FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

July 28, 2011

U.S. Securities and Exchange Commission
Office of the Chief Accountant
100 F Street, N.E.
Washington, DC 20549

Reference: Comments on Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers - Exploring a Possible Method of Incorporation

Thank you for the opportunity to comment on the May 26, 2011 paper prepared by the U.S. Securities and Exchange Commission (SEC), that explores a possible method for incorporating International Financial Reporting Standards (IFRS) into the U.S. financial reporting system (SEC Staff Paper).

The Federal Energy Regulatory Commission (FERC or Commission) is an independent Federal government agency responsible for regulating the interstate transmission of electricity, natural gas, and oil. The Commission also regulates the wholesale of sale of electricity and gas in interstate commerce. Rate-regulated entities subject to the Commission's jurisdiction include public utilities, natural gas pipeline companies, and oil pipeline carriers. , Among its other responsibilities, the Commission establishes rates, terms, and conditions of providing utility service, the Uniform System of Accounts for the industries it regulates, and financial reporting requirements. Most of the rate-regulated entities subject to the Commission's jurisdiction maintain accounting records and file financial statements with the Commission prepared under U.S. Generally Accepted Accounting Principles (GAAP) with certain departures necessary for cost-of-service regulation. Consequently, the SEC's Work Plan considering the adoption of IFRS into the U.S. financial reporting system is extremely important to the Commission and its jurisdictional entities.

Any transition to IFRS should be done carefully and provide ample opportunity for regulators and rate-regulated entities to continue to identify and assess the impact of the adoption of IFRS on its operations. With that in mind, FERC supports the Condorsement approach as outlined in the SEC Staff Paper. Specifically, this approach would provide regulators and rate-regulated entities time to understand and reconcile differences between GAAP and IFRS, and prevent unintended effects on rates. Also, the Condorsement approach provides regulators, rate-regulated entities, the SEC, the FASB, and others with the much-needed platform to continue to press for an international standard that recognizes the economic effects of energy industry regulations.

The method used for convergence to IFRS will involve significant implementation costs. Such costs will generally be included in customers' energy bills, which can be a harsh reality in times when many Americans face financial hardship when paying bills to meet their basic needs. Any method eventually used to adopt IFRS should be one of the least-cost alternatives, given the fact that these costs will be passed on to customers.

Rate-Regulated Entities and SFAS 71

A key to understanding the energy regulatory environment is the concept of the regulatory compact. Under the regulatory compact, rate-regulated entities incur costs to provide reliable energy service to all present and future customers in an exclusive territory in exchange for the rights to be compensated for all prudently incurred costs plus a reasonable return on invested capital. To establish cost-of-service rates, the Commission relies on accounting information to derive an appropriate revenue requirement for rate-regulated entities. The Commission generally allows most routine costs of providing service to be recovered in rates in the period the costs were incurred. The Commission will generally require large, non-routine costs of providing utility service to customers to be recovered in future periods to prevent large increases in customer bills. Thus, the economic impact of the Commission's ability to establish utility rates can create assets and liabilities for rate-regulated entities.

In 1982, the FASB recognized the importance of the relationship of accounting and ratemaking when it issued Statement of Financial Accounting Standards No. 71, Accounting for the Effect of Certain Types of Regulation (SFAS 71). This Statement allows rate-regulated entities to prepare financial statements to reflect the economic effects of ratemaking by recognizing regulatory assets and liabilities.[1] Not without reason, the FASB acknowledged that "regulation creates different circumstances that require different accounting."[2] The Commission also issued accounting Order No. 552 to establish specific accounts and criteria to record regulatory assets and liabilities. The Commission believes that an international standard similar to SFAS 71 is needed to allow rate-regulated entities to appropriately recognize the effects of regulation.

As of December 31, 2010, rate-regulated entities have net regulated assets (regulated assets minus regulated liabilities) of $73 billion, representing roughly 20 percent of shareholders' equity. The majority of the regulatory assets reflected on the balance sheet of rate-regulated entities are supported by a decision(s) by the Commission

[1] SFAS 71 is applicable to regulated entities whose rates are designed to recover costs of providing regulated services or products.

[2] SFAS 71, P 59.

or a state utility commission that specifically provides the recovery of a previously incurred cost in a future period. For example, some rate-regulated entities have deferred certain costs to enhance the reliability of their transmission systems as a regulatory asset. The basis for deferring the costs of enhancing reliability is supported by the Commission's Policy Statement on Bulk Power System Reliability (Policy Statement), issued in April 2004. The Commission issued this Statement as a result of reliability and vegetation management issues that caused the electric power blackout in August 2003, affecting large portions of the Northeast and Midwest United States and Ontario, Canada. The Statement addressed several issues that relate to the Commission's role regarding reliability of the nation's interstate bulk-power systems. It also assured public utilities that the Commission would approve applications to recover prudently incurred costs necessary to ensure reliability, including prudent expenditures for vegetation management. In subsequent accounting filings and rate proceedings at the Commission, public utilities have consistently been granted authority to defer the costs to enhance reliability and recover them in future periods.

Rate-regulated entities defer recognition of costs as a regulatory asset if it is probable that a regulator will allow an increase in future rates to recover a specific cost. These costs generally had been already incurred by rate-regulated entities but not yet recovered by them. The Commission, through its enforcement program, also conducts audits of regulatory assets and liabilities to ensure that rate-regulated entities have a legitimate basis for recording amounts as regulatory assets and liabilities. As a result of the regulatory compact, specific orders and precedents regulators have issued, and audits conducted under the Commission's enforcement program, there is sufficient basis for rate-regulated entities to expect recovery from customers of regulatory assets.

Since the inception of SFAS 71 in 1982, the U.S. has recognized that accounting for rate-regulated entities should reflect the economic effects of regulation where a principal consideration is the cause-and-effect relationship of costs and revenue. However, under IFRS, there is no financial statement recognition of cost deferrals permitted as regulatory assets or liabilities. Removal of the regulatory asset amounts would significantly impact the majority of rate-regulated entities and could require recognition of billions of dollars of expense in the year of IFRS adoption, along with a significant reduction in stockholders' equity. The absence of a standard similar to SFAS 71 under IFRS could lead to large swings primarily in expense, which can lead to significant increases in customers' electric and gas utility bills.

It is crucial that the SEC and the FASB staff further evaluate the regulatory construct for rate-regulated entities as well as their market position. Therefore, the SEC and the FASB staff should carefully examine and propose accounting mechanisms, similar to the mechanisms in the SFAS 71 that now allow regulatory accounting and GAAP to converge. In their analysis, the SEC and the FASB staff should understand the information used to set future utility rates by a regulator is the more useful information investors have used in making decisions.

Use of Public Financial Statements

Publicly issued financial statements are vital in setting rates. The Commission's accounting regulations and GAAP are largely based on the same accounting concepts and economic principles. Historically, financial reports prepared for the Commission and the SEC have been substantially similar. When new accounting standards have been issued under GAAP, the Commission has generally adopted these standards for accounting and ratemaking purposes, in whole or in part, depending on their impact on the Commission's ability to carry out its regulatory responsibilities. This happened when the Commission adopted, in whole or in part, Statement of Financial Accounting Standards Nos. 109; Accounting for Income Taxes, 115; Accounting for Certain Investments in Debt and Equity Securities, 130; Reporting Comprehensive Income, 133; Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 138; Accounting for Certain Derivative Instruments and Certain Hedging Activities, 143; Accounting for Asset Retirement Obligations, 150; Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity, and many others.

Transition to IFRS

Any transition to IFRS should identify ways to minimize the potential impact to rate-regulated entities and their customers. One of these ways is through the recognition of the impact of rate regulation in general purpose financial statements. As already illustrated, rate regulation creates a direct impact upon the economic resources, obligations, and financial performance of rate-regulated entities. Therefore, FERC recommends that as the FASB addresses the remaining differences between GAAP and IFRS, the FASB and SEC carefully study and evaluate the specifics of rate regulation, and the economic benefits and obligations created by regulatory-imposed actions. We also urge that the FASB and SEC find the need to have U.S. guidance for rate-regulated entities where the International Accounting Standards Board (IASB) refuses to issue industry-specific accounting guidance and the resulting IFRS accounting standards call for an accounting and reporting that misrepresents the true financial position of rate-regulated entities. For example, if IFRS does not permit the recognition of regulatory assets and liabilities, it will negatively impact regulatory transparency and create a discrepancy between the regulatory framework and utilities' financial statements. Divergent reporting is undesirable because it would confuse users of financial information concerning the accuracy and reliability of amounts reported on financial statements. As such, including critical provisions for recognizing of the underlying regulatory construct of rate-regulated entities will allow them to continue to reflect the economics of regulation, and thus achieve transparency by balancing the results presented to the Commission, with the results presented to stockholders and investors.

Conclusion

The adoption of IFRS without the recognition of regulatory impact in financial statements would be radically different between what is reported to the Commission, the SEC, and investors. Failure to include the economic effects of regulation in financial statements would mischaracterize the financial position of rate-regulated entities and deprive users of financial statements of decision-useful information. Without an international accounting standard similar to SFAS 71, utility earnings under IFRS will be unpredictable; customer confidence could be substantially reduced; and the ability to invest in infrastructure projects may be severely impaired. Likewise, if regulators are denied the ability to create deferred cost-recovery programs, they will lose a major tool for achieving equity between ratepayers and utilities. Also, the disallowance of the recording of the effects of regulation will significantly reduce regulatory credibility because investors and lenders by and large devote funds to utilities with the expectation that the regulatory compact would be relevant to their investments. Therefore, FERC urges the SEC and the FASB to continue to have an active role in international accounting standards setting, and vigorously participate in developing new IFRS to address the needs for industry-specific standards.

Thank you for considering our comments on this important matter to the Commission and the rate-regulated entities it regulates. We look forward to continued discussion of these issues.

Sincerely,

Bryan K. Craig

Bryan K. Craig
Chief Accountant and Director
Division of Audits
Office of Enforcement