

FEDERAL ENERGY REGULATORY COMMISSION  
Office of Enforcement  
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Ms. Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549

Reference: File Number S7-27-08- IFRS Roadmap

This letter is in response to the SEC's request for comments on the Securities and Exchange Commission's (SEC) *Roadmap for the Potential Use of Financial Statements Prepared in Accordance With International Financial Reporting Standards (IFRS) by U.S. Issuers*. The Federal Energy Regulatory Commission (FERC) is an independent agency charged with regulating, among other responsibilities, transmission of electric energy, natural gas, and oil in interstate commerce, wholesale sales of electric energy and natural gas, and the reliability of the electric transmission system. Such responsibilities include rate regulation, accounting and financial reporting.

Most of the entities under FERC's jurisdiction file financial information with FERC prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP) with certain departures to recognize the economic effects of regulation. Therefore, the SEC's proposal regarding the adoption of International Financial Reporting Standards (IFRS) will have a significant impact on energy companies regulated by this agency. The following comments represent the views of the FERC staff on the SEC's proposed rule.

Under current international accounting standards, cost-based rate regulated entities would not be able to reflect the economic effects of regulation on their publicly issued financial statements as currently permitted under U.S. GAAP pursuant to Statement of Financial Accounting Standards (SFAS) No. 71, Accounting for the Effects of Certain Types of Regulation, and its predecessor, the Addendum to Accounting Principles Board (APB) Opinion No. 2. As discussed below, should the SEC adopt IFRS, I urge the SEC to encourage the International Accounting Standards Board (IASB) to adopt an accounting standard similar to SFAS No. 71 that would permit cost-based rate regulated entities to reflect the rate actions of regulators in their financial statements.

## **Need for Specialized Accounting for Cost-Based Rate Regulated Entities**

Under cost of service ratemaking, a regulator establishes the rates that a rate-regulated entity may charge its customers. The resulting rate is based on costs incurred plus a reasonable return. A rate regulator may require that costs incurred in one period be deferred and recovered from customers over a future period in order to smooth the resultant rate over time. Similarly, a rate regulator may require revenues or gains realized in the current period to be returned or refunded to customers over a future period. Cost of service ratemaking relies on accurate cost and revenue data that reflects a company's true economic position in order to establish just and reasonable rates. Adoption of sound and uniform accounting standards are particularly important for cost-based, rate regulated entities, because of the degree of reliance which must be placed on financial statement information for purposes of accurate cost-based pricing. Without reliable financial statements that depict the economic substance of the rate regulator's actions on the regulated entity, federal and state regulators, customers, and stakeholders would not be able to accurately determine the costs that relate to a particular time period, service, or line of business; determine whether a given utility has previously been given the opportunity to recover certain costs through rates; or compare how the cost of one utility relates to that of another.

Intertwined with the accounting and reporting responsibilities and authorities of the SEC and the Financial Accounting Standards Board (FASB) are those of the FERC. The FERC's Uniform Systems of Accounts (USofA) and related financial reporting regulations were adopted in 1936 and have been refined and modified over the last 70 years to support FERC's role in ensuring the justness and reasonableness of cost-based rates. The USofA and related financial reporting requirements prescribed by the Commission are based on U.S. GAAP with certain differences to accommodate the manner in which costs are recovered in cost-based rates. As mentioned, differences can occur when the regulator allows or requires costs (or revenues) to be recognized over a number of future periods rather than being recognized in the year in which they occur. Some examples of differences are plant phase-ins, normalization of significant non-recurring operating and maintenance expenses, rate refunds, and gains or losses on the sale of assets.

Such differences have not typically resulted in conflicts between FERC and SEC reporting in the past in part because of the existence of SFAS No. 71, and its predecessor, the Addendum to APB Opinion No. 2. These accounting statements recognize that differences may arise in the application of U.S. GAAP between regulated and non-regulated businesses because of the economic effect of cost of service rate-making on regulated businesses, a phenomenon not present in non-regulated businesses.

Rate-regulated entities currently report hundreds of billions of dollars in cost and revenue/gain deferrals to recognize the economic effects of regulator actions. Without an equivalent SFAS No. 71 standard, these entities may be required to derecognize reported deferrals, which could have a dramatic impact on earnings, equity and capital structure, dividends, debt covenants, and rate making. Further, cost-based rate regulated entities' results of operations as reported in financial statements to FERC could differ greatly from the results of operations reported in the same companies' publicly issued financial statements, leading to inconsistency and potential investor confusion.

In December 2008, the IASB resolved to add a project on rate regulated activities to its agenda with a tentative exposure draft publication date of May 2009. If the IASB does not ultimately adopt such a standard, the true economic position of rate-regulated entities may not be recognized. Should the SEC adopt IFRS, I urge the SEC to encourage the IASB to adopt an accounting standard similar to SFAS No. 71 to appropriately recognize the economic effects of a regulator's actions in setting cost-based rates.

Sincerely,

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