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memorandum

DATE: February 24, 1998

REPLY TO

ATTN OF: IG-30

SUBJECT: Federal Energy Regulatory Commission's Fiscal Year 1997 Financial Statement Audit (CR-FC-98-01)

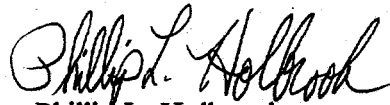
TO: Chair, Federal Energy Regulatory Commission

The attached report presents the results of the independent certified public accountants' audit of the Federal Energy Regulatory Commission's (Commission) statements of financial position, and the related statements of operations and changes in net position.

The 1997 financial statement audit was made under the provisions of the Inspector General Act of 1978 as amended, (5 U.S.C. App. 3), 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' reports on the Commission's internal control structure and compliance with laws and regulations disclosed no reportable conditions or instances of noncompliance.

Based on KPMG's unqualified opinion and our review of their audit work, we believe the financial statements fairly present the financial condition and results of operations of the Commission for the period under audit.



Phillip L. Holbrook
Acting 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
Acting Manager, Capital Regional Audit Office, IG-34


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**FEDERAL ENERGY REGULATORY
COMMISSION**

Financial Statements

September 30, 1997 and 1996

(With Independent Auditors' Report Thereon)

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FEDERAL ENERGY REGULATORY COMMISSION

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FEDERAL ENERGY REGULATORY COMMISSION FISCAL YEAR 1997 ANNUAL FINANCIAL STATEMENTS

OVERVIEW

MISSION

The Federal Energy Regulatory Commission regulates, in the public interest, essential interstate aspects of four of the nation's critical energy industries: electric power transmission and sales for resale, natural gas transportation and sales for resale, oil pipeline transportation, and nonfederal hydroelectric power. The Commission ensures that the rates, terms and conditions of service for the electric power, natural gas, and oil industries are just and reasonable and not unduly discriminatory or preferential, and that licensing, administration, and safety actions for the hydropower industry and other approvals for all four industries are consistent with the public interest. It administers numerous laws and regulations involving a number of regulatory responsibilities.

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.

The electric power industry is in the early stages of a restructuring that will bring the advantages of competition to the generation and sale of electricity. The generation sector has historically accounted for about 70 percent of the costs of the industry. If structured well, competition promises to bring significant savings to customers throughout the nation thereby benefiting individuals in making American industry more competitive in world markets. Managing the transition to competition is the most important task facing both this Commission and state public utility commissions around the country.

For over 60 years, the Commission's goal has been to protect the public by ensuring that the activities of public utilities subject to its jurisdiction adequately protect electricity consumers, while providing investors an opportunity to earn a fair return on their investment. While this basic mission has not changed, the means for achieving it have changed dramatically in recent years. Electric utilities are now operating in a much more competitive environment. Although power sales are becoming more competitive, virtually all traditional electric utilities still own and control monopoly transmission systems to deliver power to customers. Regulation is still needed to protect against the abuses of monopoly power, if a competitive bulk power market is going to thrive.

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.

Water is one of the nation's most precious resources. River systems satisfy many competing water supply and economic needs, for hydropower, irrigation, domestic and industrial uses, navigation, recreation, and preservation of environmental values. Hydropower generation represents 98 percent of the country's current renewable energy resources. The Commission has jurisdiction over about half the hydropower generation in the United States. Its job is to: (1) look at all aspects of the project proposals that come before it, including the cumulative impacts on given river systems, and consider all competing interests; (2) administer over many decades the projects and associated resource protection conditions it authorizes; and (3) ensure the safety of dams and other structures under its jurisdiction.

The Commission's regulation of nonfederal 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.

In recent years, water issues have become more important than ever, and hydropower's national roles has come under greater scrutiny. First, hydropower remains an essential national energy resource. Second, public concern about environmental issues is far greater now than even a few years ago. Third, other competing uses for water are important and politically sensitive.

The increasing awareness of hydropower development and the Commission's decisions have led to expanded participation of federal and state resource agencies, nongovernmental organizations, and the public in the Commission's regulatory processes. In recent legislation, Congress sought both to clarify the role of other agencies in the Commission's licensing process and to strike a better balance between the developmental and environmental values of concern to these entities.

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.

In the natural gas industry, the Commission's actions over the past 15 years have supported congressional mandates and fostered the emergence of basic competitive market institutions for the commodities. In that sense, the natural gas industry is several years ahead of the electric industry. Now the Commission's main challenge is to continue its regulation of gas transportation in ways that a) maintain existing competitive markets and b) foster a second generation of competitive market institutions that will remove some of the market impediments that remain today and lower the costs of trading.

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.

Natural gas access has been a success. Today, the gas market is growing and customers have more flexible, more reliable service than ever before. Gas supply curtailment of firm pipeline customers is a thing of the past. Prices fluctuate with market conditions, but average prices for all customer classes are lower than they were ten years ago (adjusted for inflation). The competitive revolution in natural gas has also had beneficial environmental effects. Gas is increasingly seen as a reliable, affordable fuel in comparison with other fuels such as coal and oil that tend to have higher emissions affecting the environment, especially air quality.

FY 1997 PERFORMANCE MEASUREMENT RESULTS

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

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

Traditionally, the Commission evaluates rate filings made by electric utilities on a cost-of-service basis. In many recent cases, however, the Commission has allowed a utility to charge market-based rates for sales of electric energy, i.e., rates negotiated by the public utility and its wholesale customer. The Commission has approved market-based rates when the seller can demonstrate that, among other things, it lacks market power. In Order No. 888, the Commission clarified and liberalized its policies for obtaining market-based rates.

In the natural gas program, the Commission provided, under the Alternatives to Cost-of-Service Ratemaking Policy Statement, refined standards for market-based rates that encourage companies to identify competitive services, and to apply for and receive market-based regulation.

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

The Commission's natural gas program developed options for performance-based regulation for areas that cannot be competitive, and established a negotiated/recourse rate program as an alternative available to pipelines that cannot demonstrate a lack of market power. During FY 1997, the Commission focused its efforts on the negotiated/recourse rate program. It accepted tariff language allowing natural gas pipelines to negotiate rates with individual customers in the tariffs of over 20 pipelines who proposed such language. In so doing, the Commission clarified the conditions to be applied to this program to ensure that non-recourse customers on a pipeline's system had adequate information to ensure non-discriminatory behavior on the part of the pipeline. The conditions further ensured that the non-recourse customers would in no way be affected by a pipeline's agreement with a negotiated rate customer.

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

Under the Policy Statement on the Treatment of Costs Relating to New Construction, the Commission determined that it was important for the marketplace to be aware of how costs relating to the construction of new natural gas facilities would be treated in a pipeline's subsequent rate case. This knowledge would allow the market to determine whether a project was viable. As a result, the Commission determined it would issue such a determination at the certificate stage of a project. In FY 1997, it has become standard procedure to address the costs and rate impact of a project in the preliminary determination, provided the pipeline can show it has contracts for the proposed capacity or the project operationally benefits the pipeline's customers as a whole.

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

In its electric program, the Commission has made great strides in substituting market forces for traditional regulation. The key to this effort has been to open up access to the nation's transmission system for sellers and buyers in the wholesale power market. The Commission's major achievement of FY 1997 was the full implementation of the open access, comparability, and stranded cost provisions of Order No. 888. This order signaled a historic change in the way transmission services are provided in the nation. The Commission anticipates that this restructuring of the electric power industry will result in substantial savings for consumers.

To further promote a competitive electric market and to support its policy of nondiscriminatory open transmission access, the Commission issued Order No. 889, Open Access Same-Time Information Systems and Standards of Conduct (OASIS). That order requires utilities with transmission to establish an electronic information and reservation system for transmission services, which transmission customers can use to check the availability and price of transmission services and to reserve space on the grid. The OASIS system began nationwide on January 3, 1997. Order No. 889 also imposes certain standards of conduct of utilities that own both generation and transmission. They must use their OASIS system for their own wholesale electric power sales and purchases, and are prohibited from exchanging certain information between their power marketers and transmission operators, except through the OASIS.

Order Nos. 888 and 889 engendered a huge compliance process because they required more than 150 utilities to file open access transmission tariffs with the Commission. To deal with these filings quickly, the Commission adopted a process of evaluating comments and issuing orders dealing with key issues comprehensively, rather than on a case-by-case basis.

In response to the emergence of open access transmission and competitive pressures, many electric utilities are opting to restructure themselves. Some mergers may enhance competition by forming more effective competitors. But others may harm competition by reducing the number of power suppliers available to customers. To protect competition in the newly emerging market environment, on December 18, 1996, the Commission issued a new Merger Policy Statement. It explains the factors used by the Commission to evaluate a merger on competition application — with particular emphasis on analyzing the effects of a proposed competition. Further, the Commission is making its regulations work better by setting out ways for merger applicants to avoid a time consuming evidentiary hearing on the effects of a proposed merger. Since the Merger Policy Statement, merger applications have been better prepared, providing the data that is needed to determine how to act on the proposed merger. The Merger Policy Statement has enabled the Commission to act promptly on over a dozen merger applications in the last nine months of 1997.

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.**

To reduce legitimate complaints that people have been excluded from environmental review processes, the Commission required that each natural gas pipeline proposing a construction project file a list of landowners affected by the route of the pipeline. The Commission mailed to these landowners all environmental information, including a description of the project and its location. The correspondence explained how the landowners could comment on the project and participate in the process. The Commission also conducted public meetings in the locales impacted by the pipeline route. In addition, the Commission prepared a landowner brochure to explain the certificate process, the rights of landowners, and the ways their opinions can be considered in the certificate process. Even though the Commission's environmental mailing lists now include thousands of affected landowners, letters still arrive indicating that landowners are not aware of proposed construction. The natural gas program will continue to seek better ways of reaching and informing affected landowners.

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

There were a large number of gas pipeline construction projects on file with the Commission, and according to press reports, more projects to be filed. The pipeline industry claimed that there is large potential growth in the gas market in the Northeastern U.S. and many pipelines proposed projects to serve this growing market. The Commission used its environmental contractors to the maximum extent to help meet the deadlines indicated by the gas markets. It maintained its natural gas environmental staff by assimilating personnel from program areas that have a declining workload. The Commission experimented with new approaches to analyzing projects, such as encouraging joint projects to minimize environmental impact and allowing the completion of environmental work in phases when possible. This measure allowed pipelines to build sections of their facilities within the time frame of the expected market demand. As a result of these actions, the Commission issued authorizations for the timely construction of over 20 major onshore pipeline projects. In conjunction with those

authorizations, the Commission issued six draft environmental impact statements and 98 environmental assessments.

The time required for environmental review in the hydropower program will decrease as more applicants select the applicant prepared environmental assessment or third-party contract processes (APEA), instead of filing an application and then having the staff prepare the required environmental documents. In FY 1997, several potential applicants used APEA processes, but none were completed. The Commission anticipates that a greater percentage of future applicants will use these new processes.

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

The Commission held outreach seminars for the natural gas industry to teach pipelines, pipeline construction contractors, and environmental consultants how to comply with environmental laws and the Commission's regulations. The Commission required environmental inspectors on construction projects to ensure that the construction methods were environmentally sound and to take corrective action before major problems developed. The Commission analyzed pipeline contractor suggestions on the procedures that it requires for construction, mitigation, and restoration of the pipeline right-of-way. The Commission made revisions where necessary to facilitate the construction of the pipeline while still protecting forests, landowner properties, wetlands, endangered species, and cultural resources through significant mitigation measures, analysis of alternatives, and strict enforcement of environmental compliance. As a result of these efforts, reports from the over 200 inspections completed during FY 1997 show an improvement in pipeline construction methods.

The Commission anticipated voluntary compliance would improve in the hydropower program. Compared to FY 1996, the number of procedural noncompliance investigations initiated in FY 1997 decreased by 42 percent. Improved compliance freed staff resources to address more complex compliance and administrative matters. The number of overdue compliance filings in FY 1997 showed a very slight increase of 3 percent over the number in FY 1996. The licensing and compliance staff continually develops communication with licensees, exemptees, federal and state agencies, and nongovernmental organizations. This approach ensures better compliance.

The Commission continues to assist hydropower project licensees and exemptees to help them understand their responsibilities under the terms and conditions of their license or exemption. In some cases, a telephone conference will suffice; in others a meeting at the project with all involved parties is necessary. These conferences can involve detailed explanations and guidance on settlement agreements, project operations, and compliance requirements.

Another tool to achieve a better rate of voluntary compliance in the hydropower program is the compliance audit. Multi-disciplinary teams conduct on-site investigations to anticipate, identify, and solve compliance problems. These visits, involving discussion of problems and possible solutions, foster better communication. Spotting problems before they become serious can save a licensee or exemptee and the Commission time and money. A substantial investment in staff resources and time is required, but results in better long-term compliance results.

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

In FY 1996, 89 dams under Commission jurisdiction were undergoing remedial work; in FY 1997, this number was reduced to 70, a decrease of 21 percent. This decrease in necessary remedial work demonstrates that a greater percentage of dams met current safety

guidelines at the end of FY 1997. As its top priority, the Commission continues to make sure the dams under its jurisdiction are safe. The dam safety program is flexible, allowing it to assimilate advances in technology and new technical challenges presented by the aging water resources infrastructure. With a state-of-the-art dam safety program, the Commission identifies those projects structures requiring remediation. Through this program it ensures that these structures meet the Commission's Engineering Guidelines and conform to the Federal Guidelines for Dam Safety. To ensure accurate and timely identification of future deficiencies, the Commission is monitoring performance to identify which structures have deficiencies, or are developing them, before they become major dam safety problems. This will ensure the safety of the public and will also reduce the costs of remediation.

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

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

As interpreted by KPMG Peat Marwick LLP, the Commission continues to receive an unqualified opinion on its financial statements along 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 total budgetary resources for the fiscal year.**

The Commission's FY 1997 performance in this area improved significantly over previous years, with costs recorded against current year obligations coming within 5.6 percent of total budgetary resources. This improvement is due, in large part, to having reduced the unobligated carryover to just \$3.5 million (from the all-time high of \$33 million in FY 1995). The progress also attests to the effectiveness of an awareness program for 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.

- **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 1997 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 4,686 payments were made to vendors in FY 1997, 4,679 of which were paid on time in accordance with the Prompt Payment Act, an on-time payment rate of 99.9 percent. The average processing time for payments to internal customers was four days, counting the date the travel voucher is received and the date of payment for all vouchers. A total of 2,986 vouchers were processed for payments to internal customers in FY 1997. Performance measurement tallies are based on the Commission's Performance Measurement Report transmitted to DOE for the quarter ended September 30, 1997.

FY 1998 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:

- improve public notice procedures for construction and facility impacts where possible;
- 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 opinion on the Annual Financial Statements.

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

Pay 95 percent of all payments accurately and on time; vendors within the time required by the Prompt Payment Act and; internal customers in 5 days or less.

Meet or exceed planned due dates 90 percent of the time for performing and completing Federal Managers' Financial Integrity Act requirements and internal financial and performance reviews.

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 of the Chief Financial Officers Act of 1990 and with the form and content for entity financial statements specified by the Office of Management and Budget in Bulletin Nos. 94-01 and 97-01.
- 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.

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, 1997 and 1996, 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; the standards applicable to financial audits contained in *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*, as amended, except for those portions of the Bulletin that relate to the Federal Financial Management Improvement Act (FFMIA) of 1996. The Department of Energy Office of Inspector General is responsible for determining compliance with FFMIA. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether 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, 1997 and 1996, 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.

As discussed in note 12 to the financial statements, the Commission implemented Statements of Federal Financial Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*, and No. 6, *Accounting for Property, Plant, and Equipment*, and changed its method for accounting for the net difference between annual charges and amounts returned to Treasury, effective October 1, 1996.

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 Nos. 94-01 and 97-01, *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 internal control over financial reporting in accordance with OMB Bulletin No. 93-06, as amended.

In accordance with *Government Auditing Standards*, we have also issued reports dated December 19, 1997, on our consideration of the Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws and regulations.

This report is intended for the information of the management of the Commission and the United States Department of Energy. However, this report is a matter of public record and its distribution is not limited.

KPMG Peat Marwick LLP

December 19, 1997

FEDERAL ENERGY REGULATORY COMMISSION

Statements of Financial Position

September 30, 1997 and 1996

Assets	1997	1996
Entity assets:		
Intragovernmental assets:		
Fund balances with Treasury (note 3)	\$ 33,248,383	41,467,439
Governmental assets:		
Accounts receivable, net (notes 4 and 5)	4,735,037	1,767,875
Employee travel advances	22,111	52,751
Cash	5,000	5,000
Property and equipment, net (note 6)	18,271,565	22,516,573
Total entity assets	56,282,096	65,809,638
Non-entity assets:		
Intragovernmental assets:		
Fund balances with Treasury (note 3)	2,775,022	2,783,111
Accounts receivable	-	1,508
Governmental assets:		
Accounts receivable, net (note 5)	883,694	783,953
Total non-entity assets	3,658,716	3,568,572
Total assets	\$ 59,940,812	69,378,210

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Statements of Financial Position

September 30, 1997 and 1996

Liabilities and Net Position	1997	1996
Liabilities:		
Liabilities covered by budgetary resources:		
Intragovernmental liabilities:		
Accounts payable	\$ 492,660	780,343
Collections due to states	2,721,793	2,649,489
Resources transferable to Treasury (note 5)	5,597,004	783,953
Miscellaneous receipts held in suspense	17,080	72,107
Government liabilities:		
Accounts payable	5,342,897	5,320,314
Lease liabilities	-	15,026
Accrued payroll and benefits	4,827,101	4,366,428
Revenue collected under protest	10,819,991	7,061,762
Total liabilities covered by budgetary resources	29,818,526	21,049,422
Liabilities not covered by budgetary resources:		
Accrued leave	8,535,381	8,112,524
Workers' compensation	246,795	256,523
Total liabilities	38,600,702	29,418,469
Net position:		
Unexpended appropriations:		
Unobligated and available	3,479,532	10,134,612
Undelivered orders	8,371,189	13,956,503
Invested capital	18,271,565	22,516,573
Cumulative results of operations	-	1,721,100
Future funding requirements	(8,782,176)	(8,369,047)
Total net position	21,340,110	39,959,741
	\$ 59,940,812	69,378,210

The accompanying notes are an integral part of these statements.

FEDERAL ENERGY REGULATORY COMMISSION

Statements of Operations and Changes in Net Position

Years ended September 30, 1997 and 1996

	1997	1996
Revenue and financing sources:		
Appropriated capital used:		
Commission	\$ 162,530,518	152,577,352
Department of Energy Dam Safety allotment received	-	100,000
Collections for states	2,721,793	2,649,489
Revenue from public sources:		
Annual charges and filing fees	211,539,349	196,835,465
Interest and penalties	534,548	490,281
Other revenue and financing sources		
Imputed financing - pension benefits paid by Office of Personnel Management (note 10)	8,353,174	-
Intragovernmental reimbursable work agreement - Nuclear Regulatory Commission	33,553	14,312
	385,712,935	352,666,899
Less - revenues returned to Treasury and other agencies	(212,536,294)	(199,637,400)
Total revenue and financing sources	173,176,641	153,029,499
Expenses:		
Operating expenses:		
Commission (note 8)	166,085,664	146,738,067
Department of Energy Dam Safety allotment used	-	100,000
Payments to states	2,721,793	2,649,489
Cost of services provided:		
Intragovernmental - Nuclear Regulatory Commission	33,553	14,312
Depreciation	2,481,004	4,710,342
Loss on disposal of property, plant, and equipment	-	1,128,943
Provision for (recovery of) bad debts	(462,398)	8,020,975
Unfunded expenses - accrued leave and workers' compensation	413,129	441,187
Total expenses	171,272,745	163,803,315
Excess (deficiency) of revenue and financing sources over total expenses	1,903,896	(10,773,816)
Add unfunded expenses	413,129	441,187
Cumulative effect of change in accounting principle (note 12)	(2,317,025)	-
Deficiency of revenue and financing sources over funded expenses	\$ -	(10,332,629)
Net position, beginning of year	\$ 39,959,741	71,274,908
Prior period adjustment (note 12)	(1,721,100)	-
Net position, beginning of year, as restated	38,238,641	71,274,908
Deficiency of revenue and financing sources over funded expenses	-	(10,332,629)
Net nonoperating changes (note 9)	(16,898,531)	(20,982,538)
Net position, end of year	\$ 21,340,110	39,959,741

The accompanying notes are an integral part of these statements.

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

September 30, 1997 and 1996

(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 1,000 (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 DOE to other DOE agencies. In addition, the Commission receives small allotments from three DOE appropriations: (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 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 or expense.

(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 a payment is not received on a timely basis. Revenue is recognized for filing fees when received.

The Commission recognizes an imputed financing source for the estimated annual pension costs in excess of contributions made by the Commission during the year. These costs will ultimately be funded by the Office of Personnel Management.

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

Revenues returned to Treasury and other agencies represent receipts collected and remitted to Treasury and other agencies during the year and net accounts receivable that, once collected, will be returned to Treasury.

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, 1997 and 1996, respectively.

Allowance for Doubtful Accounts

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

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(2) Continued

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation. Prior to October 1, 1996, the Commission capitalized property (other than furniture) and equipment purchases with a cost greater than \$5,000, and a total useful life exceeding two or more years. Effective October 1, 1996, the Commission increased this cost threshold to \$25,000 (see note 12). 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.

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.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(2) Continued

Net Position Accounts

Net position account balances consist of the following components:

Unexpended appropriations – Represents 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 – For 1996, 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). As described in notes 5 and 12, the Commission began reflecting this net difference as a liability to Treasury in 1997.

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.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(3) Fund Balances with Treasury

Fund balance with Treasury at September 30, 1997 consisted of:

	Obligated	Unobligated		Total
		Unrestricted	Restricted	
Entity:				
Appropriated fund balance with Treasury	\$ 18,948,860	3,479,532	-	22,428,392
Revenue collected under protest*	-	10,819,991	-	10,819,991
Total entity fund balance with Treasury	18,948,860	14,299,523	-	33,248,383
Non-entity:				
Appropriated fund balance with Treasury	36,149	-	-	36,149
Collections due to states	-	-	2,721,793	2,721,793
Miscellaneous receipts held in suspense	-	17,080	-	17,080
Total non-entity fund balance with Treasury	36,149	17,080	2,721,793	2,775,022
Total fund balance with Treasury	\$ 18,985,009	14,316,603	2,721,793	36,023,405

Fund balance with Treasury at September 30, 1996 consisted of:

	Obligated	Unobligated		Total
		Unrestricted	Restricted	
Entity:				
Appropriated fund balance with Treasury	\$ 24,271,065	10,134,612	-	34,405,677
Revenue collected under protest*	-	7,061,762	-	7,061,762
Total entity fund balance with Treasury	24,271,065	17,196,374	-	41,467,439
Non-entity:				
Appropriated fund balance with Treasury	61,515	-	-	61,515
Collections due to states	-	-	2,649,489	2,649,489
Miscellaneous receipts held in suspense	-	72,107	-	72,107
Total non-entity fund balance with Treasury	61,515	72,107	2,649,489	2,783,111
Total fund balance with Treasury	\$ 24,332,580	17,268,481	2,649,489	44,250,550

*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, 1997 consisted of:

	Annual charges	Other	Total
Uncollected billings	\$ 13,363,770	25,810	13,389,580
Allowance for doubtful accounts	(8,650,460)	(4,083)	(8,654,543)
Total net accounts receivable	\$ 4,713,310	21,727	4,735,037

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

(5) Resources Transferable to Treasury

Resources transferable to Treasury reflect the amount of accounts receivable, excluding refunds; that are outstanding as of September 30, 1997. For 1996, resources transferable to Treasury reflect the amount of non-entity accounts receivable that are outstanding as of September 30, 1996 (see note 12). Resources transferable to Treasury consist of:

	1997	1996
Entity accounts receivable	\$ 13,363,770	-
Allowance for doubtful entity accounts	(8,650,460)	-
Total net entity accounts receivable	4,713,310	-
Non-entity accounts receivable	2,737,090	2,378,637
Allowance for doubtful non-entity accounts	(1,853,396)	(1,594,684)
Total net non-entity accounts receivable	883,694	783,953
Total resources transferable to Treasury	\$ 5,597,004	783,953

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, 1997 consisted of:

	Depreciation method	Service life	Acquisition value	Accumulated depreciation	Net book value
Equipment	Straight-line	5 years	\$ 5,254,353	3,561,644	1,692,709
Furniture	Straight-line	10 years	9,070,773	1,676,200	7,394,573
Leasehold improvements	Straight-line	20 years	10,129,300	970,641	9,158,659
ADP software	Straight-line	2 years	3,434,041	3,408,417	25,624
Total			\$ 27,888,467	9,616,902	18,271,565

For the period ended September 30, 1997, the Commission wrote off \$4,588,224 of equipment and related accumulated depreciation of \$2,271,199 as a result of the Commission's change in capitalization threshold (see note 12).

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

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(7) Leases

Operating Leases

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 on these leases are 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.

(8) Commission Operating Expenses

Commission operating expenses for fiscal years 1997 and 1996 by object classification were as follows:

	1997	1996
Personal services and benefits	\$ 114,982,784	103,835,878
Travel and transportation	2,027,486	2,057,154
Rental, communications, and utilities	20,367,313	20,377,230
Printing and reproduction	2,345,193	1,968,087
Contractual services	20,469,449	15,344,930
Supplies and materials	1,512,389	1,506,128
Equipment not capitalized	3,760,484	42,439
Insurance claims and indemnities	28,220	125,062
Expenses incurred by other DOE agencies	592,346	1,481,159
Total operating expenses	\$ 166,085,664	146,738,067

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(9) Nonoperating Changes

Nonoperating changes that affected the net position for fiscal years 1997 and 1996 were:

	1997	1996
Increases:		
Transfers-in:		
Current year appropriations	\$ 146,290,000	131,290,000
Transfers of cash from others (allotments received)	2,683,042	2,602,750
Recoveries of prior year appropriations	917,669	892,740
Total increases	149,890,711	134,785,490
Decreases:		
Transfers-out:		
Appropriated capital used	(165,252,311)	(155,326,841)
Change in future funding requirements	(413,129)	(441,187)
Other	(1,123,802)	-
Total decreases	(166,789,242)	(155,768,028)
Net nonoperating changes	\$ (16,898,531)	(20,982,538)

(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.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(10) Continued

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 paid by the Commission for both plans for fiscal years 1997 and 1996 was approximately \$8.9 million and \$8.5 million, respectively. During fiscal year 1997, an additional \$8.3 million of pension expense was recognized by the Commission for amounts that will ultimately be funded through the Office of Personnel Management (OPM) (see note 12).

(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.

(12) Changes In Accounting Principles

Capitalization Policy

In fiscal year 1997, the Commission adopted the provisions of the FASAB's Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*.

In conjunction with the implementation of SFFAS No. 6, the Commission changed its policy for the capitalization of equipment, increasing the threshold for capitalization from \$5,000 to \$25,000 effective October 1, 1996. The new capitalization threshold, which was adopted to reduce administrative costs, has been applied retroactively to equipment acquisitions of prior years. The cumulative effect of this change in accounting principle on fixed assets as of October 1, 1996, resulted in a loss of \$2,317,025. Implementation of SFFAS No. 6 had no other material accounting or reporting impact on the Commission.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(12) Continued

Pension Expense

In fiscal year 1997, the Commission adopted the provisions of SFFAS No. 5, *Accounting for Liabilities of the Federal Government*. The provisions of SFFAS No. 5 require an employer entity to recognize pension expense equal to the service cost for its employees for the year based on the pension plan's actuarial cost method and assumptions. The difference between pension expense and contributions made by the entity should be reported as an imputed financing source. As a result, the Commission recognized total pension expense of \$17.2 million for the year ended September 30, 1997, and an imputed financing source of \$8.3 million to reflect the portion of 1997 pension expense that will ultimately be funded by OPM. Implementation of SFFAS No. 5 had no other material accounting or reporting impact on the Commission.

Net Difference Between Annual Charges and Amounts Returned to Treasury

Effective for fiscal year 1997, the Commission changed its accounting and reporting for the net difference between annual charges and amounts returned to Treasury to more accurately reflect the nature of the difference. The difference equals net accounts receivable from annual charges that will offset future years' appropriations, when collected. The Commission had previously reported the difference as cumulative results of operations within net position. However, during fiscal year 1997, the Commission recorded a prior period adjustment of \$1,721,100 to eliminate the balance of cumulative results of operations. In addition, the Commission recorded the accumulated net difference as of September 30, 1997 as resources transferable to Treasury, a liability account, and an increase in revenues returned to Treasury and other agencies to demonstrate that the Commission will remit such amounts to Treasury when collected.

Independent Auditors' Report on Internal Control over Financial Reporting

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, 1997, and have issued our report thereon dated December 19, 1997. Our report referred to the Commission's changes in certain accounting principles. We conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *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*, as amended.

The management of the Commission is responsible for establishing and maintaining internal controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal controls 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 internal controls, fraud may nevertheless occur and not be detected. Also, projection of any evaluation of internal controls 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, we considered the Commission's internal control over financial reporting in order to determine our auditing procedures for the purposes of expressing our opinion on the financial statements, and not to provide an opinion on the internal control over financial reporting. Accordingly, we do not express such an opinion. With respect to internal controls, 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 internal controls.

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 policies and procedures designed to permit the preparation of reliable and complete performance information, and we assessed control risk.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements 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. Our consideration of internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses under standards established by the American Institute of Certified Public Accountants and OMB Bulletin 93-06, as amended. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted other matters involving internal control and its operation that we have reported to management of the Commission in a separate letter.

This report is intended for the information of the management of the Commission and the United States Department of Energy. However, this report is a matter of public record and its distribution is not limited.

KPMG Peat Marwick LLP

December 19, 1997

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, 1997, and have issued our report thereon dated December 19, 1997. Our report referred to the Commission's changes in certain accounting principles. We conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *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*, as amended, except for those portions of the Bulletin that relate to the Federal Financial Management Improvement Act (FFMIA) of 1996. The Department of Energy Office of Inspector General is responsible for determining compliance with FFMIA.

The management of the Commission is responsible for complying with laws and regulations applicable to the Commission. As part of obtaining reasonable assurance about whether the Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin 93-06, as amended. However, providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit. Accordingly, we do not express such an opinion.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* and OMB Bulletin No. 93-06, as amended.

This report is intended for the information of the management of the Commission and the United States Department of Energy. However, this report is a matter of public record and its distribution is not limited.

KPMG Peat Marwick LLP

December 19, 1997

KPMG Peat Marwick LLP

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

January 29, 1998

Federal Energy Regulatory Commission:

We have audited the financial statements of the Federal Energy Regulatory Commission (the Commission or FERC) as of and for the year ended September 30, 1997, and have issued our report thereon dated December 19, 1997. In planning and performing our audit, we considered the Commission's internal controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal controls. We have not considered internal controls since the date of our report.

During our audit, we noted certain matters involving internal controls and other operational matters that are not considered reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*, as amended, and are presented for your consideration. These comments and recommendations, which we have discussed with Commission management, are intended to improve internal controls or result in other operating efficiencies and are summarized in Exhibit A.

We would be pleased to discuss these comments and recommendations with you at any time. This report is intended solely for the information and use of the Commission's management and should not be used for any other purpose.

Very truly yours,

KPMG Peat Marwick LLP

EXHIBIT A

PERFORMANCE MEASURES

Condition:

The *Overview* section of FERC's fiscal year (FY) 1997 financial statements is incomplete and does not provide sufficient program performance and comparative data to effectively measure FERC's performance during the year.

Criteria:

Per OMB Bulletin No. 94-01, *Form and Content of Agency Financial Statements*, federal agencies are required to develop and provide financial, statistical and other information for presentation in the *Overview* section of their financial statements. The *Overview* should describe the "reporting entity, its mission, activities, accomplishments, and overall financial results and condition." The accomplishments section should include "explicit measures of program performance," including outputs and outcomes.

To meet the mandates of the Chief Financial Officers Act, Government Performance and Results Act (GPRA), Government Management Reform Act, and other related publications, the following additional information should be reported in the *Overview*:

1. Information that links financial results to program performance;
2. Program and financial accomplishments of the entity in relation to its mission and objectives; and
3. Both ongoing and planned financial and program initiatives.

Cause:

In FY 1996, the program offices compiled their annual performance statistics for inclusion in the *Overview*. However, this practice was discontinued, and the program offices did not compile this information during FY 1997.

Effect:

Performance measure information included for the FY 1997 *Overview* is incomplete. The incomplete *Overview* section causes FERC to be in non-compliance with OMB Bulletin No. 94-01 and does not provide the reader with sufficient quantitative information to assess FERC's FY 1997 performance against its goals and objectives.

Recommendation:

We recommend that FERC's Department of Financial Services ensure that:

1. All program offices compile established goals/measurements to provide reliable and sufficient quantitative information for inclusion in FERC's *Overview*.
2. A detailed list of all personnel who contributed to the *Overview* is maintained to easily identify contacts for questions and clarification of *Overview* data; and

3. A review of applicable regulations is performed to identify and address items not included in the FY 1997 *Overview*, to ensure compliance with these regulations within the required time frame, and to enhance clarity within the reports.

Auditee Response:

The FY 1997 measurements reported in the *Overview* address the results of each program's performance for the year. The offices were furnished their respective measurements and they provided responses on their results. We agree they do not contain as many statistics as in previous years. However, quantitative information is not the only form of measurement. The responses included accomplishments as they related to their program's objectives and initiatives. As the Commission implements GPRA and the Strategic Plan, the performance measurements and their results will eventually include quantitative information which should conform with the audit requirements. It will be an evolutionary process, and will be fine tuned each year.

For the FY 1998 performance measurements, the program offices will be requested to provide more statistics in their responses. The results will be reviewed to ensure they include the quantitative aspects of their performance prior to inclusion in the *Overview* for the FY 1998 financial statements.

NON-OPERATING CHANGES

Condition:

FERC's FY 1997 non-operating changes note discloses an "other" decrease of approximately \$1.12 million. FERC cannot identify the nature of this decrease.

Criteria:

Per OMB Bulletin 94-01, *Form and Content of Agency Financial Statements*, federal agencies are required to disclose the detail of non- operating changes in the notes to their financial statements.

Cause:

This condition is most likely caused by accounting entries that reduce equity but do not properly increase appropriated capital used.

Effect:

Since FERC cannot identify the nature of the \$1.12 million decrease, it may not be properly classified in the non-operating changes note.

Recommendation:

We recommend that FERC review each accounting entry that affects equity, determine if the entry should affect appropriated capital used, and determine if the proper entry, if any, is simultaneously made to appropriated capital used. This process will help identify the specific cause of the \$1.12 million unidentifiable difference.

Auditee Response:

We have researched extensively the difference noted on the footnote for non-operating changes and recognize this difference cannot be identified. Conversations were held with OMB and they agree minimal guidance was provided on the preparation of this note. In addition, they have recognized the difficulty in actually getting the note to flow. Inquires to other agencies were made with respect to this note and some agencies did not reflect this note within their financial statement packages. DOE is one such agency. However, we understand we could not omit this because it would reflect non-compliance with OMB Bulletin No. 94-01.

A serious effort was made in reviewing each individual line item on our income statement, and we feel confident with their respective numbers. Therefore, we do not feel this adjustment should be made, thereby increasing our appropriated capital used and our operating expenses. Since we use these balances as a basis for billing industry for the costs of the Commission, we do not feel an accounting adjustment so the footnote flows is warranted. We want the difference to be reflected in the note instead. Since we do not consider the number to be material as it relates to our total expenses, we are committed to recognizing the difference in the note in accordance with the OMB guidance.

BACKUP RECORDS**Condition:**

Weekly full backups are created for the operating system and application program files on Friday evenings. These backups are transported off-site on the following Monday. Weekly full backup tape sets are stored off-site for 28 days prior to being returned on-site to be destroyed.

Criteria:

Federal Information Processing Standards (FIPS) Publication 31, section 8.5 indicates that backup media should be maintained in off-site storage for an appropriate period of time. The industry standard for full backup media is generally six months.

Effect:

Damage to backup media while retained on-site could result in the inability to restore historical data older than 28 days. This data includes audit trail related information which may be needed for any type of historical trend analysis or for performing investigative related activities.

Recommendation:

We recommend a conventional grandfather-father-son tape backup and recovery approach. This utilizes daily incremental backups with a weekly full backup taken off-site. Weekly full backups are then appended into a monthly backup set. The monthly backup set should be maintained in off-site storage for a minimum of six months to ensure a reasonable availability for recovery of financial data which may be lost or destroyed.

Auditee Response:

We concur. The ADP and Telecommunications Services Division (ATSD) will work with off-site tape storage vendor to work out a six month rotation schedule for the weekly backup tapes.

DISASTER RECOVERY TESTING

Condition:

Testing of the FERC HP3000 Disaster Recovery Plan is not performed on a consistent basis. The last test was performed in April 1995.

Criteria:

FEDERAL REGISTER Vol. 61, No. 34 revision to OMB Circular A-130 indicates the following:

(d) Contingency Planning. Establish and periodically test the capability to perform the agency function supported by the application in the event of failure of its automated support. Normally the Federal mission supported by a major application is critically dependent on the application. Manual processing is generally not a viable backup option. Managers should plan for how they will perform their mission and/or recover from the loss of existing application support, whether the loss is due to the inability of the application to function or a general support system failure. Experience has demonstrated that testing a contingency plan significantly improves its viability. Indeed, untested plans or plans not tested for a long period of time may create a false sense of ability to recover in a timely manner.

Effect:

Without periodic testing, FERC management may not identify all possible disaster/business disruptions associated with the HP3000 resulting in the unavailability of data.

Recommendation:

The HP3000 Disaster Recovery Plan should be tested on an annual basis with the results documented. The test should include a disaster or business interruption scenario, the results of testing, and any recommendations for future consideration based on the testing.

Auditee Response:

We concur. ATSD is currently working with an independent disaster recovery vendor to develop a disaster recovery plan that includes all platforms (HP, IBM, RS/6000, LAN). These plans include actual testing of the plans.

CUSTOMER RESPONSE FORM

The Office of Inspector General has a continuing interest in improving the usefulness of its products. We wish to make our reports as responsive as possible to our customers' requirements, and, therefore, ask that you consider sharing your thoughts with us. On the back of this form, you may suggest improvements to enhance the effectiveness of future reports. Please include answers to the following questions if they are applicable to you:

1. What additional background information about the selection, scheduling, scope, or procedures of the audit would have been helpful to the reader in understanding this report?
2. What additional information related to findings and recommendations could have been included in this report to assist management in implementing corrective actions?
3. What format, stylistic, or organizational changes might have made this report's overall message more clear to the reader?
4. What additional actions could the Office of Inspector General have taken on the issues discussed in this report which would have been helpful?

Please include your name and telephone number so that we may contact you should we have any questions about your comments.

Name _____ Date _____

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When you have completed this form, you may telefax it to the Office of Inspector General at (202) 586-0948, or you may mail it to:

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Department of Energy
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If you wish to discuss this report or your comments with a staff member of the Office of Inspector General, please contact Wilma Slaughter at (202) 586-1924.