

Accounting Changes Since PPL Electric Utilities Corporation's Last Base Rate Case

2007

- In March 2007, PPL Electric Utilities Corporation (PPL Electric) filed a proposed distribution rate increase of \$84 million (subsequently amended to \$77). In December 2007, the Pennsylvania Public Utility Commission (PUC) entered its order granting PPL Electric a distribution rate increase of \$55 million.

In January 2005, severe ice storms hit PPL Electric's service territory. The total cost of restoring service, excluding capitalized cost and regular payroll expenses, was \$16 million. In August 2005, the PUC issued an order granting PPL Electric's petition for authority to defer and amortize for regulatory accounting and reporting purposes a portion of these storm costs subject to certain conditions. As a result of the PUC Order and in accordance with Statement of Financial Accounting Standards (SFAS) 71, PPL Electric deferred \$12 million of its previously expensed storm costs. The ratemaking treatment of these costs was decided in the above mentioned rate case. The PUC Order approved PPL Electric's proposed ten year amortization of storm damage expenses.

- PPL Electric deferred storm restoration costs associated with the September 2003 Hurricane Isabel in accordance with the PUC declaratory order of January 2004. Based on the December 2004 order mentioned above, the remaining costs were being recovered through customer distribution rates and were being amortized over ten years beginning on January 1, 2005.

In August 2006, the Commonwealth Court of Pennsylvania overturned the PUC's decision of December 2004 that previously allowed PPL Electric to recover, over a 10-year period, restoration costs incurred in connection with Hurricane Isabel, which occurred in September 2003. As a result of the PUC's 2004 decision and in accordance with SFAS 71, PPL Electric had established a regulatory asset for the restoration costs. Effective January 1, 2005, PPL Electric began billing these costs to customers and amortizing the regulatory asset. The Commonwealth Court denied recovery of these costs because they were incurred when PPL Electric was subject to capped rates for transmission and distribution services, which extended through December 31, 2004. As a result of the Court's decision, PPL Electric recorded a charge to income, reversed the remaining unamortized regulatory asset and recorded a regulatory liability for restoration costs previously billed to customers from January 1, 2005 through December 1, 2006. In August 2007, PPL Electric began refunding these costs on customers' bills, which will continue through December 2009.

2008

- In August 2008, PPL Electric asked the Federal Energy Regulatory Commission (FERC) for a change in the way transmission rates are calculated to support continued investment in its transmission system by switching to formula-based rates. Under formula-based rates, a fixed earnings level is set for the utility, and the utility annually adjusts its transmission rates, subject to FERC review. The rate design ensures that there is no over-recovery or under-recovery of the actual costs of providing transmission delivery service.

In October 2008, the FERC accepted the proposed rate for filing, effective November 1, 2008, subject to refund. In August 2009, the FERC approved the formula-based rate recovery mechanism. The annual update of the rate is now implemented automatically without requiring specific approval by the FERC before going into effect. PPL Electric accrues or defers revenues applicable to any estimated true-up of this formula-based rate.

2009

- Effective January 1, 2009, PPL Electric prospectively adopted accounting guidance that changes the accounting and reporting for business combinations occurring after its adoption. In addition, this guidance requires entities to recognize changes in unrecognized tax benefits acquired in a business combination, including business combinations that occurred prior to January 1, 2009, in income tax expense rather than in goodwill. The January 1, 2009 adoption did not have a significant impact on PPL Electric; however, the impact in future periods could be material.
- Effective January 1, 2009, PPL Electric adopted accounting guidance that was issued to improve the relevancy, comparability, and transparency of the financial information an entity provides when it has a noncontrolling interest in a subsidiary and when it changes its ownership interest in a subsidiary. This guidance:
 - requires ownership interests in subsidiaries held by parties other than the parent to be presented in the consolidated statement of financial position within equity, but separate from the parent's equity;
 - requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest to be presented on the face of the consolidated statement of income;
 - addresses the accounting for changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary and for the deconsolidation of a subsidiary; and
 - requires enhanced disclosures relating to noncontrolling interests.

PPL Electric adopted this guidance prospectively except for the presentation and disclosure requirements, which required retrospective application. The January 1, 2009 adoption did not have a significant impact on PPL Electric; however, the impact in future periods could be material.

- Effective January 1, 2009, PPL Electric prospectively adopted accounting guidance that applies to all derivative instruments, including bifurcated derivative instruments and nonderivative instruments that are designated and qualify as hedging instruments, as well as related hedged items. This guidance requires an entity to expand disclosures to provide greater transparency about:
 - how and why it uses derivative instruments;
 - how derivative instruments and related hedged items are accounted for; and
 - how derivative instruments and related hedged items affect its financial position, results of operations and cash flows.

The guidance was issued to provide greater transparency by enhancing existing disclosures; therefore, the adoption did not have a material impact on PPL Electric's financial statements.

- Between 2007 and 2009, PPL Electric adopted accounting guidance that requires the use of, as appropriate, a market approach (generally, data from market transactions), an income approach (generally, present value techniques and option-pricing models), and/or a cost approach (generally, replacement cost) to measure the fair value of an asset or liability. These valuation approaches incorporate inputs such as observable, independent market data and/or unobservable data that management believes are predicated on the assumptions market participants would use to price an asset or liability. These inputs may incorporate, as applicable, certain risks such as nonperformance risk, which includes credit risk.

Since adopting this guidance, PPL Electric prioritizes fair value measurements for disclosure by grouping them into one of three levels in the fair value hierarchy. The highest priority is given to measurements using Level 1 inputs. The appropriate level assigned to a fair value measurement is based on the lowest level input that is significant to the fair value measurement in its entirety. The three levels of the fair value hierarchy are as follows:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities that are accessible at the measurement date. Active markets are those in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 - inputs other than quoted prices included within Level 1 that are either directly or indirectly observable for substantially the full term of the asset or liability.
- Level 3 - unobservable inputs that management believes are predicated on the assumptions market participants would use to measure the asset or liability at fair value.

The initial adoption of this guidance did not have a material impact on PPL Electric's financial statements, as this guidance only impacts fair value disclosures.

- Effective January 1, 2009, PPL Electric prospectively adopted accounting guidance that applies to liabilities issued with an inseparable third-party credit enhancement when the liability is measured or disclosed at fair value on a recurring basis. This guidance indicates that an issuer shall disclose the existence of a third-party credit enhancement, and the fair value measurement of the liability shall not include the effect of this third-party credit enhancement.

The initial adoption did not have a material impact on PPL Electric's financial statements, as this guidance only impacts the fair value disclosure of certain credit-enhanced debt instruments.

- Effective April 1, 2009, PPL Electric retrospectively adopted accounting guidance that modified the requirement that an entity have the intent and ability to hold an impaired debt security to recovery in order to conclude an impairment was temporary. Under this guidance, an impairment of a debt security is other than temporary if (1) an entity has the intent to sell the security, (2) it is more likely than not that an entity will be required to sell the security before recovery, or (3) an entity does not expect to recover the entire amortized cost basis of the security, referred to as a credit loss.

In addition, this guidance changes the recording of an other-than-temporary impairment on a debt security if the reason for the other-than-temporary impairment is the recognition of a credit loss. In this situation, the other-than-temporary impairment will be separated into the credit loss component, which is recognized in earnings, and the remainder of the other-than-temporary impairment, which is recorded in OCI.

For a debt security held at the beginning of the period of adoption for which an other-than-temporary impairment was previously recognized, if an entity does not intend to sell the debt security and it is not more likely than not that the entity will be required to sell the debt security before recovery of its amortized cost basis, the cumulative effect of applying this guidance was recognized as an adjustment to the opening balance of retained earnings with a corresponding adjustment to AOCI.

The April 1, 2009 adoption did not have a significant impact on PPL Electric; however, the impact in future periods could be material.

- Beginning with the period ended September 30, 2009, PPL Electric adopted accounting guidance that establishes the FASB Accounting Standards CodificationTM (ASC) as the primary source of authoritative GAAP, other than guidance issued by the SEC. This guidance eliminates the previous GAAP hierarchy of accounting and reporting guidance and replaces it with two levels of literature: authoritative and non-authoritative, and organizes GAAP pronouncements in a consistent manner by accounting topic. The adoption did not impact PPL Electric's results of operations, cash flows or financial positions since the ASC did not change existing GAAP.

2010 and beyond

- Effective January 1, 2010, PPL Electric will adopt accounting guidance that was issued to revise the accounting for transfers of financial assets. This guidance:
 - eliminates the concept of a qualifying special-purpose entity (QSPE); therefore, QSPEs will be subject to consolidation guidance;
 - changes the requirements for the derecognition of financial assets;
 - establishes new criteria for reporting the transfer of a portion of a financial asset as a sale;
 - requires transferors to initially recognize, at fair value, assets obtained and liabilities incurred as a result of a transfer accounted for as a sale; and
 - requires enhanced disclosures to improve the transparency around transfers of financial assets and a transferor's continuing involvement.

Early adoption is prohibited. This guidance will be applied prospectively to new transfers of financial assets. Disclosures will be required for all transfers, including those entered into before the effective date. Comparative disclosures are encouraged, but not required, for periods in which these disclosures were not previously required. The January 1, 2010 adoption is not expected to have a significant impact on PPL Electric; however, the impact in future periods could be material.

- Effective January 1, 2010, PPL Electric will adopt accounting guidance that was issued to replace the quantitative-based risks and rewards calculation for determining which entity, if any, has a controlling financial interest in a variable interest entity (VIE) and is the primary beneficiary. The primary beneficiary must consolidate the VIE. This guidance:
 - prescribes a qualitative approach focused on identifying which entity has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and the obligation to absorb losses of or the right to receive benefits from the VIE that could potentially be significant to the VIE;
 - requires ongoing assessments of whether an entity is the primary beneficiary of a VIE;
 - requires enhanced disclosures to improve the transparency of an entity's involvement in a VIE;
 - requires that all previous consolidation conclusions be reconsidered; and
 - requires that QSPEs be evaluated for consolidation (resulting from the elimination of the QSPE concept in the guidance addressing accounting for transfers of financial assets).

If the initial application results in consolidation of a VIE, the assets, liabilities and noncontrolling interests of the VIE will be measured at their carrying amounts as if this guidance had been applied from the point in time the entity became the primary beneficiary of the VIE (unless the fair value option is elected). Any difference between the net amounts required to be recognized and the amount of any previously recognized interest will be reflected as a cumulative-effect adjustment to retained earnings. If initial application results in deconsolidation of a VIE, any retained interest in the VIE will be measured at its carrying value as if this guidance had been applied from the inception of the VIE.

Early adoption is prohibited. Comparative disclosures are not required for periods in which these disclosures were not previously required. PPL Electric is assessing the potential impact of adoption to the financial statements. The January 1, 2010 adoption is not expected to have a significant impact on PPL Electric; however, the impact in future periods could be material.

- Effective January 1, 2010, PPL Electric will prospectively adopt accounting guidance that was issued to improve disclosures about fair value measurements. This guidance:
 - requires disclosures be provided for each class of assets and liabilities, with class determined on the basis of the nature and risks of the securities;
 - for recurring fair value measurements, requires disclosure of significant transfers between Levels 1 and 2 and transfers into and out of Level 3 and the reasons for those transfers; and
 - clarifies that a description of valuation techniques and inputs used to measure fair value is required for Level 2 and Level 3 recurring and nonrecurring fair value measurements.

Effective January 1, 2011, PPL Electric will adopt provisions of this guidance that require Level 3 activity of purchases, sales, issuances and settlements to be provided on a gross basis.

Early adoption is permitted. Comparative disclosures are required only for periods ending after initial adoption. PPL Electric is assessing the potential impact of adoption. The potential impact of adoption is not yet determinable but could be material.