



Public Service Commission

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-M-E-M-O-R-A-N-D-U-M-

RECORDS AND REPORTING

SEP 10 AM 2:05

STATE OF FLORIDA PSC

DATE: SEPTEMBER 10, 1998

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)

FROM: DIVISION OF AUDITING AND FINANCIAL ANALYSIS (SLEMKEWICZ, LEE) *DL*
 DIVISION OF ELECTRIC AND GAS (MILLS) *CM*
 DIVISION OF LEGAL SERVICES (C. KEATING) *WCK RUE*

RE: DOCKET NO. 980723-GU - PETITION FOR APPROVAL OF ACCOUNTING METHODOLOGY FOR YEAR 2000 COSTS BY CITY GAS COMPANY OF FLORIDA.

AGENDA: 09/22/98 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CLBB
DM
RLT

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\AFA\WP\980723.RCM

CASE BACKGROUND

On June 9, 1998, City Gas Company of Florida (City Gas) filed a petition for approval to defer expenses incurred in the remediation of in-house data processing systems to Year 2000 compatibility and to amortize those expenses over a five year period. NUI Corporation (NUI), of which City Gas is an operating division, has undertaken a program of remediation, replacement and testing to address Year 2000 computer issues. The estimated cost to be incurred by NUI through September 30, 1998, is \$909,888 with \$200,175 being allocated to City Gas. The regulated portion of the \$200,175 that City Gas seeks deferral and amortization of is \$161,960.

DOCUMENT NUMBER DATE

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DISCUSSION OF ISSUES

ISSUE 1: Should the Commission approve City Gas' petition to defer expenses incurred in the remediation of in-house data processing systems to Year 2000 compatibility and amortize those expenses over a five year period?

RECOMMENDATION: No. The Commission should deny City Gas' petition to defer and amortize expenses incurred in remediation of in-house data processing systems for Year 2000 compatibility. (SLEMKEWICZ)

STAFF ANALYSIS: As stated in the petition, NUI has incurred various capital expenditures and operating expenses in addressing Year 2000 compatibility issues. In some instances, programs and applications have been replaced and the costs capitalized. Computer hardware has also been assessed and any non-compliant hardware will be replaced and capitalized. The issue before the Commission is the accounting treatment of the expenses for the remediation of in-house developed systems that will not be replaced.

There is no question that City Gas must address the Year 2000 problem and Staff is not taking issue with City Gas' efforts to remediate any potential Year 2000 issues. However, Staff does not support City Gas' request to defer and amortize certain operating expenses that would normally be expensed as incurred. Expensing these costs as incurred is consistent with generally accepted accounting principles (GAAP) guidelines in EITF 96-14 concerning the expensing of costs associated with modifying internal software for the year 2000.

The Emerging Issues Task Force (EITF) was established by the Financial Accounting Standards Board (FASB) to assist the FASB in the early identification of emerging issues affecting financial reporting through the timely identification, discussion and resolution of financial issues within the framework of existing authoritative literature. The Task Force reached a consensus that external and internal costs specifically associated with modifying internal-use software for the year 2000 should be charged to expense as incurred. As a result, *EITF 96-14: Accounting for the Costs Associated with Modifying Computer Software for the Year 2000* was issued.

More recently, the American Institute of Certified Public Accountants (AICPA) released *Statement of Position 98-1* -

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Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. In this statement, the AICPA provided guidance on accounting for the costs of internal-use computer software. The AICPA specifically noted that its statement of position (SO_r) did not change the conclusions reached in EITF 96-14 concerning the immediate expensing of costs for modifying existing internal-use software for the Year 2000. As a result of these two pronouncements, City Gas will be required to immediately expense the estimated \$38,215 of remediation costs that will be allocated to its unregulated operations.

For its regulated operations, City Gas has asserted that these expenses are extraordinary and qualify for deferral and amortization. Staff would categorize these remediation expenses as out-of-the-ordinary, but not so extraordinary or having such a large financial impact that they could potentially distort City Gas' financial statements. The \$161,960 expense cited in the petition is less than 40 basis points on return on equity (ROE). Per City Gas' surveillance report for June 1998, its earned ROE is 6.71%, which is less than its authorized ROE midpoint of 11.30%. In addition, the deferral of these costs would create a regulatory asset that would remain on City Gas' books for five years.

As of June 30, 1998, City Gas has actually booked \$173,079 in expenses related to the remediation of its internal-use computer software for the Year 2000. The portion of that amount allocated to regulated operations is \$140,037. This represents approximately 33 basis points on ROE. If this amount was deferred without any amortization during the current fiscal year ending September 30, 1998, City Gas' reported ROE would increase from 6.71% to approximately 7.04% for the twelve month period ended June 30, 1998.

In evaluating City Gas' request to deviate from normal accounting practices, Staff considered factors such as the current level of the utility's earnings, the potential effect on return on equity and the nature of the costs involved. Given the current level of City Gas' earnings, the deferral of 40 basis points of costs does not seem reasonable and would not serve to improve the utility's financial viability. By expensing these costs currently, City Gas' future earnings will be higher than they would otherwise be if these costs were deferred and amortized. Based on the circumstances in this docket, Staff does not believe that it would be appropriate to consider deferral unless the effect on return on equity was, at a minimum, 100 basis points.

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It is Staff's opinion that City Gas has failed to sufficiently demonstrate the need to defer and amortize the expenses associated with the remediation of its in-house systems. Therefore, Staff recommends that City Gas' petition be denied and that City Gas expense these costs as incurred consistent with GAAP, EITF 96-14 and SOP 98-1. It should also be noted that these costs have not been reviewed for prudence or reasonableness and are, therefore, subject to review in future proceedings in which such costs are included.

Should the Commission approve City Gas' petition to defer and amortize these Year 2000 remediation expenses, Staff has three areas that it believes need to be addressed. First, Staff would recommend that the approval be limited to the actual costs incurred as of September 30, 1998. City Gas should be directed to file a petition if it desires to defer and amortize any additional Year 2000 costs incurred after September 30, 1998. Second, the annual amortization should begin in City Gas' current fiscal year which began October 1, 1997, and ends September 30, 1998. It is unclear in the petition when the amortization would begin. Third, it is Staff's opinion that the requested five year amortization period is not appropriate. Staff suggests that a three year amortization period would more closely match the purpose for these particular expenditures, i.e., remediation costs for the Year 2000. The costs would be fully amortized by September 30, 2000, if a three year amortization period, beginning October 1, 1997, was utilized.

ISSUE 2: Should this docket be closed?

RECOMMENDATION: This docket should be closed if no person, whose substantial interests are affected by the proposed action, files a protest within the 21 day protest period. (C. KEATING)

STAFF ANALYSIS: At the conclusion of the protest period, if no protest is file, this docket should be closed.