Depreciation Expenses, A New Focus of Regulatory Scrutiny

Since the 1960's and 1970's, we have seen utilities undertake large build-outs of assets, e.g., generation plants, transmission infrastructure, etc. Moving forward to today, those same assets are reaching the age where replacement is required, and regulated utilities are experiencing the need to invest significant levels of additional capital to finance the asset replacement. As these new investments enter a utility's rate base, the "return on" invested capital, and the "return of" capital, through depreciation, will cause significant increases in the overall revenue requirement. Therefore, even if the depreciation rates do not increase, the amount of depreciation expense included in revenue requirement is significantly more than prior to the capital expenditure related to the replacement.

Concentric has witnessed that, in many cases, the accumulated depreciation reserve accounts are significantly under-funded in periods following the large capital replacement programs. This is a result of the large capital programs undertaking the retirement of assets which are younger than the average service life estimate resulting in a shortfall of historic accumulated depreciation expense. The historic recovery of the cost of removal provisions (also known as "negative salvage") have proven to be significantly understated and unable to fund the cost of removal programs. As such, accumulated depreciation rates following large capital expenditure programs are faced with only depreciating the new investment but also funding the deficient position of the accumulated depreciation accounts. As such, the depreciation expense component of the revenue requirement is now becoming much more significant and is facing much more regulatory scrutiny than ever before. Depreciation studies can usually be completed through extracts of data files that are already existing in the accounting systems of most regulated utilities. Our depreciation study process specifically includes a meeting with the accounting group to fully understand the accounting data that are available. We are familiar with most of the accounting systems used by regulated utilities and can develop extract templates from most systems resulting in a minimal disruption to the day-to-day operations. Concentric approaches a depreciation study with accepted and recognized procedures designed to minimize the client burden of the study. On projects where Concentric is providing ratemaking support to other practice areas, we will also investigate if the data provided to the other practices can be leveraged for the depreciation study.

Concentric's depreciation practice has provided expert testimony in over 100 proceedings. This testimony has related to the development of depreciation policy, depreciation parameters, regulated group accounting issues, account componentization, capital-related items related to accounting standards (Canadian GAAP, USGAAP, and IFRS), and asset valuation for both regulatory and property tax purposes. Our team is comprised of professional accountants, professional engineers, certified depreciation professionals, and experienced regulatory staff who are uniquely qualified to advise clients in the implementation of sound plant accounting and depreciation practices. Only through the implementation of sound policies and practices, combined with the wealth of experience in developing appropriate depreciation parameters, will the utility have a reasonable assurance of the timely recovery of invested capital as well as having made provision for the future costs of removal that will be required at the time of asset retirement.

Contact us for advice on whether a depreciation study would be beneficial for your utility.

By: Larry Kennedy, Vice President