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CR-FC-97-01

United States Government

Department of Energy

memorandum

DATE: **February 14, 1997**

REPLY TO
ATTN OF: IG-30

SUBJECT: **Federal Energy Regulatory Commission's Fiscal Year 1996 Financial Statement
Audit - (CR-FC-97-01)**

TO: **Chair, Federal Energy Regulatory Commission**

The attached report presents the results of the independent certified public accountants' audit of the Federal Energy Regulatory Commission's (FERC) financial statements as of September 30, 1996. The auditors have expressed an unqualified opinion on the 1996 statement of financial position and the related statements of operations and changes in net position.

The 1996 financial statement audit was made under the provisions of the Inspector General Act (5 U.S.C. App.) as amended, the Government Management Reform Act (31 U.S.C. 3515), and Office of Management and Budget implementing guidance. The auditors' work was conducted in accordance with generally accepted government auditing standards. To fulfill our audit responsibilities, we contracted with the independent public accounting firm of KPMG Peat Marwick LLP (KPMG) to conduct the audit for us, subject to our review.

The auditors' report on the FERC internal control structure disclosed no reportable conditions that could have a material effect on the financial statements. The auditors also considered the overview and performance measure data for completeness and material consistency with the basic financial statements. The auditors' report on compliance with laws and regulations disclosed no instances of material noncompliance.

We believe that the financial statements, together with KPMG's opinion and our review of that work, provide FERC management and the Department's Chief Financial Officer with a basis for evaluating FERC's financial position and results of operations for the period audited.

In accordance with DOE Order 2320.2B, "Establishment of Departmental Position on Inspector General Reports," as amended by the October 11, 1994, memorandum on "Implementing Guidelines for Streamlining Pilot," no further action is required.

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rf **MASTER**

We appreciate the cooperation of your staff during the review.



Gregory H. Friedman
Deputy Inspector General
for Audit Services

Attachment

cc: Executive Director and Chief Financial Officer, FERC
Director of Financial Policy and CFO Operations Division, FERC
Department of Energy Chief Financial Officer, CR-1
Manager, Capital Regional Audit Office, IG-34

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The Global Leader

**FEDERAL ENERGY REGULATORY
COMMISSION**

Financial Statements

September 30, 1996 and 1995

(With Independent Auditors' Report Thereon)

FEDERAL ENERGY REGULATORY COMMISSION

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FEDERAL ENERGY REGULATORY COMMISSION FISCAL YEAR 1996 ANNUAL FINANCIAL STATEMENTS

OVERVIEW

MISSION

The Federal Energy Regulatory Commission oversees America's natural gas and oil pipeline industries, electric utilities, and hydroelectric projects. We protect customers of these industries from the exercise of market power and protect the environment as the industries may affect it, under law and at the lowest practicable cost. We are committed to being fair, honest, and open in our dealings with regulated entities, other stakeholders and the public.

THE COMMISSION IN BRIEF

The Federal Energy Regulatory Commission (the Commission) was created through the Department of Energy (DOE) Organization Act on October 1, 1977. Its predecessor, the Federal Power Commission (FPC) established in 1920, was abolished, as the new agency inherited most of FPC's energy agenda.

The Commission administers laws and regulations involving key energy issues. These include: the transportation and sale of natural gas in interstate commerce; regulation of electric utility wholesale rates and transactions; licensing, inspection and administration of non-federal hydroelectric projects; and oversight of related environmental matters.

The Commission consists of five members appointed by the President, with the advice and consent of the Senate, to five-year staggered terms. No more than three members may belong to the same political party. The President designates one member to serve as Chair and administrative head of the Commission. Commissioners have an equal vote on regulatory matters.

The Commission generally meets twice a month to transact business. It considers, on a case-by-case basis, licenses and certificate applications, rate filings, and other matters submitted by regulated entities, and sets industry-wide rules. Meetings are open to the public under the provisions of the *Government in the Sunshine Act*.

The Commission collects the full cost of its operations from annual charges and fees authorized by the Federal Power Act (FPA), the *Omnibus Reconciliation Act of 1986*, and other laws. Congress annually adopts a budget appropriation that gives the Commission the authority to use funds from the Treasury to meet operating expenses. The Commission must return to the Treasury all revenue from annual charges and fees, therefore, there is no direct taxpayer funding.

ELECTRIC POWER

MISSION

Ensure that the activities of the regulated entities serve the public interest. Encourage and rely on competitive markets, where appropriate, while maintaining more traditional forms of regulation where competitive markets do not exist or market forces do not work to protect the public interest.

Changes taking place in the electric industry today are nothing short of revolutionary. During the next few years, the Commission's role will be to guide the industry through the transition to a fully competitive market for wholesale generation. The transition must be carefully managed to ensure it is successful and to ensure that competition is working to produce lower electricity cost and prices in the future.

The Commission is aggressively pursuing policies intended to foster open-access transmission and the development of a fully competitive bulk power market for electricity. The *Energy Policy Act of 1992* granted significant new authority to compel public utilities to provide transmission service on a fair and nondiscriminatory basis.

On April 24, 1996, the Commission issued Order No. 888, Promoting Wholesale Competition Through Open Access Nondiscriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities. Order No. 888 requires all public utilities that own, control, or operate facilities used for the transmission of electric energy in interstate commerce to provide comparable open access transmission services. The rule also addresses the recovery of stranded costs — that is, investments and other costs that a utility incurred in good faith to serve wholesale customers that could go unrecovered if the customer uses a utility's open access transmission tariffs to reach other suppliers. This mechanism was judged to be critical to providing the financial viability of the industry during a transition period. At the same time, the Commission issued Order No. 889, Open Access Same-Time Information Systems and Standards of Conduct. Order No. 889 requires transmission owning utilities to provide access to information and to conduct power sales transactions in a nondiscriminatory way.

The Commission is also working to address other key issues related to moving to a more fully competitive wholesale electric generation market including: transmission pricing, alternative power pooling institutions, and regional transmission groups.

HYDROPOWER

MISSION

Support the regulation of non-federal hydropower for the benefit of the public, considering all resources and beneficial uses of the Nation's waterways.

Hydropower is a domestic, renewable resource that offers an abundant, clean source of electric energy. The 1,625 regulated hydropower projects represent half the nation's hydropower energy generation. Hydropower makes up 98 percent of the total renewable energy production and provides about 13 percent of the country's electric capacity. On an annual basis, the use of hydroelectric generation avoids the consumption of the equivalent of about 410 million barrels of oil, or 100 million tons of coal. This reduces the nation's reliance on oil from foreign sources, contributing to national security and advancing the goal of energy self-sufficiency. Hydropower also makes a significant environmental contribution in that avoidance of coal burning prevents the annual discharge into the atmosphere of up to 7.7 million tons of particulate matter.

The Commission's regulation of non-federal hydropower for the benefit of the public, considering all resources and beneficial uses of the nation's waterways, ensures that the water resource developments:

- are safely constructed, operated, and maintained consistent with environmental values and the public interest; and
- serve the diverse public needs of the area in which they are located.

NATURAL GAS AND OIL PIPELINES

MISSION

Ensure that the construction and operation of natural gas facilities are in the public convenience and necessity, and consistent with protection of the environment; and recommend policies and programs that blend competitive forces with regulation so that natural gas and oil pipelines can provide reliable service at just and reasonable rates, respond to market signals, and develop new markets.

The Commission's regulatory philosophy and efforts are focused on the continued development and enhancement of competition through open-access transportation. To this end, the Commission has the continuing role of shepherding and leading the industry toward a more competitive environment. The gas and oil program has changed dramatically and continues to evolve as market opportunities grow.

To achieve our goals in this program, the Commission will:

- work with all segments of the industry to pursue regulatory initiatives leading to greater competition and flexibility for rate payers;
- develop policies and solutions to meet and deal with emerging industry opportunities such as the use of market-based rates or other incentive rate mechanisms;
- analyze and act on filings reflecting industry responses to such initiatives as market-based rates, negotiated rates, and other nontraditional incentive rate proposals;
- act as facilitators to resolve disputes involving tariff rate and miscellaneous service issues through an informal resolution process;
- improve the effectiveness of environmental programs by expanding opportunities for public participation and increasing the rate of voluntary compliance; and
- continue to analyze and act on the more traditional filings.

Additionally, during FY 1996, we issued policy statements, notices of proposed rulemaking, and final rules that started new initiatives and continued building on our efforts relating to ratemaking methods for the future. These included a Notice of Proposed Rulemaking designed to improve the efficiency of the Commission's secondary capacity market program for natural gas pipelines and a Policy Statement regarding the use of alternative ratemaking methods. Additionally, a Final Rule was issued to standardize procedures for critical business practices important to the development of an integrated natural gas network. In another rule, the Commission exempted smaller oil pipelines from certain reporting burdens.

FY 1996 PERFORMANCE MEASUREMENT RESULTS

Make regulation work better and integrate market forces, where possible, into an overall regulatory model.

In FY 1996, one of the Commission's primary performance goals was to make regulation work better and integrate market forces, where possible, into an overall regulatory model. In the Natural Gas and Oil Pipelines program, the Commission finalized and implemented its updated rate filing and reporting requirements under Order Nos. 581 and 582. The comprehensive overhaul of these rate regulations and reporting requirements together with new electronic filing requirements result in a significant reduction in industry reporting burden. Order No. 581, alone, is projected to reduce annual reporting burdens by 61,824 hours.

To protect customers through fostering efficiency, innovation, and competition, the Commission:

- **Provided refined standards for market-based rates that encourage companies to identify competitive services, and to apply for and receive market-based regulation.**

In the electric power program, Order Nos. 888 and 889 revised the Commission's regulations to require all transmission tariffs to meet clear and specific standards for comparable open-access, thereby assuring that utilities seeking market-based rates have mitigated transmission market power and cannot foreclose competitors. In addition, Order No. 888 revised the Commission's regulations to establish clear and explicit standards for evaluating generation dominance with respect to generation units for which construction has commenced on or after July 9, 1996.

The market-based rate program contained in a January 31, 1996 Statement of Policy is an important step toward the Commission's long-term objective of fostering efficiency and competition in the natural gas industry. The policy statement sets forth specific criteria under which pipelines can identify competitive services and apply for market-based regulation. In FY 1996, the Commission approved market-based storage rates in six proceedings and market-based transportation rates for two additional applicants. Several additional proposals for market-based rates are currently under analysis or are in evidentiary proceedings. These include proposals for both gas and oil pipelines.

- **Developed options for performance-based regulation for areas that cannot be competitive.**

The Statement of Policy issued on January 31, 1996 sets forth an incentive regulation plan for the natural gas industry where market-based rates are not appropriate. Incentive rates permit pipelines and their customers to receive some of the benefits of greater flexibility and efficiency that are associated with market-based rates. The program is available to all pipelines on a

voluntary and experimental basis. Although no gas pipelines has yet filed a proposal for incentive rates, the Commission believes its new policy forms the basis for a viable alternative to traditional cost-based rates. The policy statement also establishes a negotiated/recourse rate program. This rate making alternative is available to pipelines that cannot demonstrate that they lack market power. Under this program a pipeline may negotiate rates with its customers as long as customers have the option of choosing a recourse service with traditional cost-based rates and terms and conditions. During the fiscal year, the Commission approved 13 pipeline companies negotiated/recourse rate proposals. Ten applications filed during the fiscal year are pending in rate and certificate proceedings.

The negotiated/recourse rate proposals raised a key issue concerning their applicability to secondary markets, i.e., capacity release by local distribution companies and other holders of firm pipeline capacity. Therefore, the Commission has instituted a rulemaking to look at the issue generically. Resolution of the issue will have wide-ranging rate and service impacts for both liquefied distribution centers (LDCs) and possibly over competing pipeline services.

- **Provided rate certainty by deciding rate treatment in certificate cases for new natural gas pipeline construction.**

Since the issuance of a Statement of Policy on May 31, 1995, the Commission has made determinations regarding the rate treatment in certificate cases involving construction of new natural gas pipelines. This policy is designed to provide rate certainty for both the pipeline proposing the project and its customers, both existing and new. As a result, in fiscal year 1996, the Commission has provided rate certainty in certificate cases authorizing over \$400 million of new natural gas pipeline construction. By comparison, in fiscal year 1995, the Commission authorized \$605 million of new gas pipeline construction without a specific determination as to the rate treatment to be afforded such costs.

The up-front rate determinations now assure that pipelines and their customers will know whether a specific project will be priced on a rolled-in or incremental basis. Prior to implementing this policy, no consistent guidance was provided to either a pipeline's existing customers or new customers served through the facilities on how the costs associated with construction projects would be recovered. This uncertainty resulted in protests on the pricing issue that were often contentious and difficult to resolve.

- **Established fully comparable open-access transmission for all transmission owners under the Commission's jurisdiction.**

During FY 1996, the Commission issued Order Nos. 888 and 889 resulting in fully-comparable open-access transmission for all electric transmission owners under the Commission's jurisdiction. Under Order No. 888, 116 public utilities were required to file open-access transmission tariffs offering comparable service effective July 9, 1996. In addition, the Commission directed all power pools to file appropriate open-access transmission tariffs by December 31, 1996. Under Order No. 889, the Commission directed the implementation of real-time information networks to ensure that the information necessary to support comparable open-access is available to all industry participants.

In the natural gas and oil program, the Commission's initiatives to revise and update its regulations and filing requirements and to increase standardization and the availability of key information are facets of the Commission's program to improve open-access services on all pipelines under its jurisdiction. Further, because the Commission has found that releases of pipeline capacity are jurisdictional activities, the review of our capacity release program may impact the amount of open-access transmission capacity on a nation-wide basis.

Additionally, the Commission has reviewed, in several specific cases, its policies with respect to jurisdictional services provided by intrastate pipelines. In two cases, the Commission found that intrastate pipeline facilities had been constructed or proposed to be constructed in such a manner as to avoid the Commission's jurisdiction. The Commission found that operating under Section 311 of the NGPA gave the pipeline a direct competitive advantage over pipelines operating under Order No. 636. The Commission found that it would be contrary to the goals of Order No. 636 to allow some pipelines that perform interstate transportation to balkanize into a chain of affiliates subject to the regulations of various states. We believe that these and other similar Commission actions reinforce its intent to create a national natural gas market, and will deter efforts to avoid Commission jurisdiction in the future.

Improve the efficiency of our environmental programs.

To protect the environment and enhance project benefits, the Commission:

- **Reduced legitimate complaints that people have been excluded from environmental processes.**

In the natural gas and oil program during FY 1996, the Commission issued numerous notices of intent (NOIs) to prepare environmental assessments and mailed them to the public to solicit comments. In addition, completed environmental assessments (EAs) were mailed to the public when requests for copies of a document were received, or in response to significant issues with a request for comments (NOAs). In FY 1995, NOIs were issued for 44 percent of the projects (36 out of 81). In FY 1996, 32 percent of the projects had NOIs issued (30 out of 93). This percentage depends on the expected impacts on or concerns raised by the public. In FY 1995 and FY 1996, a total of 14 and 13 NOAs, respectively, were issued for EAs.

- **Reduced processing time for environmental reviews.**

The following EA and environmental impact statement (EIS) processing times were achieved for natural gas projects:

- In FY 1996, 93 EAs were completed, requiring an average of 148 days. In FY 1995, 81 EAs were completed, requiring an average of 148 days.
- In FY 1996, 2 draft and 1 final EIS was completed. The average number of days to complete the draft was 416. The average number of days to complete the final was 141 for a combined total of 557 days. This is down from FY 1995 when 2 draft and 3 final EISs were completed in a combined average of 601 days.

In the hydropower program in FY 1996, the Commission undertook a pilot program to assess how the applicant-prepared environmental assessment process, authorized under the Energy Policy Act of 1992, could help reduce processing times for relicense applications. The use of this pilot process for one project resulted in an 89 percent reduction in the average time required for environmental review process, which is a major part of the overall application review process. The pilot process holds promise for significantly reducing processing times in cases where it can be applied.

For all the major hydropower relicense applications in which staff completed the environmental review process in FY 1996, the average time was 36.4 months. It took staff only 4 months to complete the environmental review process for the pilot program project. In the applicant-prepared EA process, the applicant completes the environmental review before filing

a relicense application; thereby saving the staff considerable time in completing its independent environmental review process. Several applicant-prepared environmental assessments are presently being prepared that, if filed, should also result in decreased time spent by staff in the environmental review process. The Commission staff is encouraging potential applicants to prepare applicant-prepared environmental assessments to reduce processing time for environmental reviews.

- **Increased the rate of voluntary compliance.**

FY 1996 showed a marked improvement in voluntary compliance in the natural gas and oil program. With 234 inspections completed in FY 1996, 17 noncompliance letters were issued. This contrasts with 73 letters issued in relation to 289 inspections completed in FY 1995. In FY 1995, however, a major construction project by Florida Gas Transmission Company (814 miles of pipeline and related facilities) resulted in significantly more compliance field inspections and noncompliance letters than are routinely needed.

The number of procedural noncompliance investigations initiated in the hydropower program in FY 1996 was 47 percent less than the number of FY 1995. In addition, the number of overdue compliance filings in FY 1996 was 41 percent less than the number in FY 1995. The improvement in voluntary compliance, as reflected in the decrease in noncompliance caseload, was due in large part to proactive actions carried out by staff, including post-licensing transition team activities and compliance audits.

- **Increased the percentage of dams meeting all current safety standards.**

The number of dams meeting all current safety standards is inversely proportional to the number of ongoing dam remediations. In FY 1996, the number of ongoing dam remediations decreased by 1.1 percent. In FY 1995, 90 dams were undergoing remedial work. In FY 1996, 89 dams were undergoing remedial work.

Continue to improve and enhance the Commission's fiscal and budgetary position.

- **Continue to receive an unqualified audit opinion on the Annual Financial Statements.**

As interpreted by KPMG Peat Marwick LLP, the Commission continues to receive an unqualified opinion with no material weaknesses, reportable problems, or instances of noncompliance. This measurement is of utmost importance to the Commission in presenting our financial stability to our customers and regulated entities, and ensuring our financial statements reflect true and accurate balances.

- **Formulate the budget so that current year costs are within 5 percent of the budget for the fiscal year.**

An analysis of the Commission's FY 1995 performance in this area revealed that costs were within approximately 12.5% of total budgetary resources. This rate was improved in FY 1996 to within 11% of total availability. This improvement can be attributed, in part, to a program implemented in FY 1996 by the Chief Financial Officer aimed at educating money managers in cost accrual principles, thereby ensuring that final costed levels more accurately reflect the dollar value of those goods and/or services received and accepted, but not paid for, by the end of a particular fiscal year.

Beginning in FY 1996 the Commission requested appropriations (new budget authority) at a level less than total operational requirements, to be supplemented by prior years' unobligated authority of varying amounts, until the balance of carryover funds is entirely, or nearly, eliminated. Therefore, it has become necessary to modify this performance measurement to stipulate our costs should be *within 5 percent of total budgetary resources for the fiscal year.*

- **Pay 95 percent of all payments accurately and on time; vendors within the time required by the Prompt Payment Act; internal customers in 10 days or less.**

The Commission's fiscal year 1996 payment performance measurement results surpassed the 95 percent on-time payment goal set for invoice payments to vendors within the time frame required by the Prompt Payment Act, and met the 10 days or less payment goal set for internal customers.

A total of 5,499 payments were made to vendors in FY 1996, 5,492 of which were paid on time in accordance with the Prompt Payment Act, an on-time payment rate of 99.8 percent. The average processing time for payments to internal customers was six days, counting the date the travel voucher is received and the date of payment for all vouchers. A total of 3,015 vouchers were processed for payments to internal customers in FY 1996. Performance measurement tallies are based on the Commission's Performance Measurement Report transmitted to DOE for the quarter ended September 30, 1996.

FY 1997 PERFORMANCE MEASUREMENTS

Make regulation work better and integrate market forces, where possible, into an overall regulatory model.

The Commission will continue to develop new and better ways to analyze unique and complex problems, to reach fully justified decisions more quickly, and to cut the cost of doing regulatory business. This means improving and streamlining the regulations, specifying the types of information to be filed by the regulated companies and the methods (electronic versus paper) used in making those filings.

While the use of more traditional models of regulation will continue to be necessary in noncompetitive sectors of the industries, we have encouraged the growth of competition in such sectors as natural gas producing markets, oil pipelines, and electric power generation. For example, as the electric industry begins to restructure as a result of Order Nos. 888 and 889, we will encourage and approve market-based rates. Market-based rates allow sellers to adapt quickly to competitive conditions and require less regulatory involvement. This process will continue and evolve in the foreseeable future, as it did with the natural gas industry.

To protect customers through fostering efficiency, innovation, and competition, the Commission will:

- provide refined standards for market-based rates that encourage companies to identify competitive services, and to apply for and receive market-based regulation;
- develop options for performance-based regulation for areas that cannot be competitive;
- provide rate certainty by deciding rate treatment in certificate cases for new natural gas pipeline construction; and
- establish fully comparable open-access transmission for all transmission owners under the Commission's jurisdiction.

Improve the efficiency of our environmental programs.

In regulating hydropower development and natural gas pipeline construction, the Commission will continue to balance all legitimate interests under many separate statutes, resolve questions quickly, and monitor future performance to ensure that the terms under which the utilities are allowed to build and operate balance environmental protection and project benefits.

To protect the environment and enhance project benefits, the Commission will:

- reduce legitimate complaints that people have been excluded from environmental processes;
- reduce processing time for environmental reviews;
- increase the rate of voluntary compliance; and
- increase the percentage of dams meeting all current safety standards.

Continue to improve and enhance the Commission's fiscal and budgetary position.

Specific measurements are:

Continue to receive an unqualified audit opinion on the Annual Financial Statements.

The Commission received its first unqualified opinion for the FY 1994 Annual Financial Statements, but feels that an unqualified opinion is such a critical indicator of the agency's overall financial well-being that this will be a primary performance measurement for some years to come.

Formulate the budget so that current year costs are within 5 percent of the budget for the fiscal year.

This performance measurement will require several years to achieve. The entire budget execution process will be examined and modified as necessary.

Pay 95 percent of all payments accurately and on time; vendors within the time required by the Prompt Payment Act and; internal customers in 10 days or less.

This performance measurement may require more than one year to achieve.

STATEMENT OF LIMITATIONS

- The financial statements have been prepared to report the financial position and results of operations of the Commission, pursuant to the requirements with the form and content for entity financial statements specified by the Office of Management and Budget in Bulletin 94-01.
- While the statements have been prepared from the books and records of the Commission in accordance with the formats prescribed by the Office of Management and Budget, the statements are different from the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.
- The statements should be read with the realization that they are for a component of a sovereign entity, that liabilities not covered by budgetary resources cannot be liquidated without enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

KPMG Peat Marwick LLP

2001 M. Street, N.W.
Washington, DC 20036

Independent Auditors' Report on Financial Statements

**The Federal Energy Regulatory Commission
United States Department of Energy:**

We have audited the accompanying statements of financial position of the Federal Energy Regulatory Commission (the Commission) as of September 30, 1996 and 1995, and the related statements of operations and changes in net position for the years then ended. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in note 2, these financial statements were prepared in conformity with the hierarchy of accounting principles and standards approved by the principals of the Federal Accounting Standards Advisory Board. This hierarchy is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of September 30, 1996 and 1995, and the results of its operations and changes in net position for the years then ended, in conformity with the basis of accounting described in note 2.

Our audits were conducted for the purpose of forming an opinion on the financial statements referred to in the first paragraph of this report, taken as a whole. The information presented in management's *Overview* is not a required part of the basic financial statements but is supplementary information required by OMB Bulletin No. 94-01, *Form and Content of Agency Financial Statements*. We have considered whether this information is materially inconsistent with the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements and, accordingly, we do not express an opinion on it. The performance information included in management's *Overview* is addressed in our auditors' report on the internal control structure in accordance with OMB Bulletin No. 93-06.



In accordance with *Government Auditing Standards*, we have also issued reports dated December 27, 1996, on our consideration of the Commission's internal control structure and on its compliance with laws and regulations.

This report is intended for the information of the management of the Commission and the United States Department of Energy. This restriction is not intended to limit the distribution of the report, which is a matter of public record.

KPMG Peat Marwick LLP

December 27, 1996

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FEDERAL ENERGY REGULATORY COMMISSION

Statements of Financial Position

September 30, 1996 and 1995

Assets	1996	1995
Entity assets:		
Intragovernmental assets:		
Fund balances with Treasury (note 3)	\$ 41,467,439	80,283,381
Governmental assets:		
Accounts receivable, net (note 4)	1,767,875	12,063,779
Employee travel advances	52,751	54,587
Cash	5,000	5,000
Property and equipment, net (note 6)	22,516,573	6,348,360
Total entity assets	65,809,638	98,755,107
Non-entity assets:		
Intragovernmental assets:		
Fund balances with Treasury (note 3)	2,783,111	4,693,182
Accounts receivable	1,508	217
Governmental assets:		
Accounts receivable, net (note 5)	783,953	1,838,898
Total non-entity assets	3,568,572	6,532,297
Total assets	\$ 69,378,210	105,287,404

The accompanying notes are an integral part of these statements.

Liabilities and Net Position	1996	1995
Liabilities:		
Liabilities covered by budgetary resources:		
Intragovernmental liabilities:		
Accounts payable	\$ 780,343	2,175,770
Collections due to states	2,649,489	2,488,848
Resources transferable to Treasury (note 5)	783,952	1,838,898
Miscellaneous receipts held in suspense	72,107	2,194,822
Government liabilities:		
Accounts payable	5,320,315	5,563,356
Lease liabilities (note 7)	15,026	173,832
Accrued payroll and benefits	4,366,428	3,931,998
Revenue collected under protest	7,061,762	7,717,112
Total liabilities covered by budgetary resources	21,049,422	26,084,636
Liabilities not covered by budgetary resources:		
Accrued leave	8,112,524	7,927,860
Workers' compensation	256,523	-
Total liabilities	29,418,469	34,012,496
Net position:		
Unexpended appropriations:		
Unobligated and available	10,134,612	33,224,040
Undelivered orders	13,956,503	27,576,640
Invested capital	22,516,573	6,348,360
Cumulative results of operations	1,721,100	12,053,728
Future funding requirements	(8,369,047)	(7,927,860)
Total net position	39,959,741	71,274,908
Total liabilities and net position	\$ 69,378,210	105,287,404

FEDERAL ENERGY REGULATORY COMMISSION

Statements of Operations and Changes in Net Position

Years ended September 30, 1996 and 1995

	1996	1995
Revenue and financing sources:		
Appropriated capital used:		
Commission	\$ 152,577,352	165,411,180
Department of Energy Dam Safety allotment received	100,000	34,744
Collections for states	2,649,489	2,474,727
Revenue from public sources:		
Annual charges and filing fees	196,835,465	178,990,854
Interest and penalties	490,281	589,910
Other revenue and financing sources – reimbursable work agreements:		
Taiwan		39,605
Intragovernmental - Nuclear Regulatory Commission	14,312	81,888
	352,666,899	347,622,908
Less - receipts returned to Treasury and other agencies	(199,637,400)	(186,326,006)
Total revenue and financing sources	153,029,499	161,296,902
Expenses:		
Operating expenses:		
Commission (note 8)	146,738,067	162,620,014
Department of Energy Dam Safety allotment used	100,000	34,744
Payments to states	2,649,489	2,474,727
Cost of services provided:		
Taiwan		39,605
Intragovernmental – Nuclear Regulatory Commission	14,312	81,888
Depreciation	4,710,342	2,340,548
Loss on disposal of property, plant, and equipment	1,128,943	450,618
Provision for (recovery of) bad debts	8,020,975	(61,213)
Unfunded expenses - accrued leave and workers' compensation	441,187	466,997
Total expenses	163,803,315	168,447,928
Deficiency of revenue and financing sources over total expenses	(10,773,816)	(7,151,026)
Add unfunded expenses	441,187	466,997
Deficiency of revenue and financing sources over funded expenses	\$ (10,332,629)	(6,684,029)
Net position, beginning of year	\$ 71,274,908	77,369,365
Deficiency of revenue and financing sources over funded expenses	(10,332,629)	(6,684,029)
Add nonoperating changes (note 9)	(20,982,538)	589,572
Net position, end of year	\$ 39,959,741	71,274,908

The accompanying notes are an integral part of these statements.

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

September 30, 1996 and 1995

(1) Description of Reporting Entity

The Federal Energy Regulatory Commission (Commission) is an independent federal agency that oversees key operating functions of the United States' natural gas and oil pipeline transportation, electric utility, and hydroelectric power industries.

The Commission was created through the Department of Energy's (DOE) Organization Act on October 1, 1977. The Commission's predecessor, the Federal Power Commission (FPC), established in 1920, was abolished, and the Commission inherited a significant portion of FPC's energy agenda.

The Commission administers laws and regulations involving key energy issues. These include transportation and sale of natural gas in interstate commerce; regulation of electric utility wholesale rates and transactions; licensing and inspection of private, municipal, and state hydroelectric projects; and oversight of related environmental matters.

The Commission's main legal authority is derived from the Federal Power Act of 1935 (FPA), the Natural Gas Act of 1938 (NGA), the Natural Gas Policy Act of 1978 (NGPA), and the Public Utility Regulatory Policies Act of 1978 (PURPA).

Pipeline and Producer Regulation

NGA, NGPA, the Outer Continental Shelf Lands Act, and the Natural Gas Wellhead Decontrol Act are the primary laws the Commission administers to oversee the natural gas pipeline and producer industries in the United States. Under NGA, the Commission regulates both the transportation and sale for resale of natural gas in interstate commerce; the transportation of natural gas; and the rates and practices of oil pipeline companies engaged in interstate transportation under the Interstate Commerce Act (ICA).

Electric Utilities

The Commission oversees wholesale electric rates and service standards as well as the transmission of electricity in interstate commerce. The Commission also ensures that wholesale rates charged by utilities are just and reasonable and not unduly discriminatory or preferential. It also reviews utility agreements involving interconnections and power transfers. In addition, the Commission oversees the issuance of certain stock and debt securities, and mergers. Finally, the Commission reviews rates set by the federal power marketing administrations, such as the Bonneville Power Administration, and certifies qualifying small power production and cogeneration facilities.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(1) Continued

Hydropower

The Commission's hydroelectric activity, the first work undertaken after Congress passed FPA, includes project licensing, dam safety, project compliance activities, investigation and assessment of headwater benefits, review of project proposals by other federal agencies, and interagency coordination. The Commission's licensing costs are offset by annual charges collected from license holders. The Commission also determines charges for a licensee's use of federal lands, federal dams, and Indian reservations.

Cost Recovery

As described below, the Commission recovers 100 percent of its appropriation annually through annual charges and filing fees authorized by the Omnibus Budget Reconciliation Act of 1986 and other laws.

Annual Charges

The Commission assesses most of its administrative program costs as an annual charge to each regulated entity, regardless of the number or type of services rendered to the particular entity during that year. The annual charge assessed in a fiscal year is based on an estimate of costs to be incurred during that year. Final program costs are determined from year-end accounting reports and time distribution reports by office and program. The difference in assessments that results from estimated versus final program costs is an adjustment to the following fiscal year's assessments. In hydropower regulation, the annual charges include the Commission's program costs as well as the related costs incurred by several other agencies that review the Commission's hydro license applications under Part I of FPA.

Hydropower

Authority – Section 10(e) of FPA makes the general provision that licensees under Part I of FPA shall pay reasonable annual charges to recompense the federal government for the costs of administering Part I.

Implementation – The methods for assessing annual charges to hydropower licensees are codified at 18 Code of Federal Regulations (C.F.R.) Part 11. Costs are prorated based on capacity (municipal projects), on capacity and generation (nonmunicipal projects), or on a flat rate per horsepower under 1000 (minor projects).

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(1) Continued

Gas, Electric, and Oil

Authority – Section 401 of the Omnibus Budget Reconciliation Act of 1986 provides that the Commission shall “assess and collect fees and annual charges in any fiscal year in amounts equal to all of the costs incurred by the Commission in that fiscal year.” It further provides that “fees or annual charges assessed shall be computed on the basis of methods that the Commission determines, by rule, to be fair and equitable.”

Implementation – The methods for assessing annual charges to gas and oil pipelines and to electric utilities and power marketing administrations are codified at 18 C.F.R. Parts 382.201-203. Costs are prorated to gas pipelines based on volume transported and sold, to electric utilities and power marketing administrations based on energy sold, and to oil pipelines based on operating revenues.

Filing Fees

Filing fees are calculated annually. Regulated entities pay the current fee when filing with the Commission for a specific service. A fee is based on the average time spent to perform the particular type of service and the average cost per employee, including salary, benefits, and indirect costs.

The Independent Offices Appropriations Act of 1952 (IOAA) authorizes agencies to prescribe regulations establishing charges for services, benefits, or items of value provided by an agency. In establishing a fee under the IOAA, the Commission must:

Identify the service for which the fee is to be assessed;

Explain why that particular service benefits an identifiable recipient more than it benefits the general public;

Base the fee on as small a category of service as possible; and

Demonstrate what direct and indirect costs are incurred by the Commission in rendering the service.

Section 3401 of the Omnibus Budget Reconciliation Act of 1986 also provides for fees and annual charges “computed on the basis of methods that the Commission determines, by rule, to be fair and equitable.”

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(1) Continued

Fee structure and procedures are codified in 18 C.F.R. Part 381. Fee methodology was upheld in *Phillips Petroleum Co. v. the Commission* 789 F. 2d 370 (10th Cir. 1986). Fees are updated annually and published in the *Federal Register*.

(2) Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements have been prepared to report the financial position and results of operations of the Commission.

The financial statements have been prepared from the books and records of the Commission in accordance with the form and content for entity financial statements specified by the Office of Management and Budget (OMB) in Bulletin No. 94-01, and the Commission's accounting policies, which are summarized in this note.

The statements are therefore different from the financial reports, also prepared by the Commission pursuant to OMB's directives, that are used to monitor and control the Commission's use of budgetary resources.

The financial statements include all activity related to the Commission's portion of appropriation (89X0212), including the budget authority allotted by the Department of Energy (DOE) to other DOE agencies. In addition, the commission receives small allotments from three DOE appropriates: (89X0224), (89X0243, and (89X5105).

Entity assets on the statement of financial position include those assets that the Commission has the authority to use in its operations.

Non-entity assets on the statement of financial position include those assets that result from the Commission's receipt of allotments to be used for other federal agencies or governments which include the General Services Administration, Department of Energy Dam Safety, and state governments.

Budgets and Budgetary Accounting

Congress annually adopts a budget appropriation that provides the Commission with authority to use funds from Treasury to meet operating expense requirements. The appropriated funds are not restricted to use in a specific fiscal year. The Commission must return to Treasury all revenue from annual charges and filing fees when received.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(2) Continued

Basis of Accounting

The Commission's financial statements are prepared using the accrual method of accounting. The accrual method of accounting requires recognition of the financial effects of transactions, events, and circumstances in the period(s) when those transactions, events, and circumstances occur, regardless of when cash is received or paid. The Commission also uses budgetary accounting to facilitate compliance with legal constraints and to monitor its budget authority at the various stages of execution, including allotment, obligation, and eventual outlay.

Until a sufficiently comprehensive set of accounting standards which will constitute "generally accepted accounting principles" for the federal government, are agreed to and published by the Joint Financial Management Improvement Program (JFMIP) principals, agencies are required to prepare financial statements in accordance with the following hierarchy, which is a comprehensive basis of accounting:

Individual standards agreed to and published by the Joint Financial Management Improvement Program Principals (JFMIP), based upon recommendations from the Federal Accounting Standards Advisory Board (FASAB).

Form and content requirements included in Office of Management and Budget (OMB) Bulletin 94-01, dated November 6, 1993, and subsequent issuances.

Accounting standards contained in agency accounting policy, procedures manuals, and/or related guidance as of March 29, 1991 so long as they are prevalent practices.

Accounting principles published by authoritative standard setting bodies and other authoritative sources (1) in the absence of other guidance in the first three parts of this hierarchy, and (2) if the use of such accounting standards improve the meaningfulness of the financial statements.

Revenue and Other Financing Sources

The Commission receives funds for its operating and capital expenditures through an appropriation allotment from DOE. The appropriation allotment is recognized as revenue at the time it is used to pay program or administrative expenses (primarily salaries and benefits). Appropriations used to acquire property and equipment are recognized as revenue when depreciation on property and equipment is recognized. Gain or loss on the disposal of property and equipment is recognized as revenue at the point of the sale.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(2) Continued

The Commission recognizes revenue for hydropower, gas, oil, and electric annual charges when earned. Annual charges are based on estimated current year program costs and adjustments from the prior year. Adjustments from the prior year represent the difference between estimated program costs and actual costs incurred, and are immaterial compared to estimated program costs. The Commission assesses late fee charges when payment is not received on a timely basis. Revenue is recognized for filing fees when received.

Reimbursable work agreement revenue is recognized when earned, i.e., goods have been delivered or services rendered.

Fund Balances with Treasury and Cash

The Commission does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by Treasury. The balance of funds with Treasury represents appropriated funds that are available to pay current liabilities and finance authorized purchase commitments relative to goods or services that have not been received.

Cash balances advanced to imprest fund cashiers totaled \$5,000 as of September 30, 1996 and 1995, respectively.

Allowance for Doubtful Accounts

The Commission calculates its allowance for doubtful accounts using historical collection data and specific account analysis.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation. The Commission capitalizes property (other than furniture) and equipment purchases with a cost greater than \$5,000, and a total useful life exceeding two or more years. The Commission capitalizes furniture purchases with a cost greater than \$50,000, and commercially purchased or developed computer software with a cost greater than \$25,000. Depreciation is calculated based on an estimated useful life of twenty years for leasehold improvements, ten years for furniture, two years for commercially purchased or developed ADP software, and five years for all remaining assets. Expenditures for repairs and maintenance are charged to operating expenses as incurred.

Liabilities

Liabilities represent amounts owed by the Commission as the result of transactions or events that have occurred as of year end. Liabilities for which Congress has not appropriated funds are classified as liabilities not covered by budgetary resources.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(2) Continued

Revenue Collected Under Protest

The Commission records a liability for revenue collected under protest, until a legal determination is made.

Collections for States and Other Agencies

As provided for under Part I of FPA, the Commission increases its annual charges to hydropower licensees to recover Part I costs of other agencies. Additionally, the Commission disburses 50 percent of the fees it collects from licensees for the occupancy and use of public lands to affected states in the year following collection. These collections are deposited directly into Treasury's miscellaneous receipts fund and are recorded as an intragovernmental liability.

Accrued Leave

Annual leave is accrued as a liability as it is earned. The accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current year pay rates. To the extent that the current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future appropriations. Sick leave and other types of nonvested leave are charged to expense as the leave is used.

Net Position Accounts

Net position account balances consist of the following components:

Unexpended appropriations – Represent amounts of spending authority that are unobligated and available to the Commission, or obligated but not expended.

Invested capital – Represents the Commission's cost of property and equipment acquired that has been financed by appropriations, less reductions in the investment due to depreciation.

Cumulative results of operations – Represents the net difference between annual charges and amounts returned to Treasury since the inception of the Commission. This component is equal to net accounts receivable from annual charges that will offset future years' appropriations, when collected (see note 4).

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(2) Continued

Future funding requirements – Represents the amount of appropriated funding that will be needed in future periods to liquidate liabilities incurred through the current fiscal year. Funding for these items is generally received in the year that amounts become due and payable.

Tax Status

The Commission, as a federal agency, is not subject to federal, state, or local income taxes and, accordingly, no provision for income tax is recorded.

(3) Fund Balances with Treasury

Fund balances with Treasury at September 30, 1996 and 1995, consisted of:

	1996	1995
Entity intragovernment assets:		
Appropriated fund balance with Treasury	\$ 34,405,677	72,566,269
Revenue collected under protest*	7,061,762	7,717,112
Total	41,467,439	80,283,381
Non-entity intragovernment assets:		
Appropriated fund balance with Treasury	61,515	9,512
Collections due to states	2,649,489	2,488,848
Miscellaneous receipts held in suspense	72,107	2,194,822
Total	2,783,111	4,693,182
Total fund balances with Treasury	\$ 44,250,550	84,976,563

*The Commission elects to set aside collections of annual charges that are under dispute.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(4) Entity Governmental Accounts Receivable

Entity governmental accounts receivable at September 30, 1996 consisted of:

	Annual charges	Other	Total
Uncollected billings	\$ 10,833,957	52,582	10,886,539
Allowance for doubtful accounts	(9,112,857)	(5,807)	(9,118,664)
Total net accounts receivable	\$ 1,721.100	46,775	1,767.875

Entity governmental accounts receivable at September 30, 1995, consisted of:

	Annual charges	Other	Total
Uncollected billings	\$ 13,145,610	13,616	13,159,226
Allowance for doubtful accounts	(1,091,882)	(3,565)	(1,095,447)
Total net accounts receivable	\$ 12,053,728	10,051	12,063,779

(5) Resources Transferable to Treasury

Resources transferable to Treasury reflect the amount of non-entity accounts receivable that are outstanding as of September 30, 1996 and 1995. Resources transferable to Treasury consist of:

	1996	1995
Non-entity receivables	\$ 2,378,637	2,375,424
Allowance for doubtful non-entity accounts	(1,594,684)	(536,526)
Total resources transferable to Treasury	\$ 783,953	1,838,898

When collected, these receivables are required by law to be transferred to Treasury.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(6) Property and Equipment, Net

Property and equipment, and related accumulated depreciation at September 30, 1996 consisted of:

	Depreciation method	Service life	Acquisition value	Accumulated depreciation	Net book value
Equipment	Straight-line	5 years	\$ 8,175,605	4,607,898	3,567,707
Furniture	Straight-line	10 years	9,070,773	769,124	8,301,649
Assets under capital lease	Straight-line	5 years	258,524	247,575	10,949
Leasehold improvements	Straight-line	20 years	10,984,727	464,176	10,520,551
ADP software	Straight-line	2 years	3,434,041	3,318,324	115,717
Total			\$ 31,923,670	9,407,097	22,516,573

For the period ended September 30, 1996, the Commission wrote off \$3,411,682 of equipment and related accumulated depreciation of \$2,282,739. The large write-off was due to the Commission moving into their new office space during 1995.

Property and equipment, and related accumulated depreciation at September 30, 1995, consisted of:

	Depreciation method	Service life	Acquisition value	Accumulated depreciation	Net book value
Equipment	Straight-line	7 years	\$ 6,793,816	3,577,571	3,216,245
Assets under capital lease	Straight-line	7 years	849,285	428,469	420,816
ADP software	Straight-line	3 years	4,803,062	2,091,763	2,711,299
Total			\$ 12,446,163	6,097,803	6,348,360

(7) Leases

Capital Leases

The Commission has purchased copiers under capital lease arrangements. Each lease contains a cancellation clause that allows the Commission to remove itself from future liability with a payment of a one-time removal fee ranging from \$300 to \$600. The terms of the capital leases range from 36 to 63 months. The lease agreements provide for transfer of title of the equipment at the expiration of the lease term. Each copier lease contains a monthly maintenance provision which is funded on a current basis and included in the future operating lease disclosures below.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(7) Continued

Operating Leases

In addition, the Commission has several operating leases for office equipment maintenance and software licenses with terms that range from 12 to 60 months. At the expiration of the operating lease, title to the equipment remains with the lessor. The monthly cost of each operating lease is expended on a current-year basis.

The future payments due for both capital and operating leases are:

Fiscal year ending September 30	Operating leases	Capital leases	Total
1997	\$ 15,743	15,026	30,769
Total future payments	\$ 15,743	15,026	30,769
		1996	1995
Total capital lease liability - funded (leases entered into after October 1, 1992)		\$ 15,026	173,832

The Commission has not calculated the amount of imputed interest costs implicit in its capital leases because the amount is immaterial.

Building Leases

The General Services Administration (GSA) enters into lease agreements for government buildings and maintains those lease agreements. The Commission pays GSA a standard level users charge for the annual rental of building space. The standard level users charge approximates the commercial rental rates for similar properties. The Commission is not legally a party to any building lease agreements; therefore, the Commission does not disclose future minimum lease payments on buildings.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(8) Commission Operating Expenses

Commission operating expenses for fiscal years 1996 and 1995 by object classification were as follows:

	1996	1995
Personal services and benefits	\$ 103,835,878	101,266,423
Travel and transportation	2,057,154	2,218,270
Rental, communications, and utilities	20,377,230	14,115,259
Printing and reproduction	1,968,087	1,799,449
Contractual services	15,344,930	33,779,631
Supplies and materials	1,548,567	8,083,714
Insurance claims and indemnities	125,062	382,014
Expenses incurred by other DOE agencies	1,481,159	975,254
 Total operating expenses	 \$ 146,738,067	 162,620,014

(9) Nonoperating Changes

Nonoperating changes that affected the net position for fiscal years 1996 and 1995 were:

	1996	1995
 Increases:		
Transfers-in:		
Current year appropriations	\$ 131,290,000	166,173,000
Transfers of cash from others (allotments received)	2,602,750	2,667,006
Recoveries of prior year appropriations	892,740	141,193
 Total increases	 134,785,490	 168,981,199
 Decreases:		
Transfers-out:		
Appropriated capital used	(155,326,841)	(167,920,651)
Change in future funding requirements	(441,187)	(466,997)
Other decreases	-	(3,979)
 Total decreases	 (155,768,028)	 (168,391,627)
 Net nonoperating changes	 \$ (20,982,538)	 589,572

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(10) Pension Expense

Commission employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). Employees participating in CSRS contribute 7 percent of their gross pay to the plan, and the Commission makes a matching contribution.

On January 1, 1987, FERS went into effect pursuant to Public Law 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, could elect either to join FERS and Social Security or remain in CSRS. FERS offers a savings plan in which the Commission automatically contributes 1 percent of employees' pay and matches any employee contribution up to an additional 4 percent of pay. For most employees hired since December 31, 1983, the Commission also contributes the employer's matching share for Social Security.

The actuarial present value of accumulated benefits, assets available for benefits, and unfunded pension liability of CSRS and FERS is not allocated to individual departments and agencies and is therefore not disclosed by the Commission. Total pension expense for both plans for fiscal years 1996 and 1995 was approximately \$8.3 and 8.6 million, respectively.

(11) Contingencies

The Commission has been named as defendant in a number of cases currently pending before the courts arising from the ordinary course of business. Management believes, based on the advice of general counsel, that such litigation and claims will be resolved without material effect on the Commission's financial position.

KPMG Peat Marwick LLP

2001 M. Street, N.W.
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Independent Auditors' Report on Internal Control Structure

The Federal Energy Regulatory Commission
United States Department of Energy:

We have audited the financial statements of the Federal Energy Regulatory Commission (the Commission) as of and for the year ended September 30, 1996, and have issued our report thereon dated December 27, 1996.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement.

The management of the Commission is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that transactions, including those relating to obligations and costs, are executed in compliance with applicable laws and regulations that could have a direct and material effect on the financial statements and any other laws and regulations that OMB, or the Commission's management have identified as being significant and for which compliance can be objectively measured and evaluated; funds, property, and other assets are safeguarded against loss from unauthorized use or disposition; transactions are executed in accordance with management's authorization and properly recorded and accounted for to permit the preparation of reliable financial reports in accordance with applicable accounting principles described in note 2 to the financial statements and to maintain accountability over the assets; and data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.



In planning and performing our audit of the financial statements of the Commission for the year ended September 30, 1996, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures, determined if they had been placed in operation, assessed control risk, and performed tests of the control structure. Our consideration included obtaining an understanding of the significant internal control policies and procedures and assessing the level of control risk relevant to (1) all significant cycles, classes of transactions, or account balances; and (2) the performance information control objectives described in the previous paragraph. Our consideration of the internal control structure was conducted to determine our auditing procedures for the purposes of expressing our opinion on the financial statements, to determine whether the internal control structure meets the objectives identified in the previous paragraph, and not provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

Our evaluation of the controls for performance information was limited to those controls designed to ensure the existence and completeness of the information. With respect to the performance measure control objective, we obtained an understanding of relevant internal control structure policies and procedures designed to permit the preparation of reliable and complete performance information, and we assessed control risk.

Our consideration of the internal control structure policies and procedures would not necessarily disclose all matters in the internal control structure that might constitute material weaknesses under standards established by the American Institute of Certified Public Accountants and OMB Bulletin 93-06. A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited, or material to a performance measure or aggregate of related performance data, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operations that we consider to be material weaknesses as defined above.

This report is intended for the information of the management of the Commission and the United States Department of Energy. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

KPMG Peat Marwick LLP

December 27, 1996

KPMG Peat Marwick LLP

2001 M. Street, N.W.
Washington, DC 20036

Independent Auditors' Report on Compliance with Laws and Regulations

The Federal Energy Regulatory Commission
United States Department of Energy:

We have audited the financial statements of the Federal Energy Regulatory Commission (the Commission) as of and for the year ended September 30, 1996, and have issued our report thereon dated December 27, 1996.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement.

Compliance with laws and regulations applicable to the Commission is the responsibility of the management of the Commission. As part of obtaining reasonable assurance that the financial statements are free of material misstatement, we tested compliance with laws and regulations that may directly affect the financial statements and certain other laws and regulations designated by OMB and Department of Energy (DOE), including the Budget and Accounting Procedures Act of 1950; Antideficiency Act; Federal Managers' Financial Integrity Act of 1982 (FMFIA); Prompt Payment Act; Debt Collection Act; Civil Service Reform Act; Cash Management Control Act of 1990; Federal Employees' Health Benefits Act; Federal Employees' Group Life Insurance Act; Federal Property and Administration Services Act of 1949; Federal Power Act (FPA); and Department of Energy Organization Act (P.L. 95-91). However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such laws and regulations. Accordingly, we do not express such an opinion.

As part of our audit, we also obtained an understanding of management's process for evaluating and reporting on internal control and accounting systems as required by FMFIA and compared the Commission's fiscal year 1996 FMFIA reports with the evaluation we conducted of the Commission's internal control structure.



The results of our tests of compliance disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*.

* * * * *

This report is intended for the information of the management of the Commission and the United States Department of Energy. This restriction is not intended to limit the distribution of the report, which is a matter of public record.

KPMG Peat Marwick LLP

December 27, 1996