Power and Utilities: Quarterly insights

Second quarter 2022
Introduction

In this edition of Power and Utilities: Quarterly Insights, we discuss relevant industry and accounting updates that will impact power, utility, and sustainable energy companies in 2022 and beyond.

This quarter, we highlight emerging trends in renewable natural gas (RNG), provide an overview of the key benefits of this technology, and discuss some of the related accounting and reporting considerations.

In our Accounting, reporting and SEC update section, we discuss the SEC proposals on climate disclosures and cybersecurity and provide insight into what’s coming next, with a focus on what actions companies should take now to prepare for the new rules. Our standard setting update includes the latest on FASB projects related to environmental credit programs, digital assets, and sustainability linked-financing.

Finally, in our CARS corner, we discuss the economic forces impacting utility’s capital expenditure plans.
Industry updates
Clean energy transition trends—Renewable Natural Gas (RNG)

This section features trends and new technologies impacting the clean energy transition, including discussion of related accounting and reporting considerations. This quarter, we spotlight renewable natural gas (RNG).

What is RNG? RNG is a term used to describe biogas, a naturally occurring gas produced from the breakdown of organic matter, that has been converted for use in place of traditional fossil natural gas. RNG comes from a variety of sources, including municipal solid waste landfills (69%), livestock farms (19%), food production facilities (7%), and wastewater (5%). RNG is used as an alternative to traditional fossil fuels in various applications, such as vehicle fuel, fuel for electricity generation, and industrial thermal applications (e.g., fuel for heating and cooling/refrigeration equipment).

There has been a significant increase in investments in RNG projects by private equity, as well as by traditional regulated gas utilities, as entities look for a cleaner alternative to traditional natural gas. According to the Environmental Protection Agency (EPA), landfill and agriculture RNG operational projects in the United States increased from 13 projects in 2005 to 174 projects in 2021. According to the RNG Coalition, there are another 112 RNG projects currently under construction in the United States and Canada and 125 additional projects planned.

Beyond the general shift towards cleaner technologies and the increased demand for the RNG commodity itself, the EPA’s renewable fuel standards program (RFS) at the federal and state levels, has also driven the growth in RNG projects. Developers and equity investors are incentivized to support new renewable projects as associated environmental attributes often provide overall greater value than traditional natural gas. The two most common environment attributes are the Renewable Identification Number (RINs) and Low Carbon Fuel Standards (LCFS) credits. RINs are credits used for compliance, and are the “currency” of the RFS program at the federal level. In California, LCFS encourages the use and production of cleaner low-carbon transportation fuels, thereby decreasing petroleum dependence in the transportation sector and reducing greenhouse gas emissions. Oregon, Washington, and British Columbia have also adopted LCFS programs. Once a facility can demonstrate that RNG is used as transportation fuel and meets appropriate requirements at the federal and/or state level, the associated credits can be sold.

Overall benefits of an RNG can include the following:

- RNG provides a cleaner form of traditional natural gas. RNG is primarily composed of methane, but lacks the other elements and hydrocarbons of fossil natural gas.
- It can be easily bottled or directly injected into existing natural gas pipelines for transportation to end users, thereby creating fuel source diversity and supply, potentially easing price volatility in the natural gas markets.
- It reduces greenhouse gas emissions as RNG projects capture and recover methane produced at source sites such as livestock farms and landfills, mitigating the volume of those emissions released into the atmosphere and reducing global warming.
- Construction of RNG processing and fueling station infrastructure and the sale of natural gas-powered vehicles may benefit the local economy.

What are the accounting and financial reporting considerations?

Currently, there is not an explicit model for accounting for RINs/LCFS, but current practice is to classify environmental credits as inventory or intangible assets, similar to the accounting for renewable energy credits (see PwC’s Power and utilities guide, chapter 7). Absent authoritative guidance, we believe either classification is acceptable, provided the classification is applied consistently, and is properly disclosed. The FASB has recently added a new project to address the accounting for and disclosure of environmental credits. Refer to our FASB update section below for further discussion.

Consistent with traditional commodity transactions, companies should evaluate RNG arrangements using the commodity contract framework detailed in Chapter 1 of PwC’s Power and utilities guide. This framework is broadly applicable to contracts that involve commodities and requires the evaluation of the underlying contract to determine whether it is subject to leasing, derivative, revenue (or expense), and/or consolidation guidance in accordance with US GAAP. Below is a summary of common areas for companies to consider related to RNG commercial transactions. They should be considered in light of a company’s specific facts and circumstances and terms of the specific agreement.
Industry updates

Lease accounting
A contract should first be evaluated to determine if it is or contains a lease, which would include determining if a contract explicitly or implicitly identifies the RNG facility and if the contract provides the right to control the RNG facility through the lease term.

Revenue recognition
The project owner should account for any non-lease and non-derivative components using the revenue recognition criteria in ASC 606. RNG arrangements may often be bundled contracts that include multiple products, including the generated gas, the related environmental attributes, and other marketing services for natural gas producers. Project owners will need to evaluate the unit of account and determine whether the contract should be viewed as separate products (e.g., brown gas and environmental credits) vs. a single, bundled RNG product.

The offtaker would account for any non-lease and non-derivative components following an executory contract model.

VIE consolidation
Companies will also need to consider whether RNG agreements involve a variable interest entity (VIE) and if consolidation accounting is required under either the VIE or voting interest model. There are different considerations in assessing the design of a VIE depending on whether a contract contains a lease, is a derivative, or is accounted for as an executory contract.

Capitalization of costs
In addition to contractual accounting considerations related to RNG offtake arrangements, the construction of RNG facilities may require modifications to existing gas pipelines or other existing assets. Companies should consider which elements are capitalizable, or if certain costs should be expensed in the period incurred.

Derivative accounting
If the RNG arrangement is not a lease, it should be evaluated to determine if it is a derivative in its entirety or contains an embedded derivative. ASC 815-10-15-83 describes three criteria that all must be met for a commodity contract to qualify as a derivative instrument: (1) there is an underlying, and one or more notional amounts and/or payment provisions; (2) there is little or no initial net investment; and, net settlement is permitted or required.

One consideration in determining whether this type of contract contains a derivative under US GAAP is whether it has a specified notional amount. A contract has a notional if it specifies a fixed amount of RNG or guarantees that it will provide a minimum amount of RNG. While RNG offtake agreements can often include fixed or minimum quantities, in the event that a stated quantity is not explicitly stated in the contract, certain default or settlement provisions may nonetheless provide a notional. If the contract has a notional amount, it should also be evaluated to consider if the contract permits net settlement and/or if there is an active market for the natural gas or related RINs and LCFS. Sellers and offtakers should monitor these markets as they continue to evolve.
Accounting, reporting and SEC updates
## SEC updates

### SEC climate proposal

The SEC’s proposed climate change rules have attracted significant interest from preparers, investors, academics, auditors, and mainstream media. The proposed rules include numerous provisions which would require registrants to provide more expansive disclosures both within and outside the audited financial statements. A summary of the main provisions of the proposed rules can be found here: [The SEC wants me to disclose what? The SEC’s climate disclosure proposal](#).

The SEC extended the comment period on the proposed rules from May 20 until June 17. Submitted comment letters can be found [here](#).

While the Commission will need to consider public input on the proposal and adopt a final rule before any new disclosures would be required, companies should begin to understand and operationalize the proposed disclosure requirements. Below is a summary of some of the key provisions within the proposal and suggested actions companies may want to take now to start preparing.

<table>
<thead>
<tr>
<th>Area</th>
<th>Requirement</th>
<th>Action</th>
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<tbody>
<tr>
<td>Disclosures included within the audited financial statement</td>
<td>Financial impact metrics&lt;br&gt;Quantitative disclosure of the impacts of severe weather events and other natural conditions as well as transition activities on individual financial statement line items, if the impact is greater than a bright-line 1% threshold (determined as the sum of the absolute value of positive and negative impacts).</td>
<td>The 1% “bright-line” threshold is one of the provisions that has garnered the most interest within the proposal. Many companies are likely not capturing information at this level and will need to enhance current processes and controls to accurately collect the data that would be required.</td>
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<td></td>
<td>Expenditure metrics&lt;br&gt;Quantitative disclosure of amounts capitalized and expensed related to severe weather events and other natural conditions as well as transition activities, following the same 1% threshold as the financial impact metrics. Expenditures and costs related to meeting any disclosed GHG emissions reduction targets or other climate-related commitments.</td>
<td>It may be challenging for companies to determine the financial impacts and expenditure amounts of certain business decisions or transactions that may be partially, but not solely, related to climate change or emissions reduction goals.</td>
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<td></td>
<td>Impact on estimates and assumptions&lt;br&gt;How estimates and assumptions are impacted by climate-related events and transition activities.</td>
<td>Companies will need to assess their policies, practices, and controls for identifying and reporting on these expenditures in accordance with the proposed rule. Companies will also need to monitor these amounts, disclosures, methods, and assumptions within the proposed new disclosures.</td>
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<tr>
<td>Other information</td>
<td>Contextual information about how each specified metric was derived, including a description of significant inputs and assumptions. Description of the impact of physical risks and transition risks, which include risks reasonably likely to have a material impact in the short, medium, and long term,</td>
<td>Inventory climate-related data and develop processes to define key climate metrics and methodologies.</td>
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### SEC climate proposal (cont.)

<table>
<thead>
<tr>
<th>Area</th>
<th>Requirement</th>
<th>Action</th>
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<tbody>
<tr>
<td>Non-financial statement disclosures</td>
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<tr>
<td>Other information</td>
<td>Potential impacts of risks on the company’s strategy, business model, and outlook and on the financial statement metrics.</td>
<td>Assess the risks of climate change affecting the business, and develop appropriate disclosure controls and procedures.</td>
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<tr>
<td>Governance and oversight of climate-related risks</td>
<td>Board of Directors oversight of climate-related risks. Whether any member of the board of directors has expertise in climate-related risks, and if so, the nature of the expertise. Management’s processes for identifying, assessing, and managing climate-related risks.</td>
<td>Develop training to ensure the board understands the extent of the proposed governance disclosures and encourage directors to assess whether any changes are warranted in the board’s processes related to oversight of climate-related risks.</td>
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Additionally, the proposed rules would require all issuers to disclose scope 1 and scope 2 emissions. Large accelerated and accelerated filers would also need to obtain third-party attestation over scope 1 and scope 2 emissions under a phased approach. Companies (except smaller reporting companies) would also be required to disclose scope 3 emissions if those emissions are material, or if the company has set a GHG emissions reduction target that includes its scope 3 emissions.

<table>
<thead>
<tr>
<th>Type</th>
<th>Description</th>
<th>Attestation requirement</th>
<th>Examples of emissions common to the utilities and sustainable energy industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scope 1</td>
<td>Direct greenhouse (GHG) emissions that occur from sources that are controlled or owned by an organization (e.g., emissions associated with fuel combustion in boilers, furnaces, vehicles).</td>
<td>Required attestation from independent third party (large accelerated and accelerated filers only)</td>
<td>All: Vehicle fleet fuel use, emissions from energy used for own use Electric: Leaks of other chemicals from equipment Gas: Leaks from pipelines and equipment</td>
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<tr>
<td>Scope 2</td>
<td>Scope 2 emissions are indirect GHG emissions associated with the purchase of electricity, steam, heat, or cooling that is consumed by operations owned or controlled by a company.</td>
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<td>Purchased power for the company’s facilities and equipment</td>
</tr>
<tr>
<td>Scope 3</td>
<td>Scope 3 emissions are all other indirect GHG emissions that occur in the upstream and downstream activities of an organization’s value chain.</td>
<td>Not required</td>
<td>• Electricity and gas used by customers • Purchased goods and services • Commuting and business travel by employees • Emissions from unconsolidated investments and financed entities • Emissions from assets leased to others</td>
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SEC cybersecurity proposal

On March 9, the SEC proposed new rules for public companies that would require Form 8-K disclosures when material cyber events occur. The proposed amendments would also require disclosure of policies and procedures for managing cyber risk, along with information on board oversight of cybersecurity risks and whether any directors have expertise on cybersecurity.

SEC’s proposed disclosure requirements for public companies

<table>
<thead>
<tr>
<th>Topic</th>
<th>Proposed disclosures</th>
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<tbody>
<tr>
<td>Cyber incident reporting</td>
<td>Information about “material” cybersecurity incident within four business days of determining the incident is material in a Form 8-K.</td>
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<td>Material updates on previously disclosed cybersecurity incidents in Form 10-Ks and Form 10-Qs.</td>
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<td>Information on cybersecurity incidents that were previously undisclosed as individually immaterial that have become material in the aggregate in Form 10-Ks and Form 10-Qs.</td>
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<tr>
<td>Cyber risk management and strategy</td>
<td>Policies and procedures for the identification and management of risks from cybersecurity threats, including whether cybersecurity is part of the business strategy, financial planning, and capital allocation</td>
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<tr>
<td>Cyber governance</td>
<td>The board’s oversight of cybersecurity risk and the name and expertise of the board member with expertise in cybersecurity, if any.</td>
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<td></td>
<td>Management’s role and expertise in assessing and managing cybersecurity risk and implementing cybersecurity policies, procedures, and strategies.</td>
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For more details on the proposal, see PwC’s In brief, SEC proposes new cybersecurity disclosure requirements.
SEC cybersecurity proposal (cont.)

The comment period on these proposed new rules closed on May 9, with more than 130 submitted comments. PwC’s response reflected general support for enhanced disclosure related to cybersecurity risk and the Commission’s efforts to standardize cybersecurity disclosures for all public companies, but includes a number of recommendations, including:

- A modification to the proposed rule to take into consideration a potential governmental, governmental agency, or law enforcement instruction to delay disclosure;
- Alignment of the definition of “cybersecurity incident” with those commonly used in the industry;
- Modifications to remove the requirement to disclose whether the incident has been remediated and to include, as part of the disclosure of the nature and scope of the incident, whether any cash, securities, inventory, or other tangible or intangible assets were lost as a result of the incident; and
- Additional guidance regarding how to aggregate previously undisclosed related incidents, including the time period over which incidents should be aggregated.

Industry view?

The American Gas Association (AGA) and the Interstate Natural Gas Association of America (INGAA) provided a joint comment letter in response to the SEC proposed rules. The Edison Electric Institute (EEI) also provided feedback. In addition to reflecting support for several key elements of the cybersecurity reporting approach contemplated by the Commission’s proposal, the EEI and AGA/INGAA letters reflected viewpoints that are generally consistent with those raised in PwC’s comment letter.

What should I be doing now to prepare?

Management needs to work on assessing whether changes are needed in how cyber incidents are identified and communicated to the financial reporting team. It should also ensure the board is assessing whether changes would be needed in the information they receive or to prepare for new governance responsibilities and disclosures.

Questions management, the Chief Information Security Officer, and board will want to address:

- Have we performed a gap assessment of how current risk management practices and disclosures align with the proposed SEC rules, and do we have a plan to address those gaps?
- How is cybersecurity plugged into the disclosure committee—the team handling disclosure, controls and procedures (DC&P)—and other teams tasked with reporting information externally?
- Which aspects of the rules are relatively easy to address and which ones may require more time or information to assemble?
- How prepared is our company to disclose different types of information—and have we considered what the anticipated market reactions are to our disclosure?
- What will require significant changes in our cyber risk management practices and will we make continuous assessments of the effectiveness of those changes?

What’s next?

The SEC will consider the feedback received and adopt a final rule, likely before the end of the year. In the interim, companies should consider whether their processes, controls, governance structure, or disclosures would need to be enhanced to comply with the proposal if it were finalized as currently drafted.
Accounting, reporting and SEC updates

Accounting and reporting updates

Standard setting items on the horizon—FASB project updates

<table>
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<tr>
<th>FASB project</th>
<th>Summary</th>
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<tr>
<td>Accounting for Government grants</td>
<td>In November 2021, the FASB issued Accounting Standards Update No. 2021-10, Government Assistance (Topic 832): Disclosures by Business Entities about Government Assistance, to increase transparency in financial reporting. The guidance was effective for annual periods beginning after December 15, 2021.</td>
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<td>In response to feedback received from the recent agenda consultation issued by the FASB, on June 13, 2022, the FASB issued an invitation to comment (ITC) on whether certain of the requirements in IAS 20, Accounting for Government Grants and Disclosure of Government Assistance, should be incorporated into US GAAP. Stakeholder feedback is due no later than September 12, 2022.</td>
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<td>Accounting for environmental credit programs</td>
<td>At the May 25 FASB meeting, the FASB discussed the research performed to date surrounding regulatory credits. Based on this discussion, the board voted to add a project to its technical agenda.</td>
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<td>The new project will address the recognition, measurement, presentation, and disclosure requirements for participants, including nongovernmental creators of environmental credits, in both compliance (involuntary) and voluntary programs that result in the creation of environmental credits, including:</td>
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<td>• Those created under compliance programs, such as cap-and-trade and baseline allowance programs;</td>
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<td></td>
<td>• Renewable energy credits/certificates (RECs);</td>
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<td>• Renewable identification numbers; and</td>
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<td>• Carbon offset credits.</td>
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<td>The preliminary scope of the project will focus on environmental credits that are legally enforceable and can be traded. The new project will not address the accounting for tax credits, tax incentives, or investments in renewable energy structures or entities (such as partnerships). Refer to Chapter 6: Emission allowances and Chapter 7: Renewable energy credits of PwC’s Utilities and power companies guide for guidance to consider prior to the issuance of new guidance from the FASB.</td>
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<tr>
<td>Accounting for and disclosure of digital assets</td>
<td>As certain power, utility, and sustainable energy companies consider investments in crypto mining or look to serve crypto mining load, the FASB project on accounting for digital assets continues to be top of mind. At the May 11 FASB meeting, the board voted unanimously to add a project to its technical agenda to develop recognition, measurement, presentation, and disclosure guidance for certain digital assets. FASB members acknowledged that there would be challenges with regard to scoping of the topic, as well as with weighing the application of ASC 820, Fair Value Measurement, in light of the volatility of the crypto marketplace.</td>
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“The prevalence of the issue is broad throughout the economy—not necessarily public companies—but I think given its breadth in the economy I think it’s important to address,”
—FASB member Fred Cannon

Refer to PwC’s Crypto assets guide for a discussion of the relevant accounting and reporting considerations related to crypto assets prior to the issuance of new guidance from the FASB.
At the May 11 FASB meeting, the FASB staff provided an update on the results of the continuing research into the topic of accounting for sustainability linked financial instruments, or financial instruments with ESG-linked features.

Feedback received from the Board’s agenda consultation included frequent challenges in applying the embedded derivative guidance and derivative scope exceptions when evaluating ESG-related provisions within financial instruments, such as bonds in which the interest payments vary on the basis of sustainability-linked metrics.

Respondents highlighted both that ESG-linked financial features would generally be expected to meet all of the bifurcation criteria, and further that these may not qualify for either of the derivative scope exceptions for non-exchange traded contracts. Respondents also questioned whether the fair value of such features provides decision-useful information to investors and other stakeholders.

Respondents suggested potential paths forward, all of which remain on the Board’s agenda for continued investigation. These included:

- Development of a new, or modification to the existing, derivative scope exception for non-exchange-traded derivatives;
- Specification that ESG features embedded in financial instruments should not be bifurcated; and
- Expansion of the implementation examples to address how to apply the embedded derivative bifurcation guidance to ESG-linked financial instruments.

**What next?**

The Board directed the staff to continue its research on this topic, which will be considered at a future decision-making meeting where the Board will decide whether to add a project to its technical agenda. In the absence of any new guidance, issuers should ensure to continue to apply the guidance in ASC 815-15 to all ESG-linked financial instruments.
CARS corner
Economic forces impacting capex plans in the power, utility, and sustainable energy sector

As we wrap up the second quarter, many companies are continuing to work through the operational impacts of supply chain constraints and inflation. These issues have impacted some utilities’ abilities to obtain certain materials, parts, and supplies such as gas regulators and electric transformers. An uncertain supply chain often has downstream impacts to planned capital expenditures (capex). In addition to supply chain constraints, inflationary vendor pricing can further impact capex plans. The combination of these two issues has driven cost increases in labor and the parts and materials needed to complete planned projects. This has required many companies to be agile with their capital plans, either reorganizing planned work by delaying current projects or pulling future projects forward, in response to availability and pricing of materials and labor.

With capital plans in flux, companies should keep cost capitalization guidance top of mind. Although ASC 360-10-05-3 defines PP&E, it does not include any specific guidance for the capitalization of costs incurred during the development of self-constructed assets for a reporting entity’s own use (i.e., capital projects). However, many of the concepts included in the 2001 proposed Statement of Position from the Financial Reporting Executive Committee of the AICPA (FinREC), Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment reflect current practice regarding the accounting treatment for the capitalization of costs for capital projects. In 2003, the FinREC redeliberated and submitted a proposed Statement of Position to the FASB for approval (herein referred to as the unissued PPE SOP). Although it was not approved for issuance by the FASB and is nonauthoritative, the unissued PPE SOP contains guidance related to the capitalization of costs of an asset constructed or obtained for a reporting entity’s own use that is helpful when considering the accounting treatment for such costs. For further detail regarding considerations related to capitalization of costs, refer to Chapter 1 in PwC’s Property, plant, equipment and other assets guide and Chapter 12 in PwC’s Utilities and power companies guide.

In case you missed it…Keeping up with the latest CARS publications

Our CARS practice has issued several publications highlighting key business issues related to the Federal Energy Regulatory Commission (FERC), including (1) current trends in FERC enforcement areas and (2) an updated overview of FERC versus GAAP financial reporting considerations.

Additionally, as utility companies continue to navigate the clean energy transition, within our Moving to a clean economy—Considerations for regulated utilities, we share our perspectives including an overview of the current environment and the nature of the costs utilities are facing related to the transition to clean energy.

Recent publications:

- Financial reporting to the Federal Energy Regulatory Commission: FERC versus GAAP reporting considerations—February 2022 Update
- FERC Enforcement Report brief: Proactive steps to avoid FERC noncompliance

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Thank you