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# *Stay informed* 2011 SEC comment letter trends

*Power and Utilities industry  
current developments in  
SEC reporting*

***December 8, 2011***



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The content of this publication is based on information available as of October 31, 2011. Accordingly, certain aspects of this publication may be superseded as new guidance or interpretations emerge.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.



Clients and friends:

At just the time when many of you are focusing on the preparation of your 2011 year-end financial statements, uncertainties in the economic and regulatory environments continue to add to the inherent challenges in preparing high-quality annual reports. The past year has seen the SEC place additional emphasis on compliance with many existing disclosure requirements, such as disclosures of loss contingencies and goodwill impairment. And, the economic factors impacting the industry will necessitate robust and transparent disclosure in the liquidity, market risks, and results of operations sections of MD&A and in management's discussion of risk factors in 10-K filings. Further, although standard setters continued to focus on convergence efforts during 2011, the FASB still had time to issue new accounting guidance in the current year, including modifications to goodwill impairment assessments and new disclosures for multiemployer pension and post-retirement plans. All of these factors continue to challenge entities in the power and utilities industry and signify that 2011 will again be a challenging and busy year-end.

It has been over a year since passage of the Wall Street Reform and Consumer Protection Act (Dodd-Frank or the Act). In that time, although progress has been made on some of the mandated rules in the Act, many of the rules remain in draft form and are not expected to have a significant impact on the 2011 reporting season. Reporting entities should continue to monitor Dodd-Frank developments, as rules are typically applicable shortly after they have been finalized. For example, say-on-pay votes are now required at least once every three years beginning with the first annual shareholders' meeting taking place on or after January 21, 2011. Registrants also are required to hold a "frequency" vote at least once every six years in order to allow shareholders to decide how often they would like to be presented with the say-on-pay vote. Following the frequency vote, a company must disclose in an SEC Form 8-K how often it will hold the say-on-pay vote.

We have prepared this publication to assist management teams as they identify and understand the SEC's current focus areas for the industry. The information summarized within this publication is derived from comment letters published by the SEC from January 1, 2011 to October 31, 2011 related to electric, natural gas, water, and co-generation registrants including those with regulated and unregulated operations. We have highlighted the areas where power and utilities registrants received the most comments from the SEC and have provided relevant examples of recent comment letters to aid preparers in ensuring that their disclosures are robust and consistent with the relevant accounting or reporting guidance.

We hope you find this summary to be a useful reference tool and we look forward to working with you through this financial reporting season. Please do not hesitate to reach out to your engagement team or PwC contact with questions, or if you would like to further discuss the information contained within this publication.

Best wishes,

A handwritten signature in black ink, appearing to read "Casey H", followed by a horizontal line.

Casey Herman  
U.S. Power and Utilities Assurance Leader  
December 8, 2011

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# ***Table of contents***

Overview .....	1
Management's discussion and analysis .....	2
Commitments and contingencies .....	6
Financial statement presentation and classification .....	7
Disclosure controls and procedures .....	9
Compensation and incentive plans .....	10
Regulatory .....	11
Compliance .....	12
Dividends and restricted net assets .....	13
Renewable energy credits and emission allowances .....	15
Impairments and goodwill .....	17
Additional resources .....	19
About PwC Power and Utilities .....	20
Acknowledgements .....	21

# Overview

While we have seen unprecedented events in 2011 - from the downgrade of US Treasuries to sovereign debt issues in Europe and devastating natural disasters at home and abroad - the Securities and Exchange Commission (SEC or the Commission) continues to focus on ensuring that compliant and transparent disclosures are included in filed documents. To help reporting entities gain insight into the SEC's current areas of interest, PwC analyzed comments issued by the SEC to registrants within the power and utilities industry on Forms 10-K and 10-Q that were published from January 1, 2011 to October 31, 2011. The following chart summarizes the "hot topics" identified by this analysis.<sup>1</sup>

*This publication highlights trends in SEC comments for the power and utilities industry. The topics reflect the SEC's continued focus on transparent and meaningful disclosures and the overall quality of financial reporting.*

Rank	Nature of comment	#	%
1.	Management's discussion and analysis	43	16
2.	Commitments and contingencies	39	14
3.	Financial statement presentation and classification	29	11
4.	Disclosure controls and procedures	29	11
5.	Compensation and incentive plans	22	8
6.	Regulatory	19	7
7.	Compliance	19	7
8.	<i>Dividends and restricted net assets</i>	17	6
9.	<i>Renewable energy credits and emission allowances</i>	7	3
10.	Impairments and goodwill	6	2
	All others	40	15

Items in italics and shaded are new to the Top 10 list, based on comments published between January 1, 2011 and October 31, 2011. The 2010 Top 10 list also included pension and other post-retirement benefit plans and revenue and accounts receivable; these topics dropped out of the Top 10 in the current year. Dividends and restricted net assets were included in the 2009 list but not in the 2010 list.

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 the comments may be impacted by industry-specific considerations and change from year to year. This publication has been prepared to assist power and utilities entities in their evaluation of the topics that are important for 2011 year-end financial reporting, and where efforts should be focused in drafting disclosures within the Form 10-K. Our discussion includes key comment letter trends and considerations in the above areas as well as provides representative SEC comments.

<sup>1</sup> Based on PwC analysis of comments published by the SEC from January 1, 2011 to October 31, 2011 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.

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# Management's discussion and analysis

The purpose of Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is to provide the users of financial information with historical and prospective information that is aligned with the current view of management. Management should convey details of the registrant's financial condition, changes in financial condition compared to prior periods, results of operations, and future prospects. The guidance set forth in Item 303 of Regulation S-K identifies five categories of disclosure—liquidity, capital resources, results of operations, off-balance-sheet arrangements, and tabular disclosure of contractual obligations—along with the requirements for each category. Consistent with last year, MD&A continues to be the number one area for comments in the 2011 comment letter cycle.

*The key areas for MD&A comments include the discussion of results of operations, liquidity, interest and market risks, and non-GAAP measures. Robust discussion of historical results and future prospects are a critical component of high-quality MD&A disclosures.*

## Sample comment

"Please expand your discussion under results of operations for all periods to quantify the material factors, or any multiple factors, you cite as impacting a single financial statement line item. For example, you disclose that certain utility revenues increased in [year] primarily due to price increases, which were partially offset by a lower regulatory recovery, without quantifying the impact attributable to each component. See Item 303(a)(3) of Regulation S-K.

Additionally, we note several instances where you identify a change in a financial statement line item and refer readers to other portions of your Form 10-K, often to the notes to the financial statements, for a discussion of the line item and any year-to-year changes to such items. To the extent that information elsewhere in your filing is necessary to provide an understanding as to your results of operations, financial condition or liquidity, please consider the benefit to investors of including this information and management's analysis of this information in this section of your filing, rather than presenting such information in a fragmented manner throughout the filing.

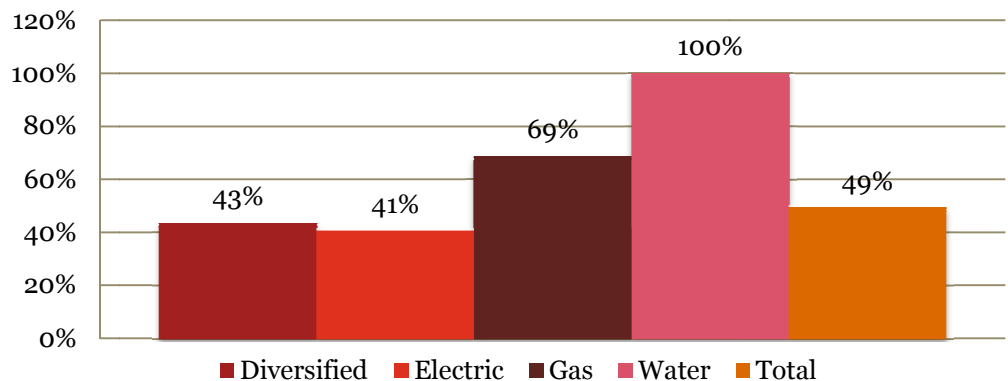
See Commission Statement about Management's Discussion & Analysis of Financial Condition and Results of Operations, Part II, SEC Release No. 33-8056 and provide us with your proposed disclosure."

## Liquidity

General economic conditions as well as the levels of debt expected to mature over the next five years continue to have an impact on operations, cash flows, and liquidity. Therefore, it is no surprise that liquidity disclosures continue to be an area of focus. Recent comments concentrate on requests to disclose items that impact the availability of credit, including limitations 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 in their liquidity section.

Liquidity disclosures typically would also identify how reporting entities plan to address negative working capital as of the balance sheet date. Based on our PwC survey of 2010 Form 10-Ks for selected power and utility entities, a significant number had negative working capital as illustrated in Figure 1.

**Figure 1: Percent of Utilities With Negative Working Capital**



**Sample comments**

(1) "Items 303(a)(1) and (2) of Regulation S-K state that you should discuss any known trends or any known demands, commitments, events or uncertainties that will result in or are reasonably likely to impact your liquidity in any material way. Please expand your disclosure to discuss the current and potential future impact on your liquidity and capital resources of the trends you have identified regarding your basis spreads.

In this regard, we note your statements in the first paragraph of this section that "new sources of natural gas have created changes in pricing dynamics between supply basins, pooling points and market areas" and that "as a result of the increase in overall pipeline capacity and new sources of supply, in [year] basis spreads on [your] pipeline systems began to narrow . . . [the] trend continued into [year], although in the latter part of [year] basis spreads on [your] pipeline spreads improved." Please disclose the consequences of this reduction in basis spreads on your financial condition and quantify this impact to the extent reasonably practicable.

Also provide an approximate timeline upon which you anticipate these reductions in basis spreads will affect your financial condition and disclose the assumptions underlying this estimate, and the likelihood that any such assumptions will change. Please provide us with your proposed disclosure. This comment also applies to your Form 10-Q."

(2) "Please tell us your consideration of discussing cash and cash equivalents held by foreign operations which is not available to fund domestic operations unless it is repatriated to the United States."

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## ***Risk factors***

Registrants are required by Item 503(c) of Regulation S-K to provide a description of significant risk factors within Item 1A of the Form 10-K. The discussion should include an explanation of the risks that specifically affect the registrant (a summary of generic risks that would apply to all entities is not sufficient). Registrants are also required to address market risks, including credit and interest risks, in Item 7A of the Form 10-K.

In October 2011, the SEC released guidance regarding public company disclosure obligations relating to cyber security risks and cyber incidents. The guidance is intended to clarify whether and how companies should disclose the impact of the risk and cost of cyber security incidents. Given the recent SEC guidance, it would not be surprising if the SEC staff focused on these disclosures in future comment letters. Accordingly, power and utilities entities should consider cyber security and data breach incidents when deciding how to fulfill their obligations under the SEC's existing disclosure requirements.

### **Sample comments**

(1) "Please delete the language in the second and third sentences in which you state that other unknown or immaterial risks may also impair your business operations. All material risks should be described in your disclosure. If risks are not deemed material, you should not reference them."

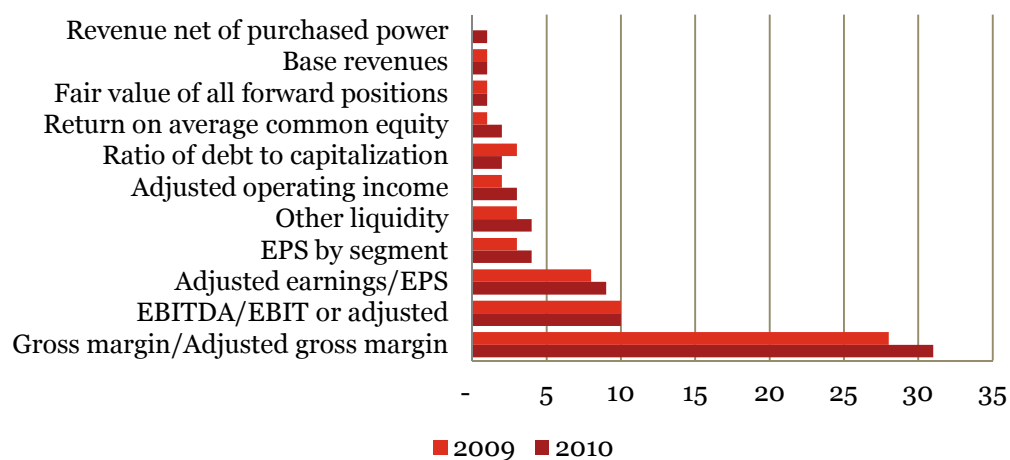
(2) "We note your disclosure in the first, fourth and fifth paragraphs under this heading as well as the related risk factors on pages [x] and [x] regarding the uncertainty surrounding the availability of surface coal mining permits, including the enhanced review by the [regulators] of your permits, and the new [regulators] guidelines related to water quality for [your] operations. To the extent these uncertainties will have, or are reasonably likely to have, a material impact, please discuss how these uncertainties will affect your liquidity, capital resources and results of operations. See Items 303(a)(1), 303(a)(2)(ii) and 303(a)(3)(ii) of Regulation S-K and Section III.B.3 of our Release No. 33-8350."

## ***Non-GAAP measures***

Through its interpretations and comments, the SEC continues to provide its views and expectations around non-GAAP measures. In early 2010, the SEC updated its interpretative guidance on non-GAAP financial measures, encouraging reporting entities to be consistent in how they portray financial results to investors. The intention of the updated guidance was to remove certain perceived constraints that some believed discouraged registrants from disclosing non-GAAP measures in SEC filings. Recent comments, though, reveal that the SEC continues to focus on the application of the non-GAAP guidance. For example, the SEC has recently focused on non-GAAP measures that exclude expenses considered to be integral to operating the business. Accordingly, companies should continue to exercise caution when evaluating whether to disclose non-GAAP measures, which measures to disclose, and how to present those measures. When presenting non-GAAP measures, registrants should ensure that the most directly comparable GAAP measure is presented with equal or greater prominence than the non-GAAP measure and a reconciliation between the two amounts is presented. Figure 2 highlights certain non-GAAP measures presented by power and utilities entities, based on our PwC survey of 2010 and 2009 Form 10-Ks for selected power and utilities entities.



**Figure 2: Non-GAAP measures**



**Sample comment**

"It appears that "total capitalization" and "debt-to-capitalization ratios," excluding non-controlling interests and debt of [subsidiary], of [parent] are non-GAAP financial measures. If you disagree, please advise. Otherwise, please tell us why you are not prohibited from presenting these non-GAAP measures and why your current disclosure complies with Item 10(e) of Regulation S-K. Please refer to Question 102.09 of the Compliance and Disclosure Interpretations regarding the use of Non-GAAP Financial Measures available on our website at <http://sec.gov/divisions/corpfin/guidance/nongaapinterp.htm>."

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# Commitments and contingencies

*The heat is still on when it comes to commitments and contingencies disclosures. The SEC continues to comment on disclosures that do not provide an estimate of loss or range of potential loss. Lack of foreshadowing prior to a significant charge also draws significant attention.*

The SEC continues to emphasize, in public remarks and comment letters, the need for registrants to better comply with existing guidance related to loss contingencies. The guidance in ASC 450-20-50 requires disclosure of certain loss contingencies that do not meet the conditions for accrual, including material loss contingencies that are considered probable but not reasonably estimable and those that are at least reasonably possible (but not probable), regardless of whether they are reasonably estimable. 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 (but not probable), the SEC staff has focused on the sufficiency of registrant disclosures regarding the nature of the contingency and the possible range of amounts. The SEC staff has indicated that it will not take exception to disclosure of reasonably possible ranges of loss in the aggregate for all contingencies, rather than on an individual contingency by contingency basis. Some of the observations made by the SEC staff in public remarks and comment letters include:

- It would be considered unusual if a company cannot reasonably estimate a range of loss for at least some of its contingencies
- More robust disclosures would be expected as matters progress
- The guidance in ASC 450 does not permit reporting entities to avoid disclosing an estimate solely because an estimate cannot be made "with precision" or "with confidence"
- Recording of a material accrual for a contingent liability related to a historical event should not be the first disclosure regarding the contingency

The increase in comment letters on this topic is not a surprise. For the 2011 year-end reporting cycle, we believe the SEC staff may continue to focus on commitments and contingencies, particularly on the adequacy of foreshadowing disclosures preceding a large settlement/charge.

## Sample comment

"We note that for several of the matters discussed you have indicated an estimate of the loss or the impact cannot be made which appears unusual given the stage and passage of time. In this regard, we do not believe that general disclosure indicating that the outcome of a matter may be material to your operating results and/or an amount cannot be estimated satisfies the criteria in ASC 450 and 410. Please either provide a range of loss or provide explicit disclosure for each of the matters that you are unable to estimate the loss or range of possible loss and the reasons why you are unable to provide an estimate.

Furthermore, if you cannot estimate the possible loss or range of possible losses, please consider providing additional disclosure that could allow a reader to evaluate the potential magnitude of the claim."

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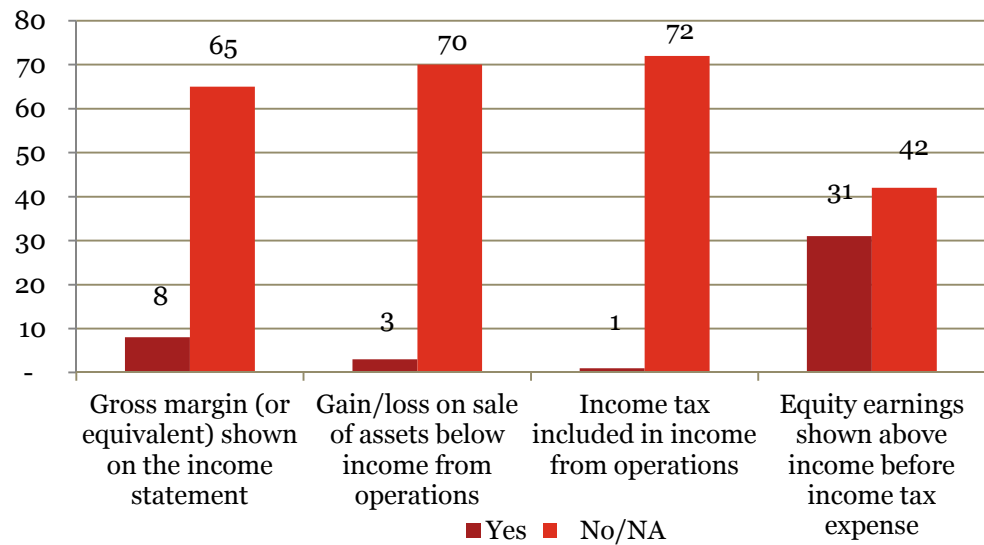
# ***Financial statement presentation and classification***

Financial reporting teams spend significant time and effort understanding changes in presentation and disclosure requirements that result from updates to existing guidance as well as disclosure requirements related to new transactions. There are numerous complex accounting areas in the power and utilities industry and the presentation and disclosure of these transactions may not be straightforward. Registrants should ensure that the disclosures of these transactions are transparent, particularly when an alternative treatment is allowed under GAAP. Common challenges highlighted through the 2011 comment letters include:

- Presentation of amounts on a gross or net basis and the assertion that the company has met the criteria in ASC 210-20-45 to elect to setoff amounts in its financial statements
- Application of the guidance related to guarantors of registered securities under Rule 3-10 of Regulation S-X and the reduced reporting and disclosure framework for guarantor financial information
- Disclosure requirements related to various stock option and restricted stock transactions
- Disclosure requirements related to material categories of capitalized indirect costs and the methods used to allocate these costs to capital projects
- Classification of certain transactions within the statement of cash flows

In addition to the above complexities, income statement classification plays an important role in overall financial statement presentation. Figure 3 highlights certain presentation elections, based on our PwC survey of 2010 Form 10-Ks for selected power and utilities entities.

**Figure 3: Deviations from S-X 5-03**



Registrants should ensure that disclosures related to the presentation and classification of significant transactions or balances clearly convey the basis for such presentation or classification. We have noted in certain instances that the SEC have questioned the basis for how certain transactions or balances have been presented or classified when it is not readily apparent in the primary financial statements or footnotes.

#### Sample comments

- (1) "You disclose that you capitalize indirect construction costs to property, plant, and equipment. Please tell us and disclose in future filings the nature of any material categories of capitalized indirect costs and the methods you use to allocate these costs to your capital projects."
- (2) "We note that your senior notes are fully and unconditionally guaranteed on a senior unsecured basis by the [subsidiary]. We further note that you did not provide separate financial statements of the [subsidiary] under Rule 3-10(a)(1) of Regulation S-X or provide condensed consolidating financial information under Rule 3-10(e) of Regulation S-X to the extent that you believe that exemption applies. Please provide us with your analysis of the required financial statements and disclosures under Rule 3-10 of Regulation S-X. To the extent that you believe that you qualify for solely narrative disclosure under Note 2 of Rule 3-10(e), please reconcile your assertion that any direct or indirect subsidiaries other than the [subsidiary] are minor to your disclosure in other documents filed with us that the [subsidiary] is a holding company through which you own your interests in your operating subsidiaries."
- (3) "We note that you only accrue the deductibles for matters covered by insurance. Please tell us how you meet the right of set-off criteria in ASC 210-20-45-1."

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# Disclosure controls and procedures

*While not an issue identified in comment letters to date, XBRL submissions are within the scope of disclosure controls and procedures.*

All reporting entities are required by Item 3-08(c) of Regulation S-K to include disclosures in their quarterly and annual filings indicating whether or not there were any changes in internal controls over financial reporting (ICFR) that occurred in the last fiscal quarter which would materially impact internal control over financial reporting. Reporting entities that have excluded recently acquired companies from their ICFR assessment must still disclose any material change in ICFR due to the acquisition. Item 3-07 of Regulation S-K outlines the requirement to disclose the principal executive and financial officers', or the equivalent, conclusions regarding the effectiveness of the registrant's disclosure controls and procedures. In addition, Section 404(b) of the Sarbanes-Oxley Act of 2002 requires that registrants include an annual report by management on ICFR, an attestation report issued by a registered public accounting firm, and a discussion of any changes in ICFR during the last fiscal quarter.

Consistent with prior years, disclosure controls and procedures continue to be one of the areas of focus in SEC comment letters. Reporting entities should evaluate their disclosures to ensure full compliance with the requirements included in the applicable sections of Regulation S-K.

## Sample comment

(1) "Please revise your disclosures regarding changes in internal control over financial reporting to comply with Item 308(c) of Regulation S-K. Specifically, please state that there were no changes in your internal control over financial reporting that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, your internal control over financial reporting."

(2) "We note that the acquisition of [entity] has been excluded from your assessment of internal controls over financial reporting as of the year ended December 31, 2010. Please tell us what consideration you gave to disclosing any changes in internal control over financial reporting related to the acquisition that occurred during the quarter ended [date]. In this regard, notwithstanding management's exclusion of [entity's] internal controls from its annual assessment, you must disclose any material change to your internal control over financial reporting due to the acquisition. Refer to Questions 3 and 7 of Frequently Asked Questions (revised September 24, 2007) on Management's Report on Internal Control Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports found here: <http://www.sec.gov/info/accountants/controlfaq.htm>."

(3) "We note that the conclusion of your principal executive officer and principal financial officer regarding the effectiveness of your disclosure controls and procedures is qualified at the reasonable assurance level. Please revise to clarify, if true, that your disclosure controls and procedures also are designed at the reasonable assurance level, or remove the reference to the level of assurance of your disclosure controls and procedures."

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# Compensation and incentive plans

Over the past year, there has been more focus on executive compensation due to the issuance of new rules pursuant to the Wall Street Reform and Consumer Protection Act (Dodd-Frank). The SEC staff comments also demonstrate a focus on ensuring that executive compensation disclosures are adequately addressing the considerations in Item 4-02 of Regulation S-K. These disclosure requirements can be extensive depending on company-specific facts and circumstances, but include, among other things, a description of the formulas and factors considered in determining executive compensation as well as the entity's comparative evaluation of actual performance. In cases where reporting entities use market data or benchmark against competitors, it is expected that this data will be specifically identified.

In response to rule-making under Dodd-Frank, the 2011 proxy season marked the first time all shareholders were given an advisory vote on executive compensation. This change appeared to prompt registrants to take a fresh look at the information included in Compensation Discussion and Analysis (CD&A). As noted in the PwC publication, *Annual Corporate Director Survey - 2011*, 45% of directors changed the CD&A to be written in more "plain English." As preparers of CD&A consider enhancing the information included in proxy disclosures, they should also ensure that the information meets the requirements set forth in Item 4-02 of Regulation S-K.

## Sample comments

(1) "Please expand your Annual Incentive Compensation discussion to disclose the specific quantitative targets you established per your discussion on page [x]. Specifically, we note that your disclosure indicates that you established quantifiable targets related to earnings per share, credit ratings, operating performance results, customer service quality and safety. We further note that your discussion on page [x] indicates that several of these targets were met or exceeded, but it does not appear that you disclosed the targets. Please tell us in further detail and revise future filings to disclose how you determine the grant date price of your stock-based compensation awards. Please also tell us and disclose the methods you use to estimate the inputs used in your Black-Scholes-Merton option pricing model, such as expected volatility, term, risk-free interest rate, and forfeiture rate. See FASB ASC 718."

(2) "In the paragraph on page [x], you disclose that you considered comparative market data, which indicates that you have engaged in benchmarking of total compensation or material elements of compensation. In accordance with Item 402(b)(2)(xiv) of Regulation S-K, please include the benchmarking information and identify the component companies."

For guidance, see Question 118.05 of our Regulation S-K Compliance and Disclosure Interpretations."

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# Regulatory

Consistent with last year, the applicability and application of ASC 980, *Regulated Operations*, as well as related disclosures, continue to be an area of SEC scrutiny. Regulatory environments differ significantly among states and reporting entities and thus the issues can vary. It is important for registrants to provide readers with a comprehensive understanding of their current regulatory environments.

The SEC continues to request clarification of the nature of costs incurred and the related regulatory treatment. The comments have also included requests for the following:

- Further information on the mechanisms by which rates are determined and the basis for the assertion that costs of providing service are recovered through rates
- For costs that may be unusual or entity-specific, a description of the cost as well as the regulatory treatment, including any judgments
- Disclosure of material regulatory assets and liabilities and the following key factors required, preferably in a tabular format:
  - Nature of the cost deferred
  - The amount deferred
  - Where regulatory assets are classified on the balance sheet
  - The recovery period
  - Whether a return is being provided (i.e., included in rate base)

The SEC has also questioned different accounting treatment for similar items due to varying regulatory environments between jurisdictions.

*The SEC continues to comment on the adequacy and transparency of regulatory-related disclosures. They have requested clarification of the basis for the assertion that rates charged to customers recover costs of service. Questions have also been raised about the mechanisms by which rates are determined.*

## Sample comments

(1) "We note your adherence to FASB ASC 980 as it relates to recognition of regulatory assets as allowed by regulators for costs that are reflected in current rates and considered probable of being included in future rates. Please supplementally explain to us the mechanism by which the [regulatory commission] establishes your rates. Please specifically show us how such rates are based on your specific costs including the extent to which your [ratio] impacts your rates as determined on a cost of service with a test period basis. Please be detailed in your explanation. We may have further comment."

(2) "Explain to us in detail how you have historically recovered pension and other postretirement costs. In this regard, please also explain to us how you concluded the probability of recovery threshold has been met pursuant to FASB ASC 980-715 with respect to the regulatory asset recorded for your unrecognized pension and other postretirement costs totaling [\$x] as of December 31, 2010."

(3) "Please clarify why your [A] segments appear to account for property, plant and equipment retirements using different methods than your [B] segment. If the difference is due to regulatory requirements, please consider revising future filings to clarify your policies. Please also confirm that charging original cost less salvage value to accumulated depreciation and amortization means that, although the charge is recorded in earnings, the gross property cost and related accumulated depreciation amounts are not removed from your balance sheet."

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# Compliance

Reporting entities place significant emphasis on ensuring that transactions are appropriately reflected in the financial statements, including disclosures, so that the information included in the filing is accurate and adequate to meet the needs of investors. In addition, an equally critical item whose significance may be overlooked during the busy year-end or quarter financial reporting process, is compliance with the instructions to Form 10-K and Form 10-Q, particularly related to signatures and exhibits. Regulation S-T outlines the general rules and regulations of electronic filings, while Regulation S-K outlines requirements specific to filings under the Securities Act of 1933, Exchange Act of 1934, and Energy Policy and Conservation Act of 1975. The SEC staff may request amendments to any filings which do not include required signatures in typed form.

As reporting entities prepare their year-end financial statements, management should revisit this guidance to ensure compliance with the requirements. Comments received in this category relate to the dates included in certifications, or with the exhibits and appendices that are required to be included and referenced within the filing. These matters do not typically require significant effort to remediate.

*While reporting entities will expend significant effort on preparing the financial statements and disclosures, they should not overlook the requirements in the instructions to Form 10-K and Form 10-Q, particularly related to signatures and dates included in certifications and exhibits.*

## Sample comments

(1) "We note that Exhibit 10(d)(1) does not include any of the schedules or exhibits that are part of the agreement. Please file with your next periodic report a complete copy of this agreement and confirm to us your intention to do so."

(2) "Please file complete copies of material agreements, including all exhibits, schedules and attachments. Please refer to Item 601(b)(10) of Regulation S-K. For example, we note that you have not provided each exhibit to the [agreement] filed as Exhibit 10.1 to your Current Report on Form 8-K filed [date] and included as exhibit 10(v) in your Form 10-K. While Item 601(b)(2) of Regulation S-K permits you to provide omitted information supplementally, there is not a similar provision in Item 601(b)(10) of Regulation S-K. Please review your material agreements and re-file complete agreements with your next periodic report. Please confirm your understanding in this regard."

(3) "Please ensure that the certifications required by Item 601(b)(32) of Regulation S-K are signed on the date of your filing. In this regard, we note that your Form 10-K was filed on [date], but your certifications are dated [different date]."

(4) "Items 1202(a)(7) and (8) of Regulation S-K specify the content of third party reports. Please ensure your future third party reports include: the professional qualifications of the technical person responsible for the report; the date on which the report was completed, i.e. the date on which all substantive work has been accomplished; and the bench mark product prices from which the average adjusted prices are derived."



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# *Dividends and restricted net assets*

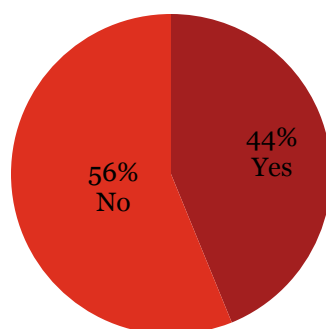
Dividend restrictions are common in the power and utilities industry. The SEC requires certain disclosures when there are restrictions on a registrant's ability to transfer or dividend assets (cash or other assets) from one or more subsidiaries. The nature of the disclosures depends on the magnitude of the restriction/limitation in relation to the registrant's consolidated net assets<sup>2</sup>.

The nature of the disclosures depends on the materiality of the restriction or limitation and may require either of the following:

1. Footnote disclosure of the restrictions/limitations
2. Footnote disclosures of the restrictions/limitations and presentation in a financial statement schedule (Schedule I) of condensed parent company-only financial data

The regulations governing what needs to be presented can be complicated, which may in part be the reason for regular SEC comments in this area. Figure 4 highlights the percentage of power and utilities entities that present parent-only financial statements (Schedule I), based on our PwC survey of 2010 Form 10-Ks for selected power and utilities entities.

**Figure 4: Schedule 1 presented**



Preparers should also consider the instructions to MD&A (Item 303 of Regulation S-K, Instruction 6), which provide that where footnote disclosure of restrictions on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends, loans, or advances is required by Regulation S-X, management's discussion of liquidity should 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.

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<sup>2</sup> These disclosure requirements are codified in Rules 4-08(e), 5-04, and 12-04 of Regulation S-X. They are also discussed in Accounting Series Release 302 (FRP 213), SAB Topic 6-K.2, and section 2810 of the SEC Division of Corporation Finance Financial Reporting Manual.

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### **Sample comments**

(1) "We note that the covenants of certain debt agreements, including those of your subsidiaries, include a requirement to maintain defined debt to capitalization ratios. We also note your disclosure in Item 5 regarding dividend restrictions imposed by regulators.

Please tell us whether debt to total capitalization ratios contained in debt agreements, as well as any debt to capitalization ratios imposed by regulators, restrict or limit your ability or the ability of your subsidiaries to pay dividends and your consideration of providing the disclosures required by Rule 4-08(e)(3)(i) and (ii) of Regulation S-X."

(2) "Please tell us your consideration of disclosing the capital structure limits imposed by the [regulatory agency] on [the Company]. Refer to Rule 4-08(e)(1) of Regulation S-X. Also, please tell us your consideration of providing the disclosures required by Rule 4-08(e)(3)(i) and (ii) for [the parent Company]."

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# *Renewable energy credits and emission allowances*

The accounting for emission allowances, renewable energy credits (RECs), and similar instruments, is challenging because of their unique nature and the lack of existing authoritative guidance. Although the FASB and IASB agreed to work together on an emissions trading project, no progress was made in 2011. Comments from responders to the IASB's Agenda Consultation paper may provide some insight as to whether the project will be pursued further in the near term<sup>3</sup>.

Although no progress was made by the FASB and IASB this year, a new development in 2011 was the SEC increasing its attention on the accounting and reporting of environmental attributes. The SEC staff has recently issued several comment letters requesting information on the accounting for RECs in the following areas:

- Revenue recognition policy upon receipt or transfer of such credits or allowances
- Basis in GAAP for classifying RECs and emission allowances as materials and supplies inventory as opposed to a different asset line
- Process for tracking credits with a cost basis and those with no cost basis

In some cases, these types of REC-related questions may be the only issues included in the comment letters.

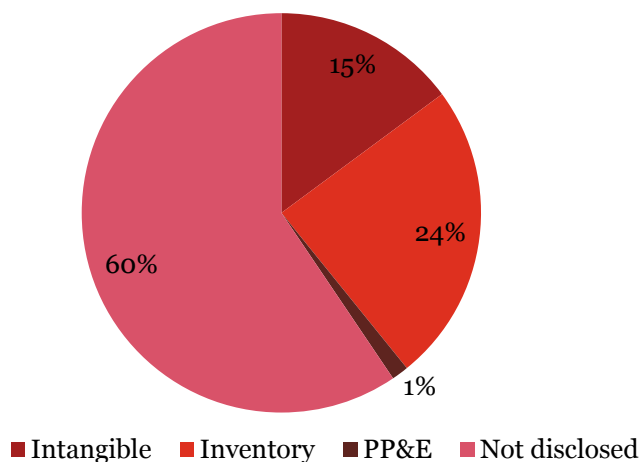
Reporting entities should review their accounting policies for RECs, as well as other environmental attributes to ensure appropriateness and consistency of application and disclosure. For further information on accounting and reporting considerations for RECs, please refer to PwC publication, *PwC Power and Utilities industry 2011 technical update*.

Figure 5 highlights the balance sheet classification of emission allowances for power and utilities entities, based on our PwC survey of 2010 Form 10-Ks for selected power and utilities entities.

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<sup>3</sup> On July 26, 2011, the International Accounting Standards Board issued a request for views (the Agenda Consultation), requesting input from stakeholders on the strategic direction and overall balance of its future work program, as well as the priority of individual projects over the next three years. The IASB has indicated that the input received will help direct and shape its thinking when allocating resources and determining which projects should take priority on its standard setting agenda.

**Figure 5: Emission allowances**



***Sample comments***

(1) "Refer to your disclosure on emission allowances where you state, "Purchases and sales of these allowances are reported as investing activities in the Consolidated Statements of Cash Flows and gains or losses resulting from sales are reported in other operations and maintenance expense in the Consolidated Statements of Income." Tell us your GAAP basis for reporting the purchases and sales of your emissions allowances as investing activities in the Consolidated Statements of Cash Flows. In this regard, explain to us why allowances which are purchased and held for consumption would not be recorded as an operating activity in the Consolidated Statements of Cash Flows."

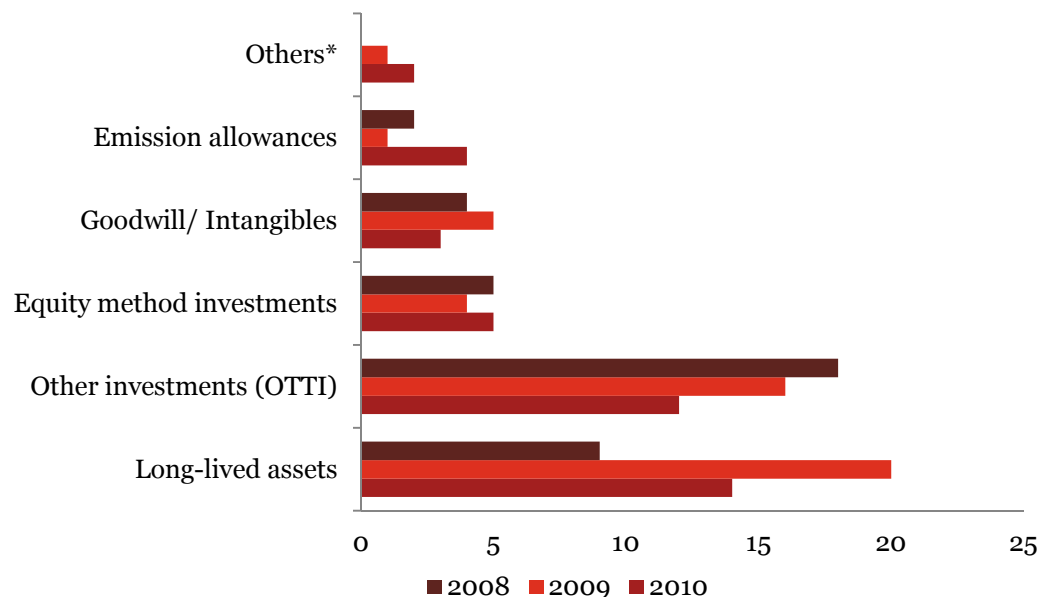
(2) "We understand that you are a net purchaser of RECs or do not create any RECs through generation. Please confirm or clarify our understanding. In addition, please tell us whether you maintain two separate cost pools for RECs and emission allowances or tell us otherwise how you are able to segregate the cost basis of credits that may have no basis from those that have a cost basis. In this regard, tell us whether you are a net purchaser or seller of emission allowances. If you sell RECs and/or emission allowances, please tell us your revenue recognition policy upon receipt or transfer of such credits or allowances. Please finally explain to us the basis in GAAP for classifying RECs and emission allowances as intangible assets as opposed to some other asset. If based on a FERC chart of accounts, please tell us the specific account which classification is made. We may have further comment."

# Impairments and goodwill

Reporting entities are required to perform an annual assessment of the carrying value of goodwill and indefinite-lived intangible assets in accordance with ASC 350. Further, interim impairment tests are required if events or circumstances indicate that it is more likely than not that the fair value of a reporting unit is below its carrying amount. For other types of assets including, but not limited to, amortizable intangible assets, other long-lived assets, investments, and emission allowances, reporting entities are required to assess such assets for impairment if events or circumstances indicate that the fair value of an asset is below its carrying value. Reporting entities are required to record and disclose any impairment that results from the assessment and clearly disclose the assumptions that led to the conclusion to recognize or not recognize an impairment charge.

Figure 6 highlights the types of impairment charges recorded in 2008-2010, based on our PwC survey of 2010 Form 10-Ks for selected power and utilities entities.

**Figure 6: Type of impairment charges**



\* Others include impairment charges related to a regulatory asset and a note receivable

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, *Testing Goodwill for Impairment*. This revised standard provides public entities with the option of performing a qualitative assessment to determine whether further impairment testing of goodwill is necessary. The revised standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. However, an entity can choose to early adopt the revised standard, provided that the entity has not yet issued its financial statements for the period that includes its annual test date.

*Impairments continue to be a hot topic, requiring reporting entities to remain alert for any impairment indicators. Early warnings of potential future issues are essential.*

Those entities that choose to early adopt the standard for the year ended December 31, 2011 should carefully consider the disclosure requirements based on their specific facts and circumstances to ensure their disclosures are robust and transparent. An informal review of third quarter filings indicates that approximately one fifth of power and utilities registrants has adopted or plans to adopt the new goodwill guidance by December 31, 2011.

In addition, the SEC staff has noted its expectation that registrants provide foreshadowing disclosures when there is a reasonable likelihood of a material impairment in future periods. As part of such disclosure, management should discuss:

- Amount of goodwill assigned to reporting unit
- Relationship between reporting unit fair value and carrying value
- Key assumptions that drive fair value
- Uncertainties in assumptions
- Any sensitivity analysis that would be relevant

### **Sample comments**

(1) "In light of the impairment losses on property, plant and equipment recognized in the most recent year and the nature of long-lived asset impairment testing, please tell us your consideration of disclosing the methods, assumptions and estimates underlying your long-lived asset impairment measurements and the uncertainties associated with the measurements in your discussion of critical accounting estimates."

(2) "We note your disclosures that the fair value calculated in the first step of the impairment test for [reporting unit] approximated the carrying value of the reporting unit and that the fair value of the [other] reporting unit exceeded the carrying amount by a significant amount. Please tell us your consideration of providing similar disclosures for your [remaining] reporting units. In this regard, tell us your consideration of disclosing (i) that the fair value of certain or all of the reporting units with material goodwill are substantially in excess of carrying value and are not at risk of failing step one of the impairment test and/or (ii) the following information for reporting units at risk of failing step one to the extent not already disclosed:

- The percentage by which fair value exceeded carrying value as of the date of the most recent test;
- A description of the methods and key assumptions used and how the key assumptions were determined;
- A discussion of the degree of uncertainty associated with the key assumptions. The discussion regarding uncertainty should provide specifics to the extent possible (e.g., the valuation model assumes recovery from a business downturn within a defined period of time); and
- A description of potential events and/or changes in circumstances that could reasonably be expected to negatively affect the key assumptions."

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# *Additional resources*

Reporting entities seeking additional information on key areas of focus of the SEC and important areas of disclosure for the power and utilities industry may also refer to the following sources of information:

- 2011 SEC comment letter survey: Form 10-K and Form 10-Q comments published by the SEC from January 1, 2011 to October 31, 2011 related to the power and utilities industry, detailed searchable file
- PwC Power and Utilities industry 2011 technical update
- PwC Power and Utilities industry 2011 financial reporting survey
- PwC Power and Utilities industry disclosure guide supplement

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# *About PwC Power and Utilities*

Drawing on the talents of more than 3,000 people worldwide assigned full time to the power and utilities sector, PricewaterhouseCoopers provides a full range of accounting and business advisory services to leading power and utilities 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 green energy sectors.

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