the preparation of the Form 10-K, information summarized from SEC staff comment letters issued to electric, natural gas, water, and co-generation registrants and certain information derived from our annual survey of financial reporting trends in the power and utilities industry. We perform this survey annually to develop benchmarking information for certain reporting areas of interest to power and utilities registrants. We reviewed registrants in the power and utilities industry with market capitalization greater than \$1 billion as of December 31, 2012, including benchmarking of Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A), the financial statements, and certain disclosures in the filing closest to December 31, 2012. Our survey included sixty-nine registrants this year. We also reviewed first quarter 2013 Form 10-Qs in the case of the new accounting standards adopted in the first quarter of 2013.

**Figure 1: Number of pages in 10-K**



**Figure 2: Average length of footnote per disclosure**



In public remarks, the SEC staff has demonstrated an awareness of the negative effect of “information overload.” Section 108 of the Jumpstart Our Business Startups (JOBS) Act<sup>1</sup> directed the SEC to study Regulation S-K and determine if its reporting requirements can be streamlined for emerging growth companies. In a recent speech,<sup>2</sup> Chair White stated that this study will be only the first step in a comprehensive review of the SEC’s disclosure requirements. White has stated the SEC will consider if there are disclosure requirements which are not necessary, if any requirements are repetitive, and more broadly, the sources which are contributing to the length and complexity of disclosures. No timeline has been provided for completion of this broad review of the disclosure requirements, so registrants will have to wait and see how the SEC addresses the issue.

*“I am raising the question here and internally at the SEC as to whether investors need and are optimally served by the detailed and lengthy disclosures about all of the topics that companies currently provide in the reports they are required to prepare and file with us.”<sup>2</sup>*

—Mary Jo White, Chair of the SEC



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<sup>1</sup> The JOBS Act created a number of special accommodations under U.S. securities laws for a newly designated group of companies known as “emerging growth companies.” A principal goal of the JOBS Act was to encourage job creation and economic growth by making it easier for private companies to access the capital markets.

<sup>2</sup> Source: The “Path Forward on Disclosure” speech presented at the National Association of Corporate Directors - Leadership Conference 2013 on October 15, 2013.

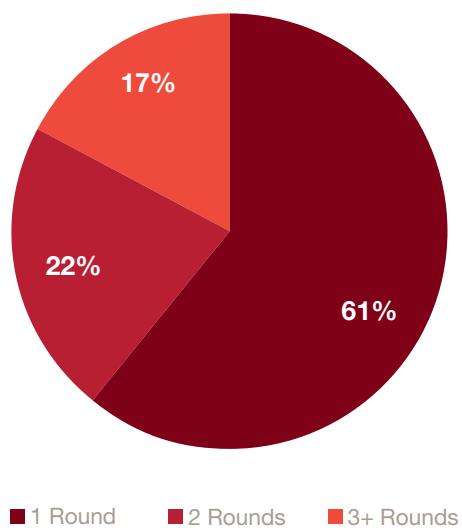
## The comment letter process

In accordance with the requirements of the Sarbanes-Oxley Act of 2002, the SEC staff reviews the filings of registrants at least once every three years. However, it is not unusual for companies to be reviewed on a more frequent basis. The depth and scope of the review varies based on the type of review performed and could include full cover-to-cover reviews, financial statement reviews, and targeted reviews. The SEC staff does not publicly disclose the criteria used as part of its selective review process. In connection with these reviews, the SEC staff may issue comment letters in response to a company's disclosure and other public information based on the staff's understanding of the company's facts and circumstances. A company's correspondence with the SEC staff is filed on EDGAR and is publicly available 20 business days after the review is complete or a registration statement is effective. However, a company may request confidentiality for certain aspects of its correspondence with the SEC.

Comment letters issued by the SEC staff may include requests for additional supplemental information so the

staff can better understand a reporting entity's accounting or disclosure, additional disclosures or revisions related to previous filings, or the inclusion of additional or revised disclosures in future filings. Responses are due within 10 business days of the receipt of a comment letter, but extensions may be requested. Depending on the complexity of the issue, there may be several rounds of correspondence with the SEC staff before the issues identified in the review are resolved. *Figure 3* highlights how many rounds of comment letters were required to resolve the comments received by power and utilities registrants (based on letters posted to EDGAR between November 1, 2012 and October 31, 2013). As noted in the figure, over 60% of comment letters were resolved with one response from the respective registrant. *Figure 4* highlights the average number of days from the issuance of a comment letter until clearance from the SEC staff over the last three years for power and utilities registrants. The average number of days declined ten days from 2010 to 2011 and stayed consistent from 2011 to 2012.

**Figure 3: Number of rounds per comment letter**



**Figure 4: Average number of days from the issuance of comment letter until clearance from SEC**



# **Comment letter response best practices**

The following are best practices for controllers to consider when they receive a comment letter:

## **Own the process. Use your accountants and lawyers but do not relinquish ownership.**

Registrants should view responding to a comment letter as a project. There should be a project manager coordinating the process including obtaining input from attorneys and accountants in developing the response.

## **Evaluate how long you believe it will take to respond. Do not rush.**

The letter from the SEC staff will indicate that the company should respond within 10 business days. Evaluate the comments and assess the information necessary to respond. If more time is needed, it is acceptable to request more time. In most instances, the company's legal counsel will make the call to the SEC staff to request an extension. A good and thoughtful response is much better than a quick response.

## **Consider the implications and timing on future filings.**

A company may receive a comment letter shortly before it is planning to file a registration statement or take down off a shelf registration. In such cases, it should evaluate the comments with its auditors and legal counsel to determine if there are implications on the offering and its timing. A company may want to discuss the timing of an anticipated offering with the SEC staff to determine if the relevant matters can be reviewed on an expedited basis.

## **Call the staff if you do not understand the comment.**

Do not hesitate to call the SEC staff if you do not completely understand the comment. The objective of the call should be to gain clarification when a comment or aspects of a comment are unclear.

## **Comment letters are public and the public may have an interest.**

There is an increasing interest from the public in the comment letter process. Companies should recognize that comment letters become part of the public domain once submitted and resolved. The diligence applied to the comment letter process should be similar to the preparation of the Form 10-K and other public reports.

## **Precedent of other filings may be helpful but do NOT cut and paste.**

The use of previous comments and responses of other companies as a basis for developing a response may be helpful, but there are limitations. While the SEC staff may have accepted a response to a similar comment, it is important to understand that each comment letter relates to a specific fact pattern. Different levels of materiality may also be involved. View the comment letter as a unique communication and respond based on your particular facts and circumstances.

## **Respond completely to the comment.**

Consider the intent of the comment from the SEC staff. The goal is to avoid a response that will lead to further comments. Therefore, provide a response that is thoughtful and complete the first time.

## **If the proposed response contemplates a change in the future, provide the proposed disclosure.**

Many comments will request additional disclosure in future filings. In order to ensure that there is a meeting of the minds as to what will be disclosed and presented, including a draft of the applicable disclosure is strongly encouraged.

## **Consider getting the views of others on the SEC staff.**

Occasionally, there may be a difference of views between a company and the SEC staff reviewer. It is acceptable to request the input of others on the SEC staff including the Senior Assistant Chief Accountant, the Associate Chief Accountant, the Deputy Chief Accountant and the Chief Accountant of the Division of Corporation Finance. Additionally, with respect to matters pertaining to the proper application of generally accepted accounting principles, companies may seek the views of the Office of the Chief Accountant of the SEC. If a company decides to seek the views of other members of the SEC staff, it is strongly recommended that this fact is discussed with the review accountant before reaching out to other staff.

## Comment letter trends

Over the last three years, power and utilities registrants have typically received from four to six unique comments per comment letter.



To help reporting entities gain insight into the SEC staff's current areas of interest, PwC analyzed comments issued to registrants within the power and utilities industry related to Forms 10-K and 10-Q with comment letters posted to EDGAR from November 1, 2012 to October 31, 2013. The following chart summarizes the "hot topics" identified by this analysis.<sup>3</sup>

Rank	Nature of comment	%	Prior year rank
1.	Management's discussion and analysis	12	1
2.	Financial statement presentation and disclosure	9	3
3.	Regulatory	8	6 (tie)
4.	Acquisition accounting	7	5
5.	<i>Fair value</i>	6	N/A
6.	Impairments	6	6 (tie)
7.	Commitments and contingencies	5	2
8.	Consolidation	5	9
9.	<i>Derivatives</i>	4	N/A
10.	Compensation and incentive plans	4	8
	All others	34	N/A

Items in italics and shaded are new to the Top 10 list. The 2012 Top 10 list also included dividends and restricted net assets and controls and procedures; these topics dropped out of the Top 10 list in the current year.

As highlighted in the table, the comments are primarily in areas impacting all industries and are not necessarily unique to this sector. However, the focus of comments in these areas that have been provided to power and utilities registrants may have industry-specific considerations. Therefore, this publication has been prepared to assist power and utilities reporting entities in their evaluation of the topics that are important for 2013 year-end financial reporting, and where efforts should be focused in drafting disclosures within Forms 10-K and Form 10-Q. Our discussion includes representative SEC staff comments as well as our views on other relevant considerations in the preparation of the Form 10-K.

<sup>3</sup> Based on PwC analysis of comments from comment letters posted to EDGAR between November 1, 2012 to October 31, 2013 related to the power and utilities industry Form 10-K and Form 10-Q filings for SIC Codes: 4900, 4911, 4922, 4923, 4924, 4931, 4932, 4941 and 4991.

The analysis included only reporting entities reporting under accounting principles generally accepted in the United States (U.S. GAAP).

# Management's discussion and analysis

As it has for the past two years, MD&A continued to be the top area for comment in the 2013 comment letter cycle. The purpose of MD&A is “to give investors an opportunity to look at the registrant through the eyes of management by providing a historical and prospective analysis of the registrant’s financial condition and results of operations, with particular emphasis on the registrant’s prospects for the future.”<sup>4</sup>

The MD&A section should convey details of the registrant’s financial condition, changes in financial condition compared to prior periods, results of operations, and future prospects. Registrants should also consider the consistency of the information presented in MD&A with other information that it publicly discloses. This could include information contained on the registrant’s website, discussed on earnings calls or included in investor materials. Below, we analyze the areas of MD&A with the most number of comments in 2013.

## Results of operations

Item 303(a)(3) of Regulation S-K contains the requirements for registrants to discuss results of operations in MD&A. Additional guidance on MD&A, including results of operations, is contained in Financial Reporting Release (FRR) 36 and FRR 72. Reporting entities should ensure that the results of operations discussion provides readers with a sufficient understanding of the significant components of revenues and expenses that, in management’s judgment, facilitate an understanding of the registrant’s results of operations. In addition to the description of the significant components of changes in historical periods, reporting entities should describe any known trends or uncertainties that are expected to have a material favorable or unfavorable impact on revenues or income from continuing operations.

Recent comments from the SEC staff have requested registrants to explain the “whys” and “implications” of changes in operating results as well as trends which may have a material impact on future operating results.

*Management should ensure that the presentation of financial analysis in MD&A aligns with other publicly available information.*



## Sample comments

- (1) *We note the decrease in operations and maintenance expenses in fiscal 2012. With a view towards enhanced transparency please tell us what consideration you gave to providing expanded disclosure with regard to the factors you consider when scheduling maintenance outages. In this regard, we assume fewer scheduled maintenance outages in fiscal 2012 may lead to more scheduled maintenance outages in fiscal 2013 and beyond which could potentially increase future operations and maintenance expenses. Lastly, tell us if there have been any regulatory rate actions negatively impacting the ability to perform scheduled maintenance outages.*
- (2) *We note your disclosure on page [XX] that the decrease in other income (expenses) is attributable in part to an increase in the allowance for funds used during construction (“AFUDC”) resulting from increased construction activity. On page [XX], you disclose that construction work in progress (“CWIP”) was \$[XX] thousand and \$[XX] thousand at December 31, 2011, and 2012, respectively. With a view toward enhanced disclosure, please tell us whether there was a change in AFUDC equity or debt rates, what the change in rates was, and how the change impacted the recorded balance.*

<sup>4</sup> SEC Financial Reporting Release 36

## Liquidity and capital resources

Liquidity disclosures within MD&A also continue to be an area of SEC staff focus. Power and utilities operations are capital intensive. Based on PwC's 2013 financial reporting survey, capital expenditure estimates for 2013 ranged from \$112 million to \$5.5 billion for power and utilities reporting entities, with average estimated expenditures per registrant of \$1.7 billion. Common capital expenditures related to green energy investments, gas generation facilities, reliability and environmental compliance. Given the significant cash flow needs to support these capital requirements, reporting entities closely monitor the financial markets to maximize opportunities to refinance existing debt or to obtain new debt at favorable rates. Any such plans should be discussed in MD&A.

Liquidity disclosures should also identify how reporting entities plan to address negative working capital, particularly if the negative working capital is driven by the level of current debt at the balance sheet date. Based on our PwC survey of Form 10-Ks over the past two years, the percentage of power and utilities reporting entities with negative working capital has increased in 2012 as illustrated in **Figure 5**.

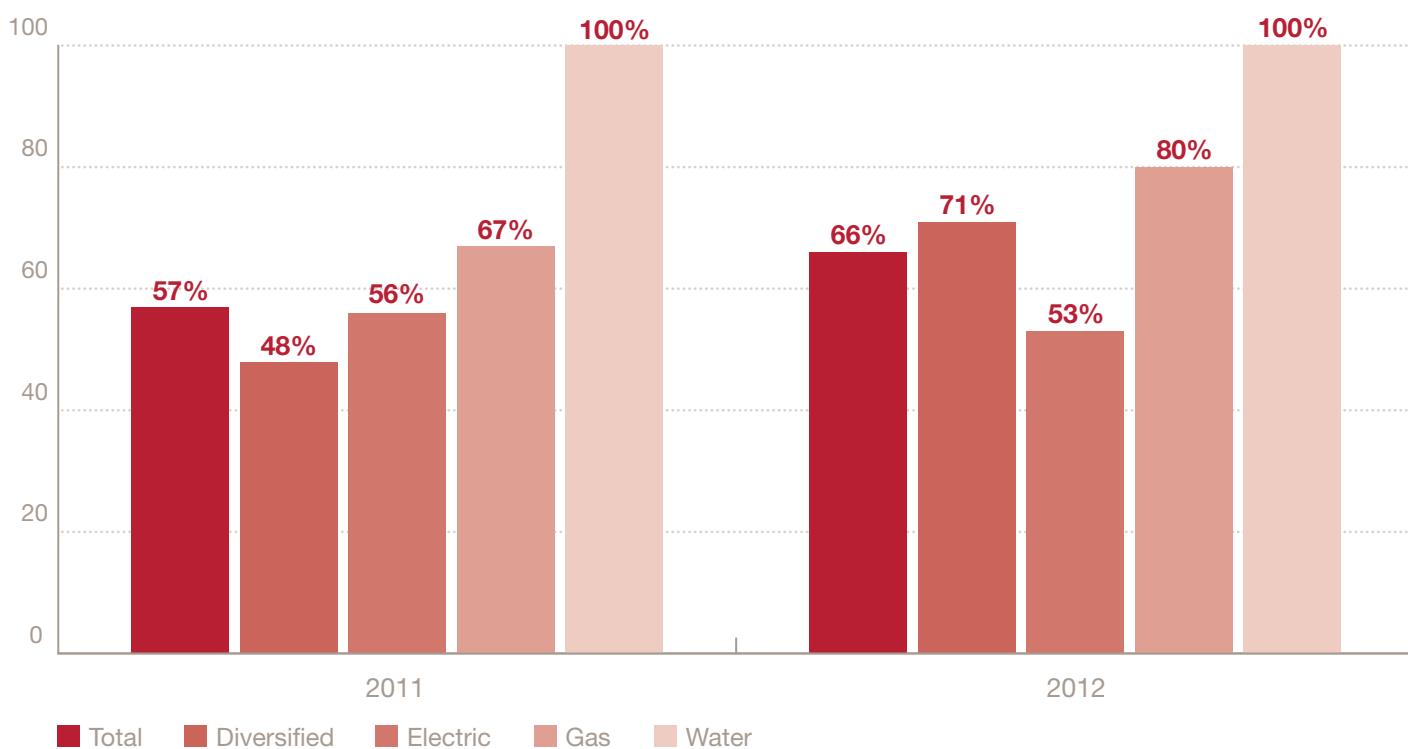
Recent comments from the SEC staff have included requests for registrants to provide more robust disclosure of fluctuations in cash flows and items that impact the availability of credit, including limitations on the ability

to draw on existing lines of credit or other borrowing limitations. Preparers of MD&A should ensure that a robust and transparent discussion of these matters is embedded within their liquidity section. Additionally, the SEC staff has compared information presented within the liquidity disclosures to other data provided within the filing, including the statement of cash flows, and has issued comments if there are inconsistencies.

## Sample comments

- (1) *We note the table showing your capital expenditures for the past three years. Please explain to us and disclose how this table reconciles to your cash flows from investing activities as seen on your statement of cash flows.*
- (2) *Please tell us and disclose in more detail the reasons for large variations in the pension contribution from 2010 through 2012. We note you have \$[XX] million and \$[XX] million in pension contributions for 2010 and 2012, respectively, but you have no such contribution for 2011.*
- (3) *Please revise to provide a more detailed analysis of the underlying reasons for changes in your cash flows and to better explain the variability in your cash flows for the periods presented. Please provide us with your proposed disclosure in your response.*

**Figure 5: Percent of registrants surveyed with negative working capital**



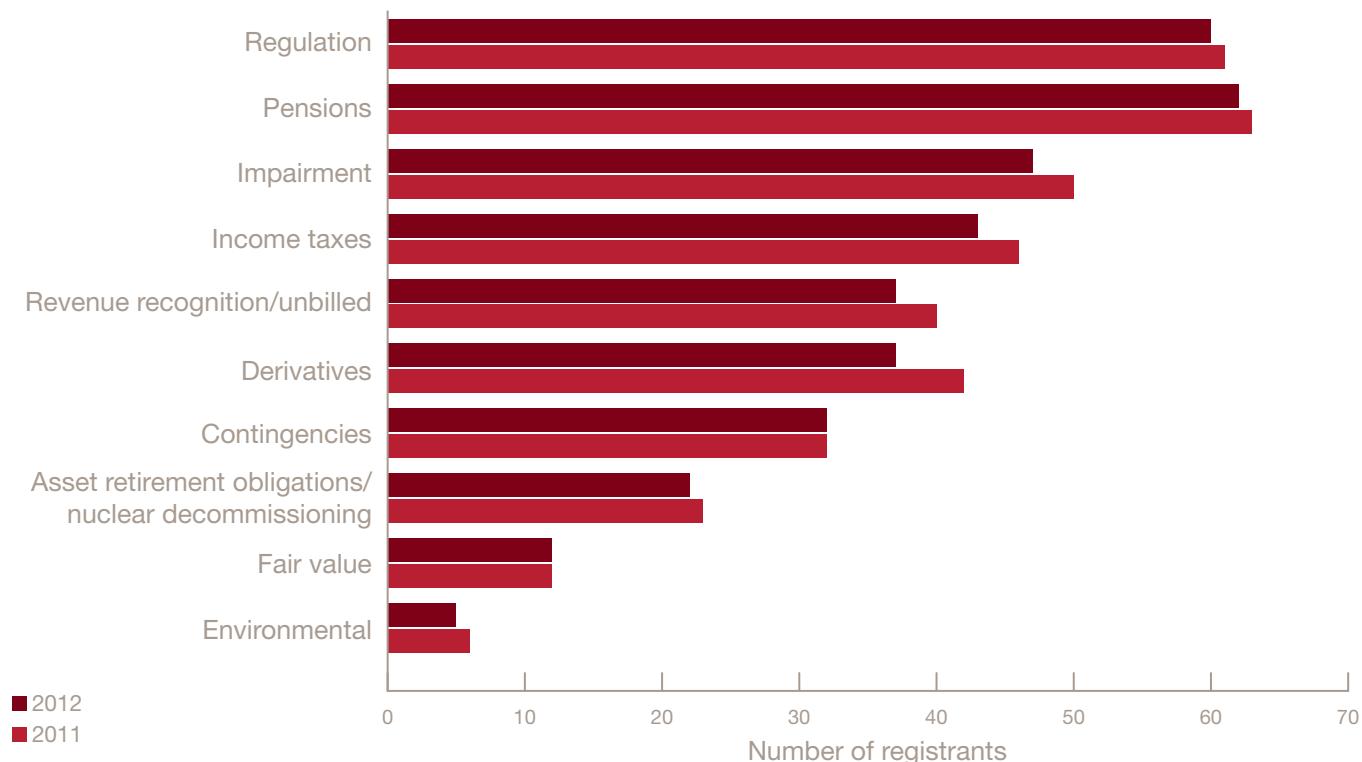
## Critical accounting policies

Over the years, the SEC has issued guidance focused on the need for an enhanced discussion and analysis of critical accounting policies in MD&A, which would include an evaluative discussion of a company's most complex, subjective, and sensitive accounting principles and estimates. In speeches, the SEC staff has also highlighted several recommendations to help registrants improve their disclosures, including being mindful to avoid merely repeating accounting policy discussions contained in financial statement footnote disclosures, ensuring all relevant policies have been disclosed, providing quantitative as well as qualitative analysis, as well as providing sensitivity analysis when appropriate. The figure below (Figure 6) highlights the ten most common critical accounting policies disclosed by power and utilities reporting entities.

## Sample comments

- (1) Please tell us how you determined that your accounting policy related to impairment of fixed assets was not a critical accounting policy involving significant judgment by your management. In this regard, we note the material impairment recorded in [20XX] by your [XX] segment, and we assume that continued declines in natural gas prices or sustained low prices could lead to further impairments in your [XX] assets or in your coal properties and equipment. If you propose to provide a critical accounting policy in future filings, please show us what that policy will look like.
- (2) Please tell us your consideration of disclosing your accounting policies related to asset retirement obligations, proportionate consolidation, and accounts receivable allowances.

**Figure 6: Critical accounting policies disclosed**



## Contractual obligations

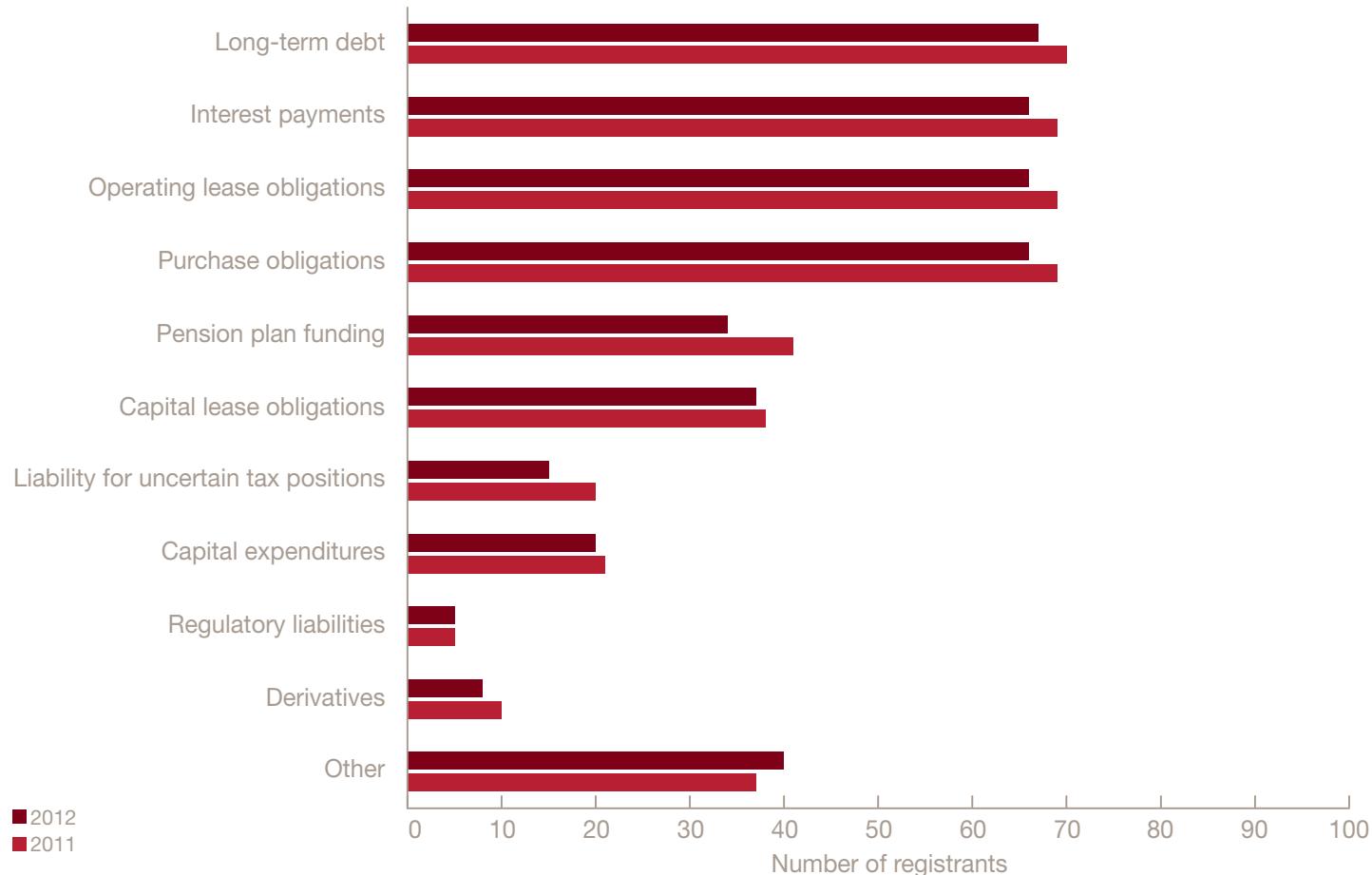
Item 303(a)(5) of Regulation S-K requires registrants to provide tabular disclosures of the amounts due under specified contractual obligations as of the most recent balance sheet date. The contractual obligations table should consist of obligations of the reporting entity that fall within the following categories:

- Long-term debt
- Capital lease obligations
- Operating lease obligations
- Purchase obligations
- Other long-term liabilities reflected on the registrant's balance sheet under GAAP

Reporting entities often question which commitments should be disclosed as part of "purchase obligations." This category is intended to capture agreements to purchase goods or services that are enforceable or legally binding on the registrant. Within the power and utilities industry, this generally includes contracts for commodities, primarily electricity, gas or fuel. Registrants should ensure that all legally binding purchase commitments, including those that are recorded in the financial statements or disclosed in the notes to the financial statements, are reflected in the MD&A contractual obligations table.

**Figure 7** describes common components of the contractual obligations tables presented by power and utilities reporting entities.

**Figure 7: Contractual obligations**



### Sample comment

(1) *Please tell us your consideration of including pension and other postretirement benefit obligations and other long-term liabilities reflected on your most recent balance sheet in the table or provide a discussion of the obligations to the extent necessary for an understanding of the timing and amount of the obligations. Please refer to Item 303(a)(5) of Regulation S-K.*

### Non-GAAP measures

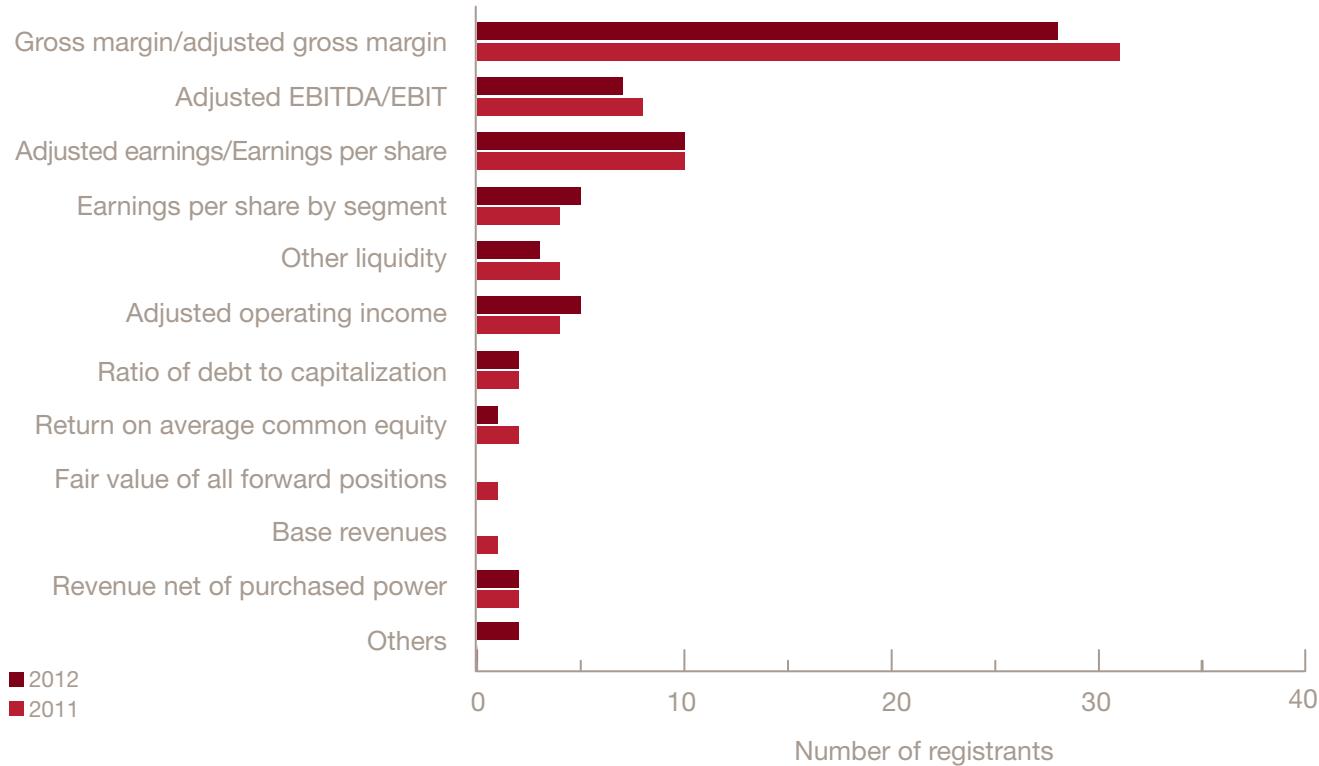
Non-GAAP measures have been a recurring topic in SEC staff comment letters across all industries. Regulation G defines a non-GAAP financial measure as a numerical measure of historical or future financial performance, financial position, or cash flows that excludes items that are included in the most directly comparable GAAP measure or that includes items that are excluded from the most directly comparable GAAP measure. When non-GAAP financial information is presented in periodic reports filed with the SEC, registrants are required to disclose:

- The reasons why management believes the non-GAAP measure is relevant to investors;
- The additional purposes, if any, for which management uses the non-GAAP measure;
- The most directly comparable measure presented with equal or greater prominence; and
- A reconciliation to the comparable GAAP measure.

In recent public speeches, the SEC staff provided examples of objectionable non-GAAP items, including full non-GAAP income statements and non-GAAP measures that exclude expenses considered to be integral to operating the business. One commonly cited example is a non-GAAP measure that excludes normal cash expenses necessary to operate the business (such as advertising costs or salaries). Also, at the December 2013 American Institute of Certified Public Accountants National Conference on Current SEC and PCAOB Developments, the SEC staff commented on a trend of reporting non-GAAP financial measures that adjust for pension actuarial gains and losses and encouraged registrants to be transparent as to the nature of any adjustments, and to disclose the methods used, the amount of the adjustment and a clear explanation as to why the measure is useful.

In addition to the examples cited above, recent comments highlight the SEC staff's efforts to ensure registrants are focused on compliance with non-GAAP disclosure guidance. The SEC staff has issued comments when the most directly comparable GAAP measure is not presented with equal or greater prominence than the non-GAAP measure, and when there is no reconciliation between the two amounts.

**Figure 8: Non-GAAP measures utilized 2012**



### Sample comments

- (1) You indicate that the capital expenditures quantified in your disclosure include both your capital expenditures and those of your equity method investee. As such, the subtotal that you are currently disclosing appears to be a non-GAAP number. If you continue to disclose the capital expenditures of your equity method investee, please separately quantify the investee's capital expenditures from your own capital expenditures, and clarify for your investors how your investee's capital expenditures affect your liquidity and capital resources.
- (2) We note your presentation of the measures "debt to capital, excluding securitization bonds" and "net debt to net capital,

Power and utilities reporting entities should consider SEC rules and guidance when evaluating whether to disclose non-GAAP measures, which measures to disclose, and how to present such measures. **Figure 8** highlights non-GAAP measures commonly presented by power and utilities reporting entities.

excluding securitization bonds." Since these appear to be non-GAAP measures, please tell us how you considered identifying these measures as such. In this regard, we note that you identify these measures as non-GAAP measures in your earnings releases. Please also apply this comment to any of your registrant subsidiaries that present similar measures.

- (3) Please explain to us and disclose the nature and basis of the adjustment "unrealized loss on property, plant and equipment" in the non-GAAP reconciliation for 2012. Please also revise your definition of the non-GAAP measure to include this adjustment on page [XX].

## Fair value

In recent comment letters, the SEC staff has focused on compliance with the new disclosure requirements required by Accounting Standards Update (ASU) No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04) which was effective in the first quarter of 2012 for calendar year-end companies.

As a reminder, the key additional disclosure requirements required by ASU 2011-04 include:

- Quantitative information about significant unobservable inputs used. The ASU permits companies to not disclose the quantitative information about unobservable inputs for valuations provided by a third party that are unadjusted (known as the third party pricing exception).
- Qualitative description of valuation process for level 2 and 3 fair value measurements

- Qualitative discussion about the sensitivity of inputs used in recurring level 3 measurements
- Disclosure of any transfers between Level 1 and Level 2 of the fair value hierarchy, including the reasons for those transfers

In recent comment letters, the SEC staff has requested disclosure of the valuation techniques and sources used for level 2 and level 3 fair value measurements. Furthermore, they have requested registrants to provide enhanced qualitative disclosure of ranges for unobservable inputs disclosed or, when the range is wide, disclosure of the weighted average amounts. The SEC staff has also requested additional disclosure about how changes in one unobservable input affect another unobservable input used in fair value measurement.

As denoted in the *table below*, power and utilities reporting entities had a number of financial assets or liabilities recorded at fair value, with derivatives, debt and equity securities and cash equivalents topping the list.

Financial asset or liability	Percentage of registrants with measure	Level 1	Level 2	Level 3
Derivatives	83%	60%	90%	67%
Debt and equity securities	54%	76%	71%	8%
Cash and cash equivalents	54%	79%	29%	0%
Nuclear decommissioning trusts	24%	88%	94%	18%
Deferred compensation	13%	56%	56%	11%
Rabbi trusts	16%	73%	45%	9%
Auction rate securities	3%	0%	50%	100%
Mutual/hedge funds	13%	78%	33%	0%
Private equity	1%	100%	100%	0%
Real estate assets	1%	100%	0%	0%
Other	26%	72%	72%	56%

Note: Level percentage represents the percentage of registrants which report the indicated asset or liability by each respective level. Registrants may have more than one type of measure.

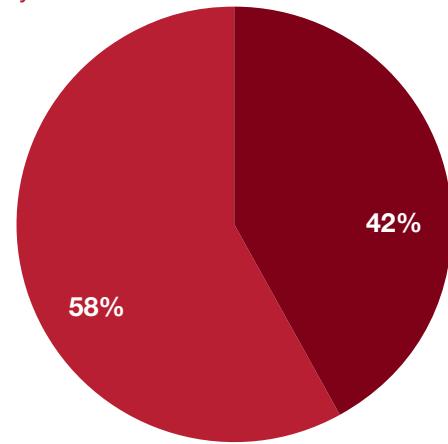
*Only 16% of power and utilities reporting entities disclosed the use of the third party pricing exception.*



**Figure 9** shows that approximately 42% of power and utilities reporting entities provided quantitative information on unobservable inputs at a level more disaggregated than their fair value hierarchy table.

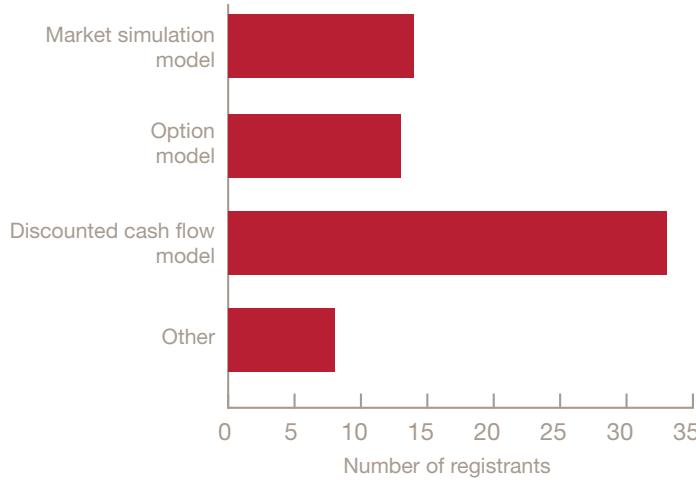
While the fair value guidance does not require disclosure at a level more disaggregated than the fair value hierarchy (i.e., at the class level), registrants should be mindful that the disclosures should contain sufficient detail to allow users to understand the unobservable inputs used and how those inputs vary over time. When considering how detailed the disclosure should be, a reasonable starting point is to evaluate the classes for each of the assets and liabilities being included in other fair value disclosures (e.g., the fair value hierarchy table), followed by consideration of the nature and risk of the types of assets and liabilities and inputs in each class.

**Figure 9:** Was the quantitative level 3 information disclosed at a level more disaggregated than the hierarchy table?

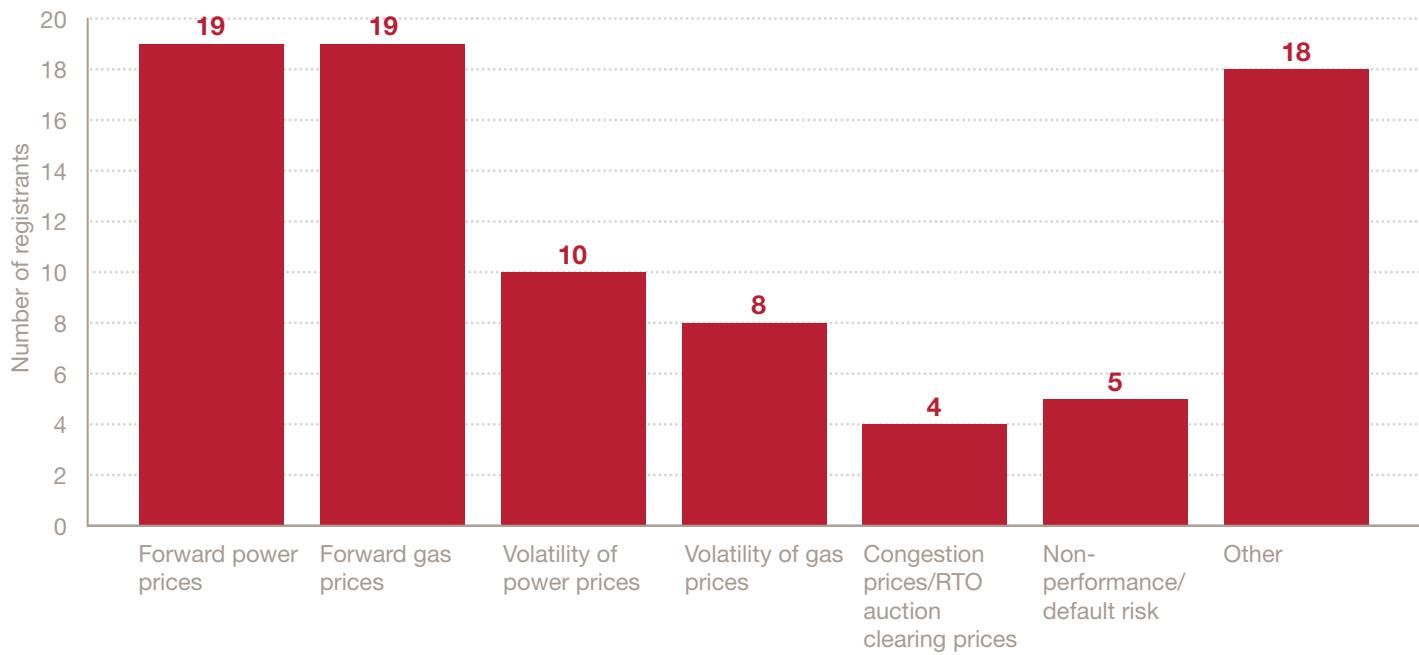


The objective of this exercise is to determine whether there are reasonable levels of homogenous pools of inputs for the level 3 assets and liabilities that can be separated out of the related class. The ASU provides guidance on the determination of classes of assets and liabilities, which includes the consideration of the nature, characteristics, and risks of the asset or liability and the level of the fair value hierarchy within which the fair value measurement is categorized. In some cases, it may be appropriate to provide further disaggregation below the class level. While we have not seen many comments from the SEC staff related to the level of disaggregation for power and utilities registrants, it is possible this may become an area for comment in the future.

**Figures 10** and **11** summarize the level 3 valuation techniques and the types of significant unobservable inputs disclosed by power and utilities reporting entities.

**Figure 10: Level 3 valuation technique used****Sample comments**

- (1) *Please provide the disclosure of the valuation techniques and inputs used to develop measurements for assets and liabilities that are measured at fair value on a recurring basis as required by ASC 820-10-50-1(a).*
- (2) *Refer to your disclosure on page [XX] where you state, “The inputs listed above would have a direct impact on the fair values of the above security types if they were adjusted. A significant increase (decrease) in the forward market or basis price would result in a higher (lower) fair value for long positions, with offsetting impacts to short positions.” Please tell us, along with your consideration for disclosing, whether there are interrelationships between the inputs used in fair valuing the level 3 assets and liabilities which could affect the fair value measurements. Refer to ASC 820-10-55-106.*

**Figure 11: Types of significant inputs disclosed**

## Derivatives

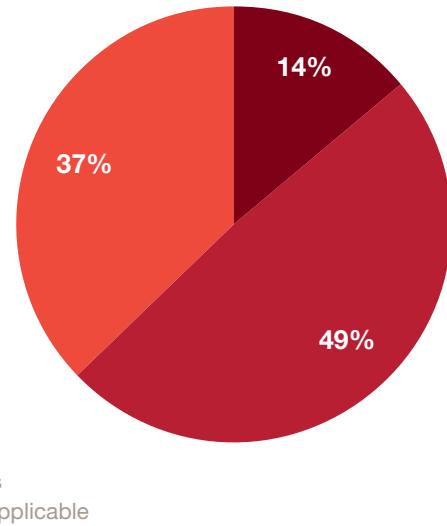
The application of derivative accounting continues to be one of the most complex areas of U.S. GAAP. It is not only difficult to analyze whether a contract represents or contains a derivative, but the disclosure requirements are also extensive. Furthermore, if a registrant has derivatives, it should also comply with the related fair value and balance sheet offsetting disclosures. See *Figure 12* for the percentage of registrants surveyed reporting derivatives on their balance sheet on a net vs. gross basis. As a result of the extensive disclosure requirements, it comes as no surprise that the average length of derivative disclosures for power and utilities reporting entities has almost doubled from just five years ago – from an average of just under two pages to just under four pages.<sup>5</sup>

Given the complexity of derivative transactions and the disclosures required, this is a frequent area for SEC staff comment. Recent SEC staff comments have focused on the appropriateness of accounting conclusions reached relating to derivative commodity contracts and the disclosure of information related to the volume of derivative activity.

While the SEC staff has long expressed the view that it would be inappropriate to reflect realized and unrealized gains and losses in separate line items on the income statement, in an emerging trend, the SEC staff has recently provided a number of comments related to the presentation and disclosure of unrealized gains and losses in other parts of the Form 10-K. Specific comments have included:

- Questions around the appropriateness of disclosing realized and unrealized gains and losses separately in the statement of cash flows, footnotes, and in MD&A for derivatives that are not designated as hedges
- Requests for clarifying disclosure to indicate how a company derives the realized and unrealized portion of the derivative gain or loss
- Comments related to the appropriateness of excluding the unrealized portion of derivative gains or losses while not excluding the realized portion, in some cases where adjusted earnings are presented as a non-GAAP measure

**Figure 12: Method of reporting derivatives on the face of the balance sheet**



To date, the SEC staff has focused these comments on companies in the oil and gas industry who engage in commodity activities. However, many of these comments would also apply to companies in the power and utilities industry. Therefore, we recommend reporting entities monitor this trend and consider if any changes or supplemental disclosures are required.

<sup>5</sup> PwC's annual survey of financial reporting trends in the power and utilities industry

## Sample comments

(1) We note in your disclosure that [subsidiary A] enters into basic service power supply contracts for residential, small and medium general service customers that are [XX] months in duration and provide for [XX]% of supply requirements. We also note your disclosure that [subsidiary B] enters into a series of two one-year and two two-year contracts, each providing [XX]% of the total supply requirements for the group of non-large general service accounts. Please tell us what factors you considered in evaluating these contracts for derivative accounting implications. See FASB ASC 815, Derivatives and Hedging.

(2) Please expand your disclosures under ASC 815-10-50 to better explain your objectives and strategies for hedging activities and the volume of activity in those instruments. Specifically: Please explain in more detail each of the types of risks you are using derivatives to mitigate, which instruments are used to mitigate each risk, and how the instrument effectively mitigates the risk. Please also provide information that would enable users of your financial statements to understand the volume of your activity in those instruments. Please show us what these disclosures will look like.

(3) We note that you present realized and unrealized gain or loss on derivatives accounted for at fair value on page xx, with a discussion of the changes on pages [XX] and [XX], and present within your reconciliation of Adjusted EBITDA, an adjustment to eliminate the unrealized portion of the gain or loss related to commodity derivative instruments. Tell us how you determined the realized and unrealized portions of these gains and losses so that we may understand how your method complies with FASB ASC 815-10-35-2. For example, if realized gains do not reflect only the change in fair value during the period of settlement, identify the specific elements reflected in each measure (e.g. premiums paid, the change in fair value from period-to-period, and settlement proceeds/payments). Please explain your rationale in leaving only the realized portion of derivative gain or loss reflected in your measure of Adjusted EBITDA, given that prior changes in fair value would ordinarily also comprise the overall economics of settlement.<sup>6</sup>

<sup>6</sup> Sample comment provided to a company in the oil and gas industry

## Balance sheet offsetting

In December 2012, the FASB issued Accounting Standards Update (ASU) No. 2011-11, *Disclosures about Offsetting Assets and Liabilities* (ASU 2011-11), which requires disclosures of gross and net information about transactions that are: (a) offset in the balance sheet or (b) subject to an enforceable master-netting arrangement or similar agreement (irrespective of whether they are offset in the balance sheet).

In January 2013, in response to concerns about the scope of the standard, the FASB amended this guidance to specify that the requirements apply only to derivatives accounted

for under the derivatives guidance (including bifurcated embedded derivatives), repurchase/reverse repurchase agreements, and securities lending and borrowing transactions. For calendar year-end companies, the additional disclosure requirements were effective January 1, 2013. Comparative prior period disclosures are also required.

The standard requires disclosure of all collateral subject to enforceable master-netting agreements, whether or not recognized on the balance sheet, and includes an example with a tabular format intended to illustrate its application, as follows:

Description*	Gross amounts of recognized assets	Gross amounts offset in the statement of financial position	Net amounts of assets presented in the statement of financial position	Gross amounts not offset in the statement of financial position		Net amount
				Financial instruments	Cash collateral received	
	A	B	C=A-B	D	E	F
Derivative assets						

*Over 40% of power and utilities reporting entities surveyed followed the tabular format exactly as it was included in the standard.*



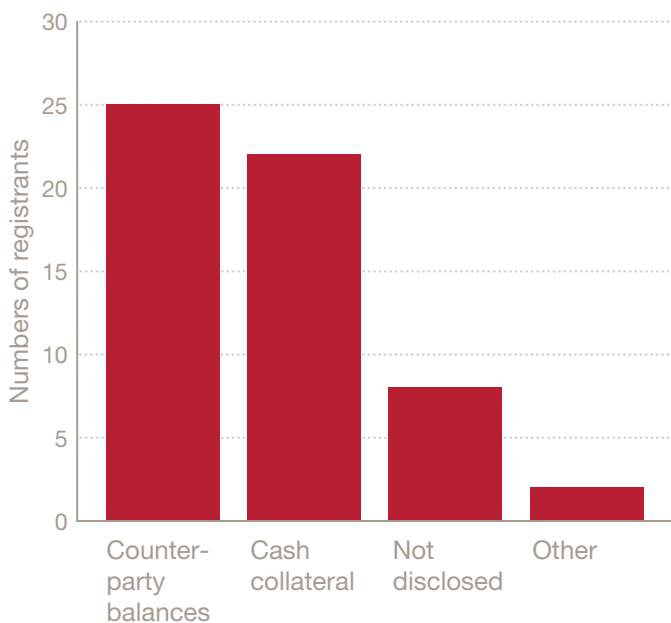
However, during the 2013 reporting cycle, there was diversity in practice in how closely power and utilities reporting entities followed this example. Some reporting entities followed the standard example exactly, while others applied a modified approach. For example, a company which elected to present derivatives net may only include the columns for amounts which were not offset, or columns C-F above. In addition, some companies with limited derivative activity met the disclosure requirements in a narrative format.

Companies should also appropriately consider the qualitative disclosures required, including a description of the rights of set-off associated with an entity's recognized assets and recognized liabilities subject to an enforceable master-netting arrangement or similar agreement, including the nature of those rights. In determining the scope of these disclosures, reporting entities often need to seek input from legal counsel due to the legal aspects of determining enforceable master-netting arrangements. Additionally, reporting entities are reminded that collateral disclosure requirements are not limited to collateral recognized on the balance sheet, but also include other collateral, such as letters of credit.

Although we have not yet seen power and utilities reporting entities receive SEC staff comments related to these disclosures, some of the SEC staff comments in other industries have focused on understanding:

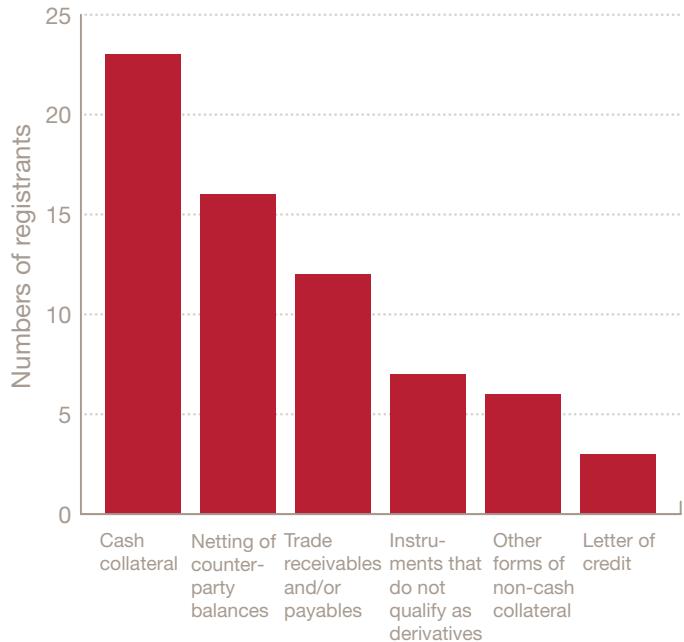
- Why the required disclosures were not included in the consolidated financial statements
- How issuers evaluated and determined whether master-netting arrangements were legally enforceable for purposes of implementing the disclosure guidance

**Figure 13: Type of amounts disclosed as offset**



In addition, in situations in which assets and liabilities were broken out by type of instrument (e.g., by swaps, futures contracts, and other derivatives) and the amounts offsetting those instruments were aggregated (e.g., total derivatives), the SEC staff has requested issuers to present the amounts offsetting those assets and liabilities in the same level of detail as the gross amounts presented. **Figure 13** and **Figure 14** summarize the items disclosed by power and utilities reporting entities as offset and as not offset.

**Figure 14: Amounts disclosed as not offset**



# Impairments

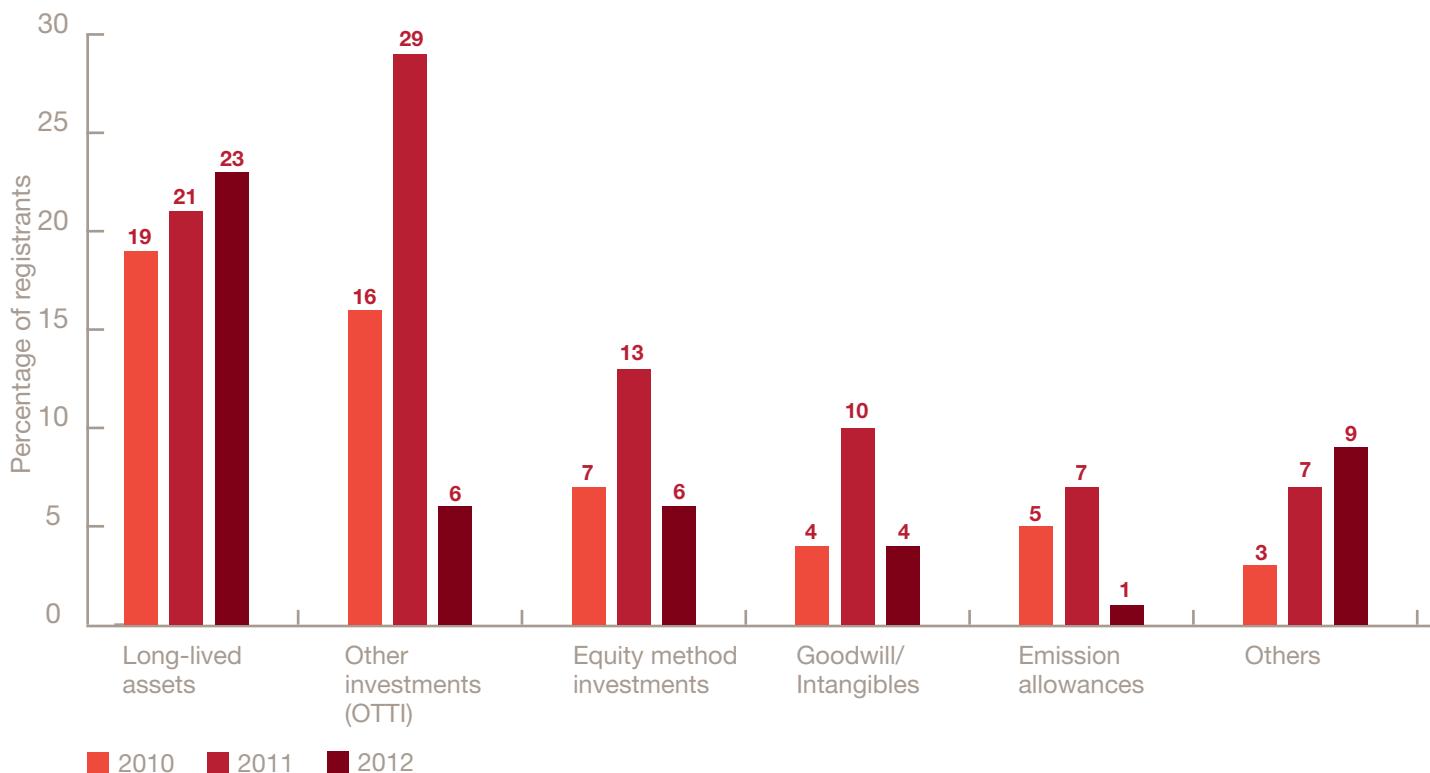
Given the slow economic recovery—as well as the high degree of judgment involved—SEC staff comments have continued to focus on impairment conclusions for goodwill and long-lived assets and the transparency of the related disclosures.

In accounting for and disclosing impairments, registrants should complete a thorough analysis of potential impairments and clearly disclose the assumptions used in the impairment assessment. Additionally, registrants should provide foreshadowing disclosure related to “at risk” reporting units or asset groups. The SEC staff has stated that a reporting unit may be “at risk” if its fair value

is not “substantially in excess of its carrying value.” When evaluating whether a reporting unit is “at risk,” registrants should consider the level of uncertainty associated with the methods and assumptions used in the fair value estimation process.

**Figure 15** highlights the types of impairment charges recorded in 2010-2012 for power and utilities reporting entities surveyed. This chart highlights the increase in impairment charges recorded for long-lived assets in 2012 versus prior periods, possibly due to continually evolving environmental requirements and continued low power and gas prices.

**Figure 15: Types of impairment charges recorded**



In summary, specific comments from the SEC staff related to the following themes:

- “Foreshadowing” disclosures in periods prior to impairment losses and the specific facts, circumstances and events giving rise to impairment charges
- Disclosure of significant inputs used to determine fair value
- Determination of reporting units and allocation of goodwill
- Identification of asset groups and why certain asset groups were impaired while others were not
- Whether a certain event constitutes a triggering event which requires a long-lived asset to be evaluated for recovery

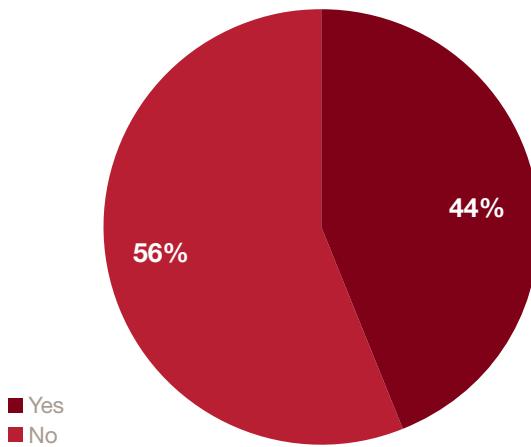
When an impairment charge is recognized, registrants should consider disclosing the events that gave rise to the impairment, such as changes in the underlying business or environment, the amount of the impairment loss, and the method of determining the fair value. Such disclosures should provide sufficient linkage to answer the question of why the charge was recorded in the current period and should not have been recorded in an earlier period.

### Goodwill step zero

In 2011, the FASB issued guidance that provides flexibility for companies to perform their annual impairment tests. For most calendar year-end filers (those who did not early adopt), 2012 was the first year of adoption of the new standard, which was intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities the option of performing a qualitative assessment, or “step zero,” to determine whether further impairment testing is necessary. While the standard did not add new disclosure requirements, reporting entities should consider disclosing the rationale for using step zero in the critical accounting estimates section in MD&A. In comment letters, the SEC staff has asked companies to expand their disclosure of the qualitative factors evaluated. In other cases, the SEC staff has inquired about which reporting units were tested on a qualitative basis and why management believed it was appropriate to perform a step zero analysis.

**Figure 16** illustrates the percent of power and utilities entities who disclosed using step zero for at least one reporting unit.

**Figure 16: Disclosed use of step zero**

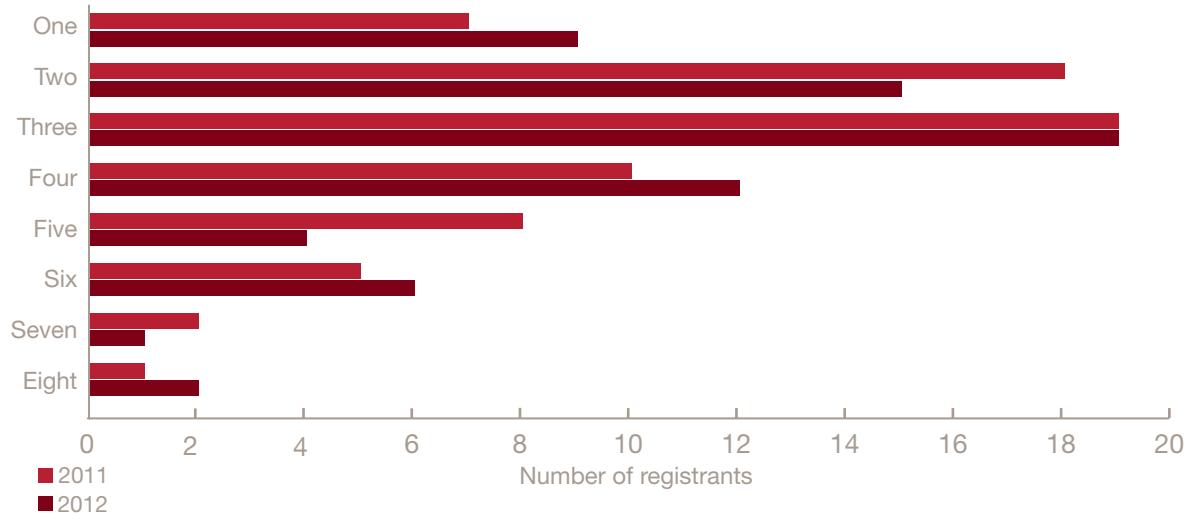


## Impairments

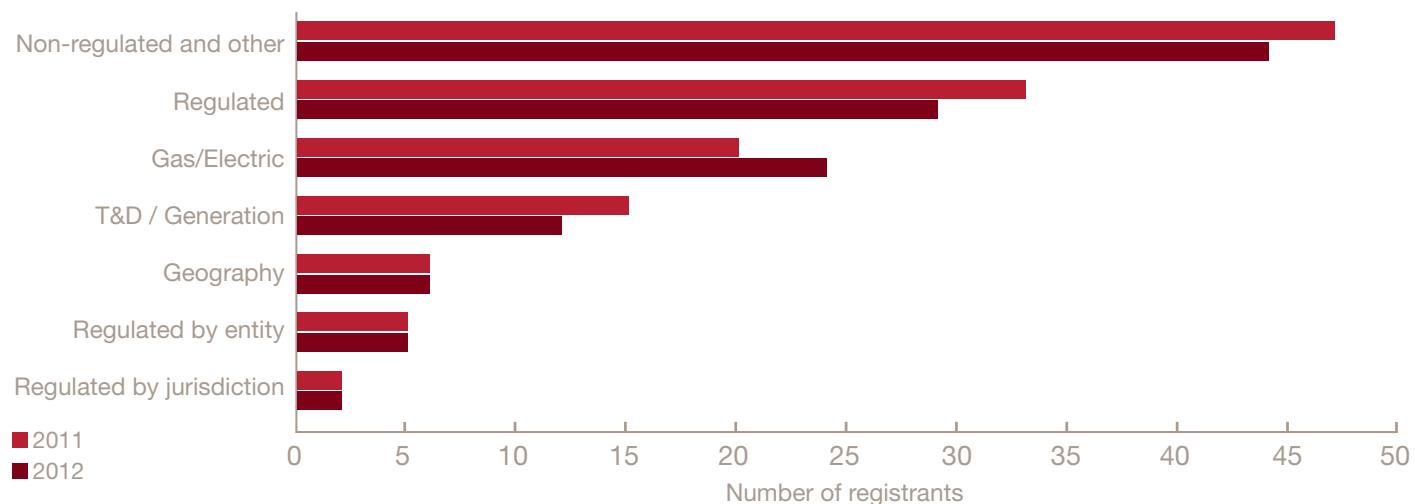
As noted above, the SEC staff has provided comments related to the determination of reporting units. The starting point in assessing a company's reporting units is its operating segment determination.

See [Figure 17](#) and [Figure 18](#) which summarizes the number of segments and the basis for segment determination for power and utilities reporting entities.

**Figure 17: Number of segments**



**Figure 18: Segment determination**



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## Sample comments

(1) We note goodwill was \$[XX] million comprising approximately [XX]% of your total assets as of December 31, 2011 and attributable to your [segment A] segment. Please tell us and revise your disclosure to clarify how you determine your reporting units.

(2) To the extent your reporting unit has an estimated fair value that is not substantially in excess of its carrying value and goodwill for such reporting unit, if impaired, could materially impact your results of operations, please identify and provide the following disclosures in future filings: Percentage by which fair value of your reporting unit exceeded its carrying values as of the date of the most recent test; Description of the methods and key assumptions used and how the key assumptions were determined; Discussion of the degree of uncertainty associated with the key assumptions. Description of potential events and/or changes in circumstances that could reasonably be expected to negatively affect the key assumptions. If you have determined the estimated fair value substantially exceeds the carrying value of your reporting unit, please disclose that determination in future filings. Refer to Item 303 of Regulation S-K.

(3) We assume the legislative changes would constitute an event that would require [Asset A] to be evaluated for recovery under ASC 360-10-35-21.c. If so, please summarize for us the results of your evaluation.

(4) We note you recorded an impairment charge of \$[XX] billion to write down the fixed assets of [Plant A] and [Plant B]. Please explain and clarify whether the [Plant C] was evaluated for impairment in connection with the upcoming sale. If so, tell us and disclose how you had conducted the impairment test along with the results. If not, please explain to us why.

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# Acquisition accounting

Several significant merger transactions in the power and utilities industry closed in 2012, including the Exelon-Constellation, Duke-Progress and Northeast Utilities-NSTAR mergers. Of the power and utilities reporting entities in our survey, 24 percent disclosed some acquisition-related activity in 2012, possibly spurred by certain challenges in the United States, including environmental compliance pressures, load growth considerations, and the current price of natural gas. Given this level of activity, acquisition accounting and the related disclosures has remained an area of focus for the SEC staff. These accounting and disclosure considerations can be complex depending on the nature of the transaction and related regulatory considerations.

A business combination that involves a regulated utility may have certain unique issues as a result of the impact of regulation, including measuring the fair value of assets and liabilities arising from, or subject to, regulation and determining when regulatory offset of fair value adjustments is appropriate. SEC staff comments in this area have focused on general acquisition accounting matters and the regulatory accounting considerations related to the transaction, including:

- The fair value of property, plant and equipment
- Whether regulatory offset is appropriate for the fair value adjustment to debt
- Application (or lack of application) of pushdown accounting

In addition, the SEC staff has questioned the reasons for significant adjustments (i.e., measurement period adjustments) to the initial purchase price allocation, particularly around the intervening events that occurred or additional information that was received, and the reasons that such information was not available at an earlier date.

In addition, the SEC staff has focused on the completeness of the acquisition-related disclosures. The presentation and disclosure guidance in ASC 805 is extensive and reporting entities should carefully consider all of the disclosure guidance related to acquisitions in preparing financial reports in the period of the acquisition and in subsequent periods.

## Sample comments

- (1) *Please tell us how you considered the pending electric deregulation in the purchase price allocation at the close of the [XX] acquisition. As part of your response, please explain to us your valuation methodology with respect to each of the generation, transmission and distribution assets.*
- (2) *With reference to applicable GAAP literature, please explain to us why the full amount of the civil penalty and disgorgement settlement was not recorded as a liability when accounting for the merger with [acquiree].*
- (3) *Please explain in detail what factors, including specific events, you considered in determining whether information obtained after the acquisition date should result in an adjustment to the allocation of the purchase price or whether that information resulted from events that occurred after the acquisition date. Refer to ASC 805-10-30-2 and ASC 805-10-30-3.*
- (4) *We read your disclosure in footnote [XX] that [acquiree]'s debt was not adjusted as a result of the Sale since [acquiree] is a rate regulated entity and your disclosure in footnote [XX] states that*
- (5) *[acquiree]'s debt discount related to the [XX]% Notes is being amortized over the life of the [XX]% Notes. We also note the predecessor's debt discount of approximately \$[XX] million as of December 31, 2011 was reversed and the successor's unamortized debt premium balance is now approximately \$[XX] million on an aggregate basis. This amount is for both [acquirer] and [acquiree]'s debt as of September 30, 2012. Please clarify for us if the debt discount on the [XX]% Notes was reversed, and if so, your basis for the reversal. Help us understand whether this was a push down adjustment or something else. Lastly, if the discount on your rate regulated debt was reversed, tell us whether you recorded a regulatory offset to record the reversal and where the offset was presented in the financial statements. If you did not record an offset, explain your basis for not recording.*
- (6) *Please tell us how you considered pushing down the deferred tax assets related to the excess of . . . historical tax basis of assets and liabilities over the net amount assigned to [entity's] assets and liabilities in the merger.*

# Consolidation

Consolidation accounting—especially the application of the variable interest entity (VIE) accounting model—is one of the more complex areas in U.S. GAAP. Appropriately evaluating variable interests, VIEs, and whether or not an entity is the primary beneficiary can involve considerable judgment. As such, it comes as no surprise that this continues to be a frequent area for SEC staff comment, especially in the area of VIE disclosures. Robust and transparent disclosures should be made to provide a comprehensive understanding of a reporting entity's consolidation conclusions as well as potential financial risk due to the entity's involvement with VIEs.

Some of the SEC staff comments have focused on the following specific items:

- Compliance with all of the disclosure requirements in ASC 810-10-50-8 including the nature of restrictions on consolidated VIE assets that are reported in the balance sheet
- The determination as to whether the reporting entity is the primary beneficiary of the VIE and, if not, disclosure of the basis for that determination
- The appropriateness of the application of the equity method of accounting related to 50% or more owned joint ventures

## Sample comments

- (1) *We note you deemed two of the acquired project companies as variable interest entities and you concluded you were not the primary beneficiary of these entities. Please summarize for us the factors you considered which led to your conclusion that you were not the primary beneficiary of these two project companies. Refer to the guidance in ASC 810-10-25-38A through G.*
- (2) *We note you considered whether you would consolidate [entity] under either the voting interest entity model or the variable interest entity model. In that regard, clarify for us whether [entity] is a variable interest entity (VIE), and if so, identify for us the variable interests in your response ... We note your statement that “[a]lthough [your company] purchases substantially all of the output of [entity], [your company] does not have any dispatch rights nor any other*

*direct voting and/or contractual rights that control the decision making of [entity]. Please explain to us how the energy service agreement works in terms of no dispatch rights while requiring you to purchase substantially all of the facility output. You state that [another entity] is the primary beneficiary of [entity] as [another entity] has the power to direct the activities that most significantly impact the economic performance of [entity]. Please identify for us these activities.*

- (4) *We note your disclosure that you formed [entity] to develop and own a natural gas liquefaction plant. You disclose that you own [XX]% of the membership interest and that you account for this investment by the equity method. Please explain to us in more detail why you account for this investment using the equity method despite your [XX]% ownership interest.*

# Regulatory

Regulated utilities continue to focus on fair and timely cost recovery and return on their investments. Nearly half the registrants in our survey disclosed requesting a new rate mechanism in a current rate case proceeding. Effective disclosures around regulation provide readers with a comprehensive understanding of the current regulatory environments, rate structures, and recovery mechanisms that result in the recognition of regulatory assets and liabilities.

Regulatory accounting and related disclosures continues to be an area of SEC staff scrutiny due to continually evolving regulatory constructs and the accounting judgment required. Key focus areas have included:

- *Support for deferral of regulatory assets*

The SEC staff continues to request clarification of the nature of costs incurred and the related regulatory treatment, including whether rate plans provide for specific recovery of costs, and if not, the basis for management's assertion that the amounts are probable of recovery. In addition, in situations where a registrant is only deferring a

portion of costs (e.g., storm costs), the SEC staff has asked why the total amount of the cost is not provided for in rates and requested supplemental disclosure.

- *More information around rate plans*

The SEC staff has asked questions to better understand specific elements of rate plans if the disclosure provided is not clear.

- *Revenue recognition*

In cases where a registrant is charging rates subject to refund, the SEC staff has requested disclosure of how the amounts are being accounted for, including whether a liability has been recorded to reflect a potential refund.

The SEC staff has also challenged registrants when it was unclear how they met the criteria for revenue recognition under an alternative revenue program.

Questions around whether appropriate disclosure of the remaining recovery period for assets not earning a return has been provided also continues to be an area for comment.

## Sample comments

- (1) Please tell us and disclose if each of the rate plans governing the jurisdictions you serve in which you have deferred the aforementioned costs specifically provide for recovery of these costs. If no specific recovery is provided for, please explain in detail and disclose why you believe these amounts should be deferred as regulatory assets under ASC 980-340-25-1.
- (2) You disclose that during 2012, [your company] incurred \$[XX] million in storm-related restoration costs, but only \$[XX] million was probable for insurance recoveries and \$[XX] million was recorded as a regulatory asset and approved for deferral. Please tell us, with a view toward disclosure, why the total amount of storm costs was not provided for in rates.
- (3) You disclose that you are charging rates subject to refund for the [Plant A] and [Plant B] generating facilities. Please tell us and disclose how you accounted for the amounts that are subject to refund and whether you have recorded a liability to reflect a potential refund.

- (4) Please tell us how you concluded plant held for future use or plant is the appropriate balance sheet classification for the \$[XX] million capital costs related to the development of the LNG facility ... as of October 31, 2012. In this regard, we note you filed a petition seeking regulatory recovery for these costs. Lastly, tell us how you evaluated the LNG facility under ASC Topic 980-360-35. We may have further comment.
- (5) Please help us understand how the 5th bullet point of the key elements of the 2012 rate agreement is intended to work. In this regard, please explain to us which assets the depreciation reserve surplus relates to and how the "excess" arose.
- (6) Please tell us your consideration of disclosing the remaining recovery period of regulatory assets not earning return. Refer to ASC 980-340-50-1.

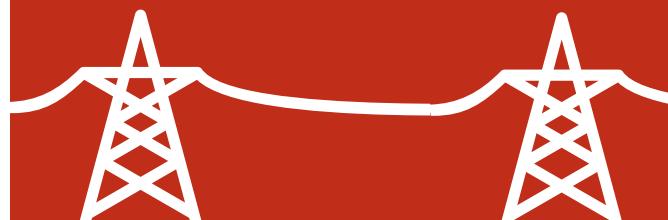
## Commitments and contingencies

U.S. GAAP requires disclosure of loss contingencies that do not meet the conditions for an accrual, including material loss contingencies that are considered probable but not reasonably estimable and those that are at least reasonably possible (but not probable). For contingencies that meet the criteria for disclosure, entities should disclose the nature of the contingency and an estimate of the possible loss or range of loss (or a statement that such an estimate cannot be made).

For loss contingencies that are reasonably possible, the SEC staff has focused on the sufficiency of disclosures regarding the nature of the contingency and the estimated loss or range of loss. In response to concerns about disclosing too much detail about individual cases, the SEC staff has indicated they will not take exception to disclosure of a range of loss in the aggregate for all reasonably possible loss contingencies. The SEC staff also considers public information in evaluating the sufficiency of a registrant's disclosures and may question why disclosures have not been provided for legal matters that have been disclosed publicly, such as in a newspaper.

Consistent with comment letter themes in MD&A and goodwill, the SEC staff has also focused on "foreshadowing" disclosures as it relates to loss contingencies and has emphasized that the period in which a loss is recognized should generally not be the first time the loss contingency is disclosed; instead, early-warning disclosures should be provided. Also, more robust disclosures are expected as matters progress over time.

*When disclosures indicate an estimate of a reasonably possible loss cannot be made when loss contingency matters have been ongoing for an extended period of time, the SEC staff may question what procedures the registrant performed to reach that conclusion.*



One area of focus in the power and utilities industry has been around environmental contingencies. In comment letters, the SEC staff has asked registrants to enhance disclosures related to environmental contingencies, including how registrants assessed the necessity of an accrual at the balance sheet date, and how the disclosures required by ASC 450-20-50 were considered.

### Sample comments

- (1) *We note in your disclosure on environmental contingencies that you believe it is reasonably possible that costs associated with such liabilities may exceed current reserves in amounts that could be material but cannot be estimated. Please clarify if your inability to estimate includes not only the additional possible loss but also the range of loss that could exceed current reserves. Additionally, please elaborate on how you can conclude that additional costs in excess of current reserves "could be material" if you are unable to estimate what that range of additional costs might be.*
- (2) *Please tell us whether any accrual has been made respecting the lawsuit commenced by [entity]. If not, please advise how you determined the likelihood that [your company] would prevail in your appeal to the (State) Supreme Court is remote. If you believe the amounts involved are immaterial to your financial position and results of operations, please supplementally demonstrate with quantification the reasonable possibility outcomes.*
- (3) *You disclose on page [XX] that you have recorded a current liability of \$[XX] million as of December 31, 2012 representing the expected program expenditures for the next 12 months. Please explain in detail the GAAP basis for recording this liability, and tell us which financial statement line item you recorded the offsetting debit to.*
- (4) *We note in 2012 an outside consultant completed an analysis of your [environmental remediation] sites to determine future expenditures to remediate these sites. Please explain whether a more recent analysis has been performed and whether the range of possible future expenditures is intended to satisfy the disclosure requirements of ASC 450-20-50-4. Furthermore, so that we can better understand, please explain and support whether you have accrued environmental liabilities associated with the remediation costs. If so, please tell us your consideration for disclosing this information. We refer you to ASC 410-30-50-10.*

# Financial statement presentation and disclosure

Financial statement presentation and disclosure is a key area of focus as reporting entities prepare for the year-end reporting cycle. This section includes a discussion of SEC staff comments on financial statement presentation and disclosure, multiple registrant reporting, and new disclosure requirements related to comprehensive income. In considering financial statement presentation and disclosure more broadly, the SEC staff has continued to focus on compliance with U.S. GAAP and SEC rules and has issued comments when financial statement presentation or disclosures do not comply with these rules. Some of these SEC staff focus areas include:

- *Statement of cash flows*

Cash flow errors continue to be a leading cause for restatement. As a result, the SEC staff has continued to scrutinize and question the classification of certain amounts in the statement of cash flows and how those amounts reconcile to other disclosures in the Form 10-K. Common comments relate to the classification of transactions and amounts, and disclosure of noncash investing and financing activities. In an area particularly relevant to power and utilities reporting entities given the capital intensive nature of their businesses, the SEC staff has focused on the cash flow presentation of capital expenditures reflected in accounts payable, which have not yet been paid for in cash. Such amounts should not be reflected as capital expenditures on the cash flow statement until the amounts are paid. Furthermore, the SEC staff has requested disclosure of the amount of capital expenditures reflected in accounts payable as a noncash investing activity.

- *Quarterly financial data requirements*

Item 302 of Regulation S-K requires disclosure in the selected quarterly financial data of both net income (loss) and net income (loss) attributable to the registrant, as well as the effect of any unusual or infrequently occurring items recognized during each full quarter. Recent SEC staff comments have included requests for registrants with non-controlling interests to disclose both net income (loss) and net income (loss) attributable to the registrant in the quarterly financial data disclosure, if not already

*Approximately 80 percent of power and utilities registrants in our survey were impacted by the new other comprehensive income disclosure requirements.*



provided. SEC staff comments have also included requests for disclosure of unusual or infrequently occurring items recognized for each full fiscal quarter, if not clearly disclosed elsewhere. Most registrants provide appropriate disclosures of such events as part of their Form 10-Qs. However, they do not always provide the required disclosures as part of the quarterly financial data.

- *Held for sale and discontinued operations*

We have also noted comments questioning a registrant's basis for reporting items as held for sale and discontinued operations or alternatively, why operations or assets have not been reflected as held for sale and as discontinued operations.

Other comments have focused on Rule 5-02 of Regulation S-X which requires separate presentation on the face of the balance sheet or additional disclosures if certain criteria are met. Power and utilities reporting entities should be mindful of changes in the amounts or balances of financial statement line items that may require certain captions to be separately presented.

## Combined periodic reporting

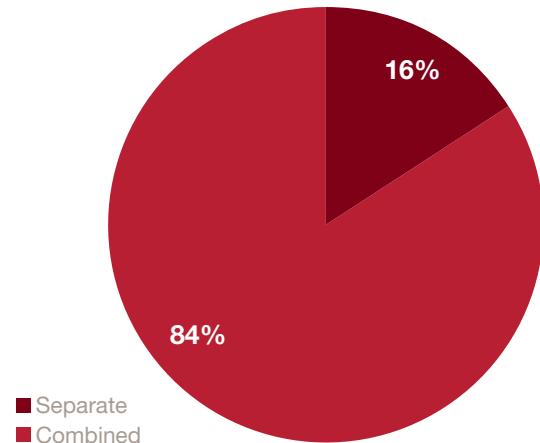
To add to the complexity of financial reporting, many power and utilities reporting entities have multiple registrants, as noted in *Figure 19*. Multiple registrants are prevalent in the power and utilities industry as it is common for operating subsidiaries of an equity registrant to issue SEC registered debt, thereby requiring subsidiary SEC reporting.

**Figure 19:** Number of registrants combined



As permitted by SEC rules, more than 80% of those reporting entities with multiple registrants included in one filing provide combined financial statement footnotes, as noted in *Figure 20*. This can enhance efficiency; however, registrants should be mindful to ensure all required disclosures are provided for each respective registrant included in the filing.

**Figure 20:** Financial statement notes



## Sample comments

- (1) We refer you to Rule 5-02.20 of Regulation S-X. Please confirm the Accounts Payable and Accrued Liabilities as well as the Other line items within current liabilities do not require further disaggregation.
- (2) We note your statements that for the current period growth capital expenditures totaled \$[XX] million and maintenance capital expenditures totaled \$[XX] million. Please tell us how these expenditures are reflected in your Condensed Consolidated Statement of Cash Flows.
- (3) We note your decision to sell certain merchant power stations. Please explain whether these assets have been classified as held for sale, the extent you have considered presenting assets held for sale separately in the balance sheet and as discontinued operations within the income statement. Reference is made to ASC 360-10-45.
- (4) Item 302(a)(1) of Regulation S-K requires the presentation of both net income (loss) and net income (loss) attributable to the registrant within supplementary financial information. Please revise to include net income (loss).
- (5) Item 302(a)(3) of Regulation S-K requires a description of the effect of any unusual or infrequently occurring items recognized during each full quarter. We believe your merger with [acquiree] would require you to provide more robust disclosure highlighting the impact of the merger on your quarterly financial information. Please revise as appropriate or explain to us why you are not required to do so.

## New disclosures related to comprehensive income

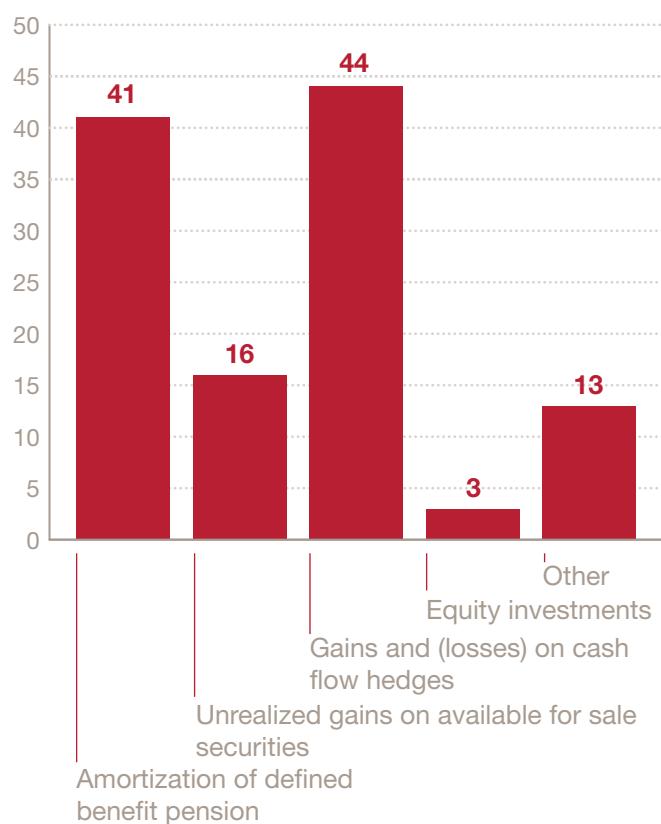
The FASB issued ASU No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* (ASU 2013-02), in February 2013. The new guidance is already effective for public companies. Private companies can adopt the standard in fiscal years beginning after December 15, 2013, and are exempt from certain interim reclassification disclosures. ASU 2013-02 is aimed at improving the reporting of amounts reclassified out of accumulated other comprehensive income.

An entity is now required to present, either parenthetically on the face of the financial statements or in a single note, significant amounts reclassified from each component of accumulated other comprehensive income and the income statement line items affected by the reclassification. However, an entity does not need to present the income statement line item affected for certain components that are not required to be reclassified in their entirety to net income, such as certain amounts amortized into net periodic pension cost which are capitalized into inventory or property, plant and equipment. An entity may elect to present the information parenthetically on the face of the financial statements where net income is presented if all of the reclassification adjustments were reclassified to net income in their entirety and the entity can identify the income statement line item impacted by the reclassification.

During the 2013 reporting cycle, there was diversity in how companies complied with the disclosure requirements, likely due to differences in the nature of the items reclassified out of accumulated other comprehensive income and their significance. Most power and utilities reporting entities met the disclosure requirement by adding to or amending an existing footnote. Some companies provided tabular disclosure similar to the example in the standard. Others addressed the disclosure by other methods, such

as disclosing the income statement line item affected by reclassification adjustments in a footnote to an accumulated other comprehensive roll-forward. **Figure 21** summarizes the components of significant amounts reclassified out of accumulated other comprehensive income disclosed by power and utilities reporting entities.

**Figure 21: Number of registrants disclosing components reclassified out of accumulated other comprehensive income**



# Compensation and incentive plans

The number of rules finalized as a result of the executive compensation requirements stipulated by Dodd-Frank increased again in 2013. On September 18, 2013, the SEC voted 3-2 to propose a rule that would require public companies to calculate and disclose its CEO compensation as a multiple of the median employee's pay, which would be incremental to the executive compensation disclosures already required. The proposed rule has been designed to provide flexibility by permitting reporting entities to use statistical sampling to identify the median employee. However, gathering information to comply with the disclosure may be challenging. The comment letter period ended December 2, 2013. Reporting entities should monitor the SEC's deliberations and start to assess their approach to compliance. For a calendar year-end company, the earliest these new disclosures would be required is 2014.

In addition to executive compensation disclosures required by Regulation S-K, reporting entities are also required to include compensation disclosures in the footnotes to the financial statements as required by U.S. GAAP.

SEC staff comments related to executive compensation and stock compensation disclosures have focused on:

- Disclosure of how the awards are recorded in the financial statements (i.e., as liability awards or equity awards)
- Consideration of disclosing the terms of the modification made to stock option awards

- Disclosure of the aggregate intrinsic values for performance units and restricted stock awards which are expected to vest
- Factors related to changes in executive compensation plans

SEC staff comments related to executive compensation and stock compensation have been in our top ten list for the last two years. Given the pending executive compensation rulemaking required by Dodd-Frank, we expect it to be a focus area of the SEC staff in years to come.

## Sample comments

- (1) *Please describe the basis for and factors considered in determining the amounts of cash restricted stock unit awards granted to the named executive officers.*
- (2) *Please tell us whether you are considering including in future proxy statements a discussion and explanation of factors considered by the Compensation Committee in deciding to remove and replace the compensation limitation based on the payment of dividends as described in the first full paragraph of page [XX]. To the extent applicable, please address the original purpose(s) of imposing such a limitation and whether those purpose(s) are currently relevant to the company's executive compensation philosophy. Also, please compare in greater detail the compensation limitation based on the payment of dividends to the compensation limitation "measured through a distinct shareholder- based metric."*

## CEO pay ratio proposal: A closer look

### Methodology for identifying median employee

- The rule does not specify a methodology for determining the median employee
- Reporting entities are permitted to identify the median employee using either their full employee population or a statistical sample

### Disclosure of methodology, assumptions and estimates

- Reporting entities are required to disclose the methodology used to determine the median employee and total compensation, including any applicable material assumptions, adjustments or estimates
- The required disclosure can be supplemented with narrative discussion or additional ratios

### Total compensation used in identifying median employee

- The definition of total compensation can be based on SEC executive compensation rules or any consistently applied compensation measure
- Reporting entities are not permitted to include full-time equivalent adjustments for part-time employees, annualizing adjustments for seasonal or temporary employees, or cost of living adjustments for non-U.S. employees
- Once the median employee is identified, compensation for purposes of calculating the ratio should be based on SEC executive compensation rules

### Employees covered

- All of a reporting entity's employees are included in the population, including full-time, part-time, temporary, seasonal, and non-U.S. employees

## Supplemental schedules

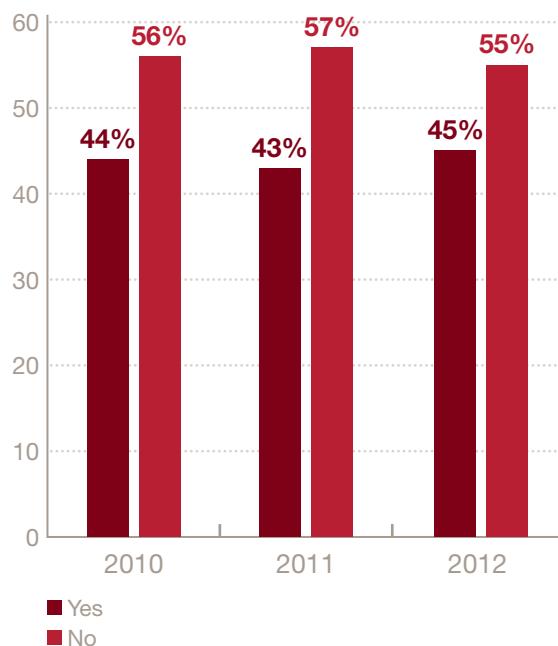
Registrants are required by SEC rules to file certain supplementary financial statement schedules unless (1) the information is already disclosed in the financial statement footnotes or (2) the schedules are not applicable or or not specifically required by the form being filed. The condensed financial information of a registrant (Schedule I) is one of the most common financial statement schedules applicable to power and utilities registrants.

Schedule I is required when a registrant's proportionate share of restricted net assets (i.e., net assets of consolidated subsidiaries which may not be transferred to the parent in the form of loans, advances or cash dividends without the consent of a third party) exceeds 25 percent of total consolidated net assets. Additionally, footnote disclosure of the restrictions or limitations may also be required. **Figure 22** highlights the percentage of power and utilities reporting entities in our survey that included Schedule I in their Form 10-K. The percentage of reporting entities that included such statements in their periodic filing has remained consistent over the last three years.

The financial information of a registrant included in Schedule I must be presented for the same periods as the audited consolidated financial statements of the registrant and can be condensed consistent with interim statements. Footnotes to the schedule generally refer to the footnotes of the consolidated financial statements for descriptions of material contingencies and significant provisions of long-term obligations and guarantees of the parent, including a five-year schedule of maturities; however, additional footnotes to the schedule may be required to supplement the disclosures.

The SEC staff continues to focus on ensuring reporting entities have appropriately considered the requirement to file Schedule I or disclose restrictions on the ability to access subsidiary net assets. In the current year, the SEC staff has placed increased focus on debt covenants which may impose restrictions on a registrant's ability to access subsidiary

**Figure 22: Parent-only financial statements included**



assets, including debt compliance ratios (e.g., a current ratio or debt-to-equity ratio required to be maintained by a subsidiary).

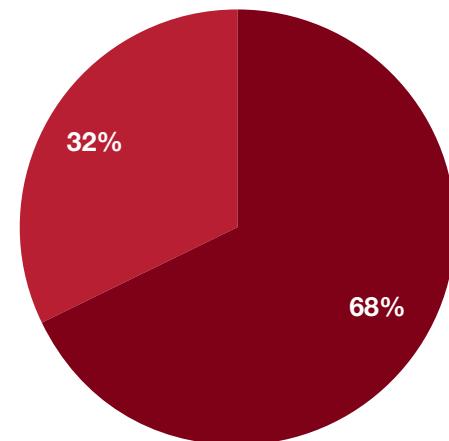
Registrants that do not present Schedule I still need to consider if footnote disclosure of restrictions is required. This is because different calculations are used to assess the requirements. Footnote disclosure is required when restricted net assets of consolidated and unconsolidated subsidiaries as well as the parent's equity in undistributed earnings of 50% or less owned affiliates exceeds 25 percent of consolidated net assets. As noted in **Figure 23**, more than 50 percent of reporting entities in our survey disclose net asset restrictions.

Management's discussion of liquidity in MD&A should also include the nature and extent of the restrictions and the impact they have had or are expected to have on the ability of the parent company to meet its cash obligations.

In preparing Schedule I, registrants should ensure that the form:

- Includes appropriate disclosures. Additional disclosures that maybe necessary include disclosures of the basis of accounting for the parent company's majority-owned subsidiaries and cash dividends paid to the parent for each of the last three fiscal years
- Properly classifies items in the statement of cash flows including loans between the parent and subsidiaries and equity-investee income and dividends
- Presents periods consistent with those presented by the parent
- Presents comprehensive income in a single continuous statement or in two separate but consecutive statements
- Demonstrates form and content consistent with interim financial statement requirements (i.e., in accordance with Article 10 of Regulation S-X)
- Includes amounts for total equity and net income which equal consolidated net income and equity attributable the company

**Figure 23: Net asset restrictions**



### Sample comments

(1) *We note your statement in the last risk factor on page [XX] that applicable law and contractual restrictions, including restrictions in certain of your subsidiaries' credit facilities and the rights of certain creditors of your subsidiaries that would often be superior to your interests, may negatively impact your ability to obtain distributions from your subsidiaries. Please explain to us how you considered the guidance in Item 4-08(e) of Regulation S-X and the need to provide Schedule I as discussed in Rule 5-04(c) of Regulation S-X. In your response, please describe the contractual restrictions and tell us the percentage of consolidated net assets that are restricted.*

(2) *In light of the covenants contained in the [A] Notes, [B] Notes and Series A and Series B Notes of the [Company] as well as project level non-recourse debt, please tell us your consideration of providing the disclosures required by Rule 4-08(e)(3)(i) and (ii) of Regulation S-X. Please also tell us the restricted net assets of consolidated and unconsolidated subsidiaries and your equity in the undistributed earnings of investments accounted for by the equity method and how you computed the amount. In addition, please tell us your consideration of providing the condensed financial information required by Rule 12-04 of Regulation S-X. Refer to Schedule I of Rule 5-04 of Regulation S-X.*

## ***About PwC Power and Utilities practice***

Drawing on the talents of more than 3,000 people worldwide assigned full time to the power and utilities sector, Price-waterhouseCoopers provides a full range of accounting and business advisory services to leading power and utilities reporting entities. Our professionals specialize in accounting and auditing, rate regulation, financial risk management, revenue assurance, taxation, transaction services, environmental regulation, Sarbanes-Oxley compliance, and other areas. In the United States, we are the public accountants or consultants for more than 400 clients in the electric, gas, water, and renewable energy sectors.

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## ***Acknowledgements***

This publication represents the efforts and ideas of many individuals within PricewaterhouseCoopers, including members of the U.S. Power and Utilities sector and the National Professional Services Group. The following PwC personnel contributed to the contents or served as technical reviewers of this publication:

Bill Carlin  
Lucas Carpenter  
Heather Horn  
David Humphreys  
Heidi Schuetze

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