Edison Electric Institute
Power by Association

American Gas Association

Date: February 13, 2015
To: EEI and AGA Accounting Committees
Subject: FERC Accounting Hot Topics Alert

We are pleased to provide you our inaugural FERC Accounting Hot Topics Alert. This Alert includes key areas to be cognizant of as you plan for and prepare your 2014 FERC Form 1 and Form 2 filings. The Alert is part of our broader project to improve the access to and understanding of FERC accounting requirements. These hot topics are based on:

- Matters discussed at the annual EEI-FERC Accounting Liaison Group meeting with the FERC Chief Accountant and his Staff;
- Recent FERC Audit Reports; and
- Topics highlighted by Deloitte for industry focus as we plan for our mid-March FERC Reporting webcast.

Also, each November, FERC issues an annual report on enforcement. Please use this link to view the 2014 Report on Enforcement, which provides information regarding the FERC's enforcement activities during its Fiscal Year ending September 30, 2014. Of particular interest is the section on the Division of Audits and Accounting on pages 30 – 43 of the report.

Equity Method of Accounting for Investments in Subsidiaries

FERC requires utilities to account for their investment in majority owned subsidiaries using the equity method of accounting. As a result, the investment is reported as a single asset on the Balance Sheet in the Form No. 1 or 2. Also, the utility's share of the net earnings of the subsidiary is reported in the Form No. 1 or 2 on a single line of the Income Statement. While the subsidiary likely would be consolidated for GAAP financial reporting purposes, reporting in the Form No. 1 or 2 is limited to the equity method of accounting.

Formula Rates

Formula rates continue to be an area of focus for the FERC Staff. In July 2014, the FERC Staff issued guidance on Formula Rate Updates which is available at this link. This guidance will help to avoid common deficiencies in the preparation of the annual update information filings regarding the format and level of support required for these filings. The FERC Staff is looking for the annual filings to enable interested parties to calculate the rates and verify each input.

Companies need to be cognizant of the inter-relationship between their Form No. 1 or 2 filings and their formula rates. Since the formula rates are derived from the amounts reported in the Form No. 1 or 2, attention must be paid to the classification of amounts reported in the Form No. 1 or 2 and how costs are treated in formula rates.

During FERC audits, the FERC Staff reviews the accounting behind the ratemaking to ensure it complies with the Commission's requirements. Recent audit issues noted by the FERC Staff during the annual liaison meeting included:

- Transmission versus distribution plant classification
- Fair value accounting instead of original cost
- Tax overpayments recorded as prepayments
- Calculation of AFUDC
- Below-the-line versus above-the-line transactions

Regarding the determination of the AFUDC rate, the calculation needs to follow the requirements of Electric or Gas Plant Instruction No. 3 (17). FERC typically does not allow companies to vary from the formula for the AFUDC rate that is presented in the Plant Instruction. FERC approval should be requested in order to vary from the formula provided in the Plant Instruction. When a state commission requires the use of a different AFUDC rate, the differences may need to be reported as regulatory assets or liabilities for FERC reporting.

Mergers and Acquisitions

FERC requires that the cost of acquiring an "operating unit or system" be recorded in Account 102, Electric Plant Purchased or Sold, which includes the acquisition of another utility. Within 6 months of the acquisition, the utility is required to file with FERC the proposed journal entries to clear the acquisition cost from Account 102 in accordance with Plant Instruction 5. Under this plant instruction, the cost of the property acquired must be recorded at its original cost of plant with any difference between the acquisition cost and the original cost of the plant recorded in Accounting 114, Acquisition Adjustments. Under certain circumstances, FERC has allowed fair value adjustments and goodwill to be recorded on a utility's books and reported in the Form No.1 or 2. In these cases, FERC has required the utility to maintain detailed records and disclosures associated with the fair value adjustments and goodwill so as to facilitate the evaluation of the effects of the transactions on common equity and other accounts for ratemaking purposes.

A focus of the FERC Staff regarding the accounting for mergers and acquisitions is the hold harmless provisions. Costs related to merger contemplation and integration should be broadly defined and excluded from FERC jurisdictional rates unless specifically authorized by the Commission. These costs are not limited to incremental costs but are the full cost (including internal labor). Typically for the FERC jurisdiction, purchase accounting adjustments to record the fair value of assets and liabilities are not includable in rates under the original cost concept as discussed above, and goodwill is not includable in rates, nor are duplicate assets and CWIP projects that are no longer useful. However, state commissions may allow ratemaking recovery of the cost of acquired assets reflecting fair value. As a result, differences may need to be considered for the recording of acquired assets for FERC accounting purposes versus what is allowed for state ratemaking purposes.

A Company must file for specific authorization from FERC to collect net savings (i.e., merger savings offset by merger costs) in FERC jurisdictional rates. The FERC Staff believes that a demonstration of merger savings is a difficult hurdle to overcome in order to collect net savings.

On January 22, 2015, FERC issued a Proposed Policy Statement on Hold Harmless Commitments. FERC is proposing to:

- clarify the scope and definition of the costs that should be subject to the hold harmless commitments;
- clarify that applicants offering hold harmless commitments must implement controls and procedures to track the costs from which customers are held harmless;
- no longer accept hold harmless commitments that are limited in duration; and
- under certain circumstances, allow applicants to demonstrate that transactions will not have an adverse effect on rates without relying on hold harmless commitments.

Comments can be filed with FERC on their proposal up to 60 days after the proposal is published in the Federal Register. The Proposed Policy Statement can be viewed using this link.

Compliance Programs

On audit, the FERC Staff is looking for a strong compliance program and culture of compliance. The FERC Staff performs a risk assessment looking to the Company's overall compliance program. The FERC Staff wants to know if there is a comprehensive understanding throughout the organization of procedures and responsibilities for complying with the Commission's regulations. This assessment includes the perspective of the individuals that carry out the daily procedures as well as the different levels of management. This assessment determines the level of detailed audit testing to be performed by the FERC Staff.

Affiliate Transactions

On audit, FERC reviews the methods of allocating costs to utilities as well as Service Company accounting for costs with regard to the impact on formula rates. Focus areas are cross-subsidization, policies/controls, work order systems, pricing of transactions, adequacy of filings, and record retention. A significant portion of audit time is devoted to labor tracking and recording of labor costs, including above-the-line versus below-the-line activities.

FERC Software

The FERC Staff acknowledges that its software for preparing and filing the FERC Form Nos. 1 and 2 needs to be replaced and soon will no longer be supported by Microsoft. Thus, FERC plans to replace its software, but the future platform has not been selected and the timing of the implementation is undefined.

FERC Order No. 784 provided new energy storage accounts and defined energy storage assets. In February 2014, FERC issued a general guidance letter (Al14-1-000) instructing companies to use the footnotes and disclosures to report the new accounts since the FERC software does not accommodate the new accounts. Please use this link to view the general guidance letter.

The EEI-FERC Liaison Group presented a detailed list software issues for the Form No. 1 to the FERC Staff. The FERC Staff has indicated that the industry should not expect any modifications to the existing FERC software since their resources are focused on the new software platform.