At a glance

The economic impact of COVID-19, combined with Federal, State and Local government responses, have created an unprecedented environment for the power and utilities industry. As a result, unique accounting and financial reporting considerations have emerged for companies within the sector. To help you shore up your company’s response, we’ve summarized some of the most common and significant issues that power and utility companies should consider as they finalize their financial reporting for 2019 and prepare their first quarter 2020 financial statements.

These considerations are not meant to be all-inclusive and may not be relevant for every company. We suggest that you read this paper in conjunction with additional materials available at [pwc.com/us/covid-19](http://pwc.com/us/covid-19), including:

- PwC’s In depth, No. US2020-02, FAQ on accounting for COVID-19 and market volatility
- In depth, No. US2020-03, CARES Act: Accounting for the stimulus

Those In depth publications contain further information on these topics that are likely to apply across industries.
Asset Impairments

Goodwill, other intangibles, long lived assets (e.g. property, plant & equipment), and financial assets including available-for-sale securities and equity method investments

COVID-19 may impact a power or utility company’s projected cash flows due to a decrease in demand for its product, supply chain disruptions, or other events. In such situations, a company needs to consider whether the disruption in its business indicates that a “triggering event” has occurred. If such an event has been identified, an impairment assessment is warranted for certain classes of assets, and the assumptions and cash flow forecasts used to test for impairment should be updated to reflect the potential impact of COVID-19. Given the current environment, we strongly recommend that companies document their thought process around impairment considerations even if no impairment trigger is identified in order to memorialize management’s views at the reporting date. If goodwill and long-lived assets of a reporting unit are held and used (as opposed to held for sale) and are tested for impairment at the same time, the impairment testing should be performed in the following order:

1. Assets and liabilities not covered by ASC 360 (including indefinite-lived intangible assets (other than goodwill in the scope of ASC 350))
2. Long-lived assets in the scope of ASC 360
3. Goodwill

The carrying values are adjusted, if necessary, for the result of each test prior to performing the next test. If an asset group is held for sale, goodwill should be tested before long-lived assets covered by ASC 360.

It is also important that companies focus on their controls around impairments and impairment assessments especially given that control operators may be working remotely which may change how controls must operate and be evidenced.

Companies should also be mindful of the need to file a Form 8-K (Item 2.06) within four business days after a decision is made to record a material charge for impairment to one or more of its assets, including impairments of securities or goodwill. However, no filing is required under Item 2.06 if the conclusion is made in connection with the preparation, review or audit of financial statements required to be included in the next periodic report, if the periodic report is filed on a timely basis and the conclusion is disclosed in the report. For example, a filing may not be required if an impairment was identified as part of the preparation of the Q1 2020 interim financial statements and was disclosed in a timely filed Form 10-Q.

Power & Utilities-specific observations

Amortized Intangibles and Other Long-Lived Assets

Amortized Intangibles and Other Long-Lived Assets, such as property, plant and equipment (PP&E), are only assessed when triggering events are identified that may indicate that the carrying amount of the asset group may not be recoverable. This is a two-step impairment test where undiscounted cash flows are first compared to the carrying value of the underlying asset.
In assessing the potential impairment of a rate-regulated asset, companies should consider whether the asset has been or is expected to be disallowed in rates or otherwise not probable of recovery through the regulatory process or if there have been any changes in regulatory factors (including the overall environment) that would suggest it is not recoverable.

Non-regulated entities will want to consider downturns in demand, contract and transactional cancellations, supply constraints, workforce constraints, and duration and severity of depressed prices on their ability to recover the carrying value of assets. For those assets whose output is fully contracted and may not be exposed to market price volatility, the risk of impairment may be less. However, the ability of the counterparty to fulfill its obligations under the contract should be evaluated given market conditions. In contrast, merchant facilities are more exposed to market price volatility and should carefully consider if an impairment trigger has occurred considering the expected length of depressed prices amongst other factors.

**Financial assets**

The impairment model for financial assets depends on the type of asset. The model for some assets was impacted by adoption of ASC 326, Financial Instruments—Credit Losses (ASC 360), which was effective for calendar year-end SEC filers (other than smaller reporting companies) on Jan. 1, 2020. See the Revenue and receivables section ahead for considerations regarding trade receivables. For other financial assets, the model for valuation and impairment varies by the type of asset. See the In Depth document referenced previously for details on these models.

**Goodwill and indefinite lived intangibles**

Goodwill and indefinite lived intangibles are tested for impairment annually or when a triggering event is identified. A triggering event occurs when an event occurs or circumstances change between annual tests that could more likely than not reduce the fair value of a reporting unit below its carrying value. Recent significant declines in market capitalization in relation to book value may be indicative of a triggering event.

Other market conditions may also indicate that a triggering event has occurred (e.g., decreased commodity prices, reduced demand, etc.). A decline in market capitalization below book value doesn’t always mean that an interim trigger has occurred. However, companies should consider both the severity and the duration of the decline as well as the reasons for the decline. Companies will also want to assess their specific facts and circumstances and the amount of “headroom” identified in the last annual impairment test. In addition, the goodwill impairment assessment is performed at the reporting unit level; therefore, companies will need to consider whether a decline in market value can be attributed to specific reporting units. For example, the rate regulated model generally provides for recovery of costs and a return on investment assuming the entity is able to access the regulatory process and it is functioning adequately. Further, capital spend projections are often a critical input to regulated utility goodwill tests given that such capital spend is a significant driver of revenue and earnings growth. Companies should evaluate any plans to suspend or reduce capital spend and its impact on the goodwill analysis.

**Revenue and receivables**

ASC 606, Revenue from Contracts with Customers, requires that in order to have a “contract” and, therefore, to be able to recognize revenue, a company must conclude that it is probable it will collect substantially all of the consideration to which it will be entitled under the arrangement. If a company continues to sell products and services to a customer when it is uncertain whether collectibility is probable—due to the potential deterioration of its customer’s financial position or that customer’s current inability to settle outstanding receivables—the question arises as to whether revenue can continue to be recognized on new transactions.
A significant change in facts and circumstances, such as a significant deterioration in a customer’s ability to pay, would be an indicator that a company should reassess whether it is probable that it will collect the remaining consideration under the contract for future goods and services. Relating to receivables, most calendar year-end SEC filers adopted the current expected credit losses standard, also known as CECL, as of Jan. 1, 2020. CECL requires companies to consider current conditions and reasonable and supportable forecasts in developing an estimate of expected credit losses. This estimate requires the use of judgment, especially in times of economic uncertainty. As a result of changing forecasts, companies should update their models and estimates to reflect the revised economic outlooks, perform sensitivity analyses based on the new forecasts, adjust probability weighting on alternative scenarios, consider qualitative adjustments, and / or provide additional disclosures.

**Power & Utilities-specific observations**

**Revenue**

Upon adoption of ASC 606, utilities generally concluded that the collectibility criterion was met. While certain classes of customers may have a lower likelihood of payment, some customers would pay and others would not, but no specific customer could be identified as not probable of collection and when viewed as a pool collectibility was assessed as probable. We understand that some utilities are evaluating if they continue to meet this collectibility criterion in situations where a customer would have been disconnected but have not been based on the current environment. In particular, certain companies have a concern that customers that would have been disconnected are now specifically identified and have a higher likelihood of non-payment. Utilities should evaluate their specific facts and circumstances when evaluating the ability to record revenue under ASC 606 if this fact pattern exists.

**Receivables**

Many states have mandated that utilities forego service terminations for non-payment for the time being. Further, utilities in other states have voluntarily agreed to forego terminating customers for non-payment.

On March 19, Edison Electric Institute announced that all EEI member companies are suspending electricity disconnects for non-payment nationwide. Several states and utilities have also discontinued charging late payment fees on delinquent balances during the crisis.

In addition, more customers may be experiencing economic difficulty as a result of the impact of COVID-19 which may impact their ability to pay their bills. A mitigating factor is that the recently passed CARES Act includes $900 million in supplemental Low Income Home Energy Assistance Program (LIHEAP) funding that will be used to help vulnerable customers pay for energy. Overall, it is likely that write-offs and bad debt expenses could increase. In particular, with the adoption of CECL in 2020 for calendar year-end and the forward-looking requirements for bad debt reserves, it is important for utilities to consider the future impact on collections when developing their bad debt reserves in the first quarter. General economic conditions may necessitate such a review even in those states which have not eliminated reduced service terminations and / or late payment charges.

Given the current uncertainty it may be hard to develop reasonable and supportable forecasts in developing an estimate of expected credit losses. However, companies may want to use data from comparable situations as a starting point. For example, some states have winter heating season disconnect moratoriums that increase delinquencies. Companies may also have information about bill nonpayment from the 2008 financial crisis or other localized natural disasters (e.g. hurricanes, etc.). While this information may serve as a starting point for developing an estimate, companies will also need to explicitly consider the current environment and economic forecast in developing their credit loss reserves as of March 31, 2020. Given the majority of the impacts from COVID-19 arose subsequent to Jan. 1, 2020 in the US, any impacts of the pandemic should be considered separately from the cumulative impact from CECL adoption if adopted on Jan. 1, 2020.

Non-regulated entities will want to consider their customer base and assess what specific impacts of the current environment they are facing when developing an estimate for bad debt reserves.

---

1 Helping customers during this time of need, Edison Electric Institute, March 19, 2020
Regulatory assets and liabilities and rate recovery

Regulated utilities generally follow the guidance of ASC 980, Regulated Operations (ASC 980) which allows for the deferral of costs when future recovery through rates is probable. In the current environment there may be certain considerations for regulated utilities given their regulatory model.

Recovery of COVID-19 related costs and lost revenue

Like most companies, it is reasonable to expect that utilities may incur increased costs and experience a reduction in revenue during this period. Increased costs may come in the form of higher bad debt costs, as previously discussed as well as increased costs associated with remote working conditions and other workforce costs to ensure system reliability and safety, supply chain cost increases, and other expense drivers. Utility companies may request recovery of such costs from their regulators either in a special filing or as part of the next general rate case.

In evaluating whether an incurred cost is eligible for deferral as a regulatory asset, a regulated utility should determine whether the cost is probable of being recovered through future revenue from rates that the regulator allows to be charged to customers. Determining whether rate recovery of an incurred cost is probable is a matter of judgment and management should evaluate the preponderance and quality of all evidence available. Different forms of evidence will provide varying degrees of support for management’s assertion that a regulatory asset is probable of recovery; not all forms of evidence will be sufficient in isolation or in combination to make such an assertion. A specific rate order specifying the nature of the cost and the timing and manner of recovery generally provides the best evidence that recovery is probable. However, the nature of the regulatory process does not always allow a utility to obtain a rate order prior to issuing its financial statements.

Forms of evidence that may support the recognition of a regulatory asset include:

- The regulated utility receives a rate order specifying that the costs will be recovered in the future
- The incurred cost has been treated by the regulated utility’s regulator as an allowable cost of service item in prior regulatory filings
- The incurred cost has been treated as an allowable cost by the same regulator in connection with another entity’s filing
- It is the regulator’s general policy to allow recovery of the incurred cost
- The regulated utility has had discussions with the regulator (as well as its primary intervenor groups) with respect to recovery of the specific incurred cost and has received assurances that the incurred cost will be treated as an allowable cost (and not challenged) for regulatory purposes
- A majority of other regulators have treated the specific incurred cost (or similar incurred cost) as an allowable cost and the regulated utility’s regulator has not specifically disallowed it
- The regulated utility has obtained an opinion from outside legal counsel outlining the basis for the incurred cost being probable of being allowed in future rates
Prior to concluding that recognition of a regulatory asset is appropriate, a regulated utility should also consider other relevant factors, such as:

- The regulatory principles and precedents established by law
- The political and regulatory environment of the jurisdiction (e.g., does further regulation occur in the courts)
- The magnitude of the incurred costs to be deferred and the related impact on ratepayers if such costs are allowed (taking into account the length of the recovery period)
- Whether ratepayers or others may intervene in an attempt to deny recovery

Some regulated utilities have costs that may benefit customers in several jurisdictions. Because recovery is based on a regulator’s action, the regulated utility should separately consider the probability of recovery in each regulatory jurisdiction. If it cannot support regulatory recovery across all jurisdictions due to different rate structures or differing fact patterns, the regulated utility should establish a regulatory asset only for those amounts attributable to jurisdictions that meet the criteria for deferral.

We are also aware that several commissions have issued, or utilities have requested, an accounting order related to the deferral of COVID-19 costs. If a regulated utility obtains an accounting order, it should assess whether a cause and effect relationship is achieved. An accounting order along with supporting evidence, such as historical precedence or an opinion from rate counsel, may provide adequate support for establishment of a regulatory asset if it supports that recovery of the specific cost in the future is probable. Reporting entities should exercise caution when placing reliance on accounting orders. An accounting order to amortize a regulatory asset or other cost with no impact on revenues does not provide the cause and effect relationship between costs and revenues required to create a regulatory asset. Similarly, an accounting order that indicates the costs may be deferred for consideration in a future rate case, with no assurance of recovery, does not provide sufficient evidence that future recovery is probable.

In the current environment, it may be difficult to support that COVID-19 related costs are probable of recovery without specific action from the regulator given the unprecedented nature of the current events. Even if an accounting order has been obtained, companies should critically assess the specific jurisdiction’s history in relation to accounting orders and the overall regulatory climate. Such decisions should be well documented for financial reporting purposes.

A good model to consider is how utilities often recover incremental costs associated with significant storms. However, we would note that the types of costs to be captured and the type of support necessary to support that such costs are incremental are likely to be very different. We also note that demonstrating that such costs which utilities are seeking recovery of are, in fact, incremental, will require robust record keeping, processes and controls to support the recovery approval process. We recommend that this process begin with an up front assessment of which costs are expected to increase as a direct result of the current situation. This can be accomplished through critically evaluating what new costs are expected to be incurred and reviewing existing cost categories for potential increases as a result of the current environment. This process is likely already being done as companies assess updated earnings guidance they plan to provide to analysts. Once this process is complete, it should be updated regularly as conditions evolve and more information becomes available. For each identified cost type, management may want to develop a record keeping process to track incremental costs and document the method used to support that such costs are incremental. We would expect that this process may vary for each cost type. Regardless, we believe it is important that this is done contemporaneously with the incurrence of the cost as attempting to determine and support that costs are incremental retrospectively will likely be difficult.
Unless a regulated entity has a decoupling mechanism in place, it may be impacted by lost revenues. While it is expected that residential load may increase, this may be more than offset by decreases in industrial and commercial load as businesses are shut down as part of “shelter-in-place” orders or other guidance to social distance as well as the impact of the depressed economic environment. For utilities that do not currently have a decoupling mechanism, it is unlikely that regulatory theory would allow for the approval of a retrospective decoupling mechanism; however, in this period of unprecedented events, such requests may be considered by commissions. To that point, a few states, including Connecticut, Wisconsin, and Wyoming, have indicated that they may be open to such recovery. As a reminder, it would be inappropriate to record a regulatory asset for lost revenues unless all of the criteria for an alternative revenue program under ASC 980-606-25 are met. The lack of an approved regulatory mechanism would result in this guidance not being met.

For entities which do have a decoupling mechanism, formula rates, and/or a bad debt tracker, some of the biggest impacts of COVID-19 may be mitigated as these mechanisms could allow for timely recovery of increased bad debt costs, other costs, and/or lost revenues. We do note that there are various types of decoupling mechanisms in place. Some mechanisms only decouple for weather or only for energy efficiency. In these cases, utilities will have to carefully evaluate if the impacts of COVID-19 are recoverable through their specific decoupling mechanism. In contrast, a full decoupling mechanism (i.e. one that captures the full difference between the revenue requirement and amounts billed) should be effective in mitigating the impacts of lost sales. In addition, some gas utilities in Georgia, North Dakota, and Ohio have straight-fixed-variable rate designs, which are designed to cover the utility’s fixed costs regardless of volumes delivered, which make such entities less impacted by reduced deliveries.

Regulatory impact on post-retirement benefits

Utilities generally have significant pension and other post-retirement benefit plans and therefore significant levels of plan assets. Pension and other post-retirement benefit expenses are typically a recoverable cost as part of the ratemaking process. We expect that the significant losses in plan assets and lower discount rates could have a sizable impact on pension funding requirements for 2021 and associated pension and other post-retirement benefit expense. In addition to the liquidity challenges that many utilities may experience from these increased pension contributions, they may also want to consider if their regulatory framework adequately compensates investors for these potential significant contributions and begin building the framework for adequate recovery on these investments if they do not already exist (i.e. inclusion of prepaid pension asset balances in rate base). Similar consideration may want to be made for recovery of increased pension and other post-retirement benefit costs in 2021.

Nuclear Decommissioning Trust Funds

Nuclear Decommissioning Trust Funds (NDTF) may have also experienced significant declines in market value. Regulated entities typically receive rate recovery for the costs associated with nuclear decommissioning. However, if a nuclear plant has been retired and there are insufficient funds for the decommissioning of the plant in the NDTF, regulators may be reluctant to charge current customers for a plant that is no longer used and useful. As a result, utilities will have to assess if recorded regulatory assets continue to meet the probability threshold for recognition.
In the current environment, many companies are tapping commercial paper or other short-term forms of financing as a defensive position to protect against liquidity uncertainty. Further, some utilities are slowing down capital spend or limiting activities to only essential projects which could result in lower Construction Work in Progress (CWIP) balances. These two factors could have an impact on the how regulated entities calculate and record Allowance for Funds Used During Construction (AFUDC).

Regulated entities following the guidance of ASC 980 may record AFUDC if future recovery is probable. Federal Energy Regulatory Commission (FERC) Order 561 prescribes the formal calculation and methodology required for jurisdictional entities. Many state regulators also follow this guidance. FERC’s methodology states that short term debt is the first source of financing for construction. As a result, if entities have higher short-term debt and/or lower CWIP balances, the AFUDC debt rate could be considerably lower and AFUDC equity may not be recorded, or would be recorded at a lower rate, as a higher proportion of CWIP would be deemed to be funded by debt.

Regulated entities should consider the need to update the calculation of AFUDC rates based on the updated balance of short-term debt and as actual data becomes available. Additionally, as the defensive draw of short-term debt may not have been deployed for capital needs, companies may consider discussing with state regulators the potential for regulatory relief / alternatives to continue to recover the true cost of capital incurred for CWIP.

We also encourage utilities to monitor legislative and regulatory activity for potential impacts on the business. We are aware of certain utilities requesting to defer rate case proceedings given the current environment and some utilities and regulators deferring implementation of rates. Depending on the exact form that certain regulatory proposals and orders take that may defer recovery of certain investments, utilities may want to consider if the phase-in plan guidance of ASC 980-340-25 would apply to recently completed plant.
Derivatives and hedging

**Power & Utility specific observations**

Power and Utility companies often enter into derivative instruments to hedge commodity risk or designate certain commodity contracts under the normal purchases and normal sales exception. Supply or demand may be interrupted which would result in lower volumes than initially forecasted. Companies may need to assess whether disruptions in normal production and delivery could have impacts on hedging relationships or derivatives designated under the normal purchases and normal sales exception. Please refer to the *In Depth* document referenced earlier for specific considerations around these topics.

**Asset retirement obligations**

Companies may need to reconsider if plants will be retired earlier than expected due to current market conditions which could result in a change in the timing of costs associated with asset retirement obligations. Companies should consider the guidance in the *PPE Guide 3.4.4.2* for further discussion of the accounting for adjustments to asset retirement obligations.
CARES Act

The “Phase Three” COVID-19 economic stabilization package, H.R. 748, the “Coronavirus Aid, Relief and Economic Security Act” (the CARES Act) was signed into law on March 27, 2020. The CARES Act features significant tax provisions that may impact Power & Utilities companies. Some of the key tax relief measures for businesses include:

- A five-year net operating loss (NOL) carryback
- A change in Section 163(j) interest deduction limitations
- Accelerated AMT refunds
- Other tax relief measures

Tax accounting considerations under ASC 740 require that the tax effects of changes in tax laws or rates be recorded discretely as a component of the income tax provision related to continuing operations in the period of enactment. For US federal tax purposes, the enactment date is the date the President signs the bill into law – in this case, March 2020. Among other considerations, the CARES Act allows for federal NOLs generated in certain post-Tax Cuts and Jobs Act (TCJA) years to be carried back for five years and temporarily removes the federal 80% of taxable income limitation for post-TCJA NOLs, allowing an NOL to fully offset taxable income. Further, temporary increases to the Section 163(j) interest expense limitation will be available for 2019 and 2020. Companies should consider the impacts of these changes on the realizability of deferred tax assets, particularly where carrybacks of NOLs were previously not allowed under federal tax law and therefore carryback was not available as a source of taxable income. Further, when carrying back an NOL to a prior year, companies should consider the impact of utilization at a higher rate (generally 35%, or blended rate for fiscal year taxpayers) than the rate used to record the deferred tax asset currently. The tax rate applied to NOLs generated in the current year should reflect the applicable tax rate for the year in which the NOL is expected to be utilized.

Disclosures and reporting

Companies should consider the relevant GAAP and SEC disclosure requirements when evaluating whether the impact of the recent events may require disclosure within the financial statements or in other areas of SEC filings. This evaluation may include the direct effects on their own operations as well as potential second order effects, which could include changes in demand for energy, the effects on supply chains, service providers, and business partners.

Public companies should consider whether there have been any material changes in the risk factors disclosed in the most recent annual report that should be disclosed in their upcoming quarterly reports.

going concern analysis

ASC 205-40, Presentation of Financial Statements, provides the guidance for assessing if the entity is a going concern and the related presentation and disclosure. Companies may need to consider any debt covenants, reduction in borrowing capacity, and the potential for any collateral calls in determining the ability to continue as a going concern. As a reminder, this analysis should consider conditions and events that may indicate that it is not probable that the entity will be able to meet its obligations as they come due within one year after the date that the financial statements are issued or are available to be issued. As a result, entities filing stand-alone reports in April will need to consider the impacts of the recent events on this assessment. A similar analysis should be performed in connection with the first quarter or any financial statement re-issuances, for example in connection with a public offering. As of the writing of this publication, we have noted that many large investor owned utilities have been able to access the capital markets. We have observed many large utilities recently access the capital markets to ensure adequate liquidity. However, this activity should be closely watched.
The risk factors could address items such as the Company’s pandemic and business continuity plan, access to supply chain, uncertainties in delay and cost of construction projects, volatility of commodity prices, decreased profitability, and tightening of the capital market. Furthermore, Management’s Discussion and Analysis may need to be updated to address the recent trends, including any uncertainties that have had or may have a material effect on the company’s liquidity, capital resources or results of operations.

Please reference In Brief No. US2020-02, SEC extends filing relief; SEC staff issues disclosure guidance for additional considerations.

Other

Companies may need to update their business continuity plans due to the effects of COVID-19. This may include increasing lines of credit and preparing for a remote workforce for an extended period of time.

The renewable energy sector may also need to consider supply chain disruptions from the current pandemic. In particular, these disruptions could endanger successful completion of certain projects in time to qualify for federal tax credits. Developers should assess if this situation affects them and make decisions about the likelihood of abandoning certain projects and the potential impairment considerations. Further disclosures about supply chain concentration risk and or the risk of not meeting tax credit deadlines should be assessed.

You are not alone.

These are uncharted waters, with business impacts changing rapidly. We’re here to help you respond to what’s facing your business.

Gavin Hamilton
Power & Utilities
Sector Assurance Leader
gavin.s.hamilton@pwc.com

Sean Riley
Power & Utilities
Assurance Partner
sean.p.riley@pwc.com

Mark Panza
Power & Utilities
Managing Director
mark.r.panza@pwc.com

More resources for you:
pwc.com/us/covid-19
pwc.com/cfodirect
pwc.com/us/utilities

On the go? Take our podcast series with you:
pwc.com/cfodirect/podcasts

© 2020 PwC. All rights reserved. PwC refers to the US member firm or one of its subsidiaries or affiliates, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details. This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.