

requirements are needed because these types of transactions and events are not clearly or consistently reported. This rule is part of the Commission's ongoing effort to address emerging accounting developments within the context of the Uniform Systems of Accounts.

5. The accounting for asset retirement obligations in this rule is consistent with the accounting and reporting requirements that jurisdictional entities will use in their general purpose financial statements provided to shareholders and the Securities Exchange Commission (e.g., companies will separately account and report the liability for the asset retirement obligations, capitalize the asset retirement costs, charge earnings for depreciation of the asset and charge operating expense for the accretion of the liability).

6. The Commission is also revising its rate filing requirements to accommodate the above-mentioned changes. In that regard, the accounting for asset retirement obligations will not affect jurisdictional entities' ability to seek recovery of costs arising from asset retirement obligations in rates. However, if billings under formula rate tariffs are affected by the adoption of these accounting requirements, the jurisdictional entity must obtain approval from the Commission prior to implementing the change for tariff billing purposes.

7. Finally, the Commission is revising the following Annual Reports: FERC Form No. 1, Annual Report of Major Public Utilities, Licensees and Others (Form 1); FERC Form No. 1-F, Annual Report of Nonmajor Public Utilities and Licensees (Form 1-F); FERC Form No. 2, Annual Report of Major Natural Gas Companies (Form 2); FERC Form No. 2-A, Annual Report of Nonmajor Natural Gas Companies (Form 2-A); and FERC Form No. 6, Annual Report of Oil Pipeline Companies (Form 6) to include the new accounts and the revised schedules.⁶

II. Background

8. The recognition and measurement of legal liabilities associated with the retirement and decommissioning of long-lived assets by various entities, including Commission jurisdictional entities, have been inconsistent over the years. Some jurisdictional entities do not recognize asset retirement

obligations in their accounts while other jurisdictional entities only recognize the amounts included in the rate setting process as a component of accumulated depreciation. The Commission, in an effort to eliminate the inconsistencies in accounting practices by jurisdictional entities for asset retirement obligations, issued its October 30, 2002 Notice of Proposed Rulemaking to revise the accounting regulations, FERC Annual Report Forms and rate filing requirements for asset retirement obligations.⁷

9. The scope of the NOPR covered certain legal obligations associated with the future retirement of long-lived assets. These obligations, generally referred to as asset retirement obligations, are legal obligations associated with the retirement of a tangible long-lived asset that an entity is required to settle as a result of an existing enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel.⁸

10. In the NOPR, the Commission broadly set forth the proposed accounting framework for asset retirement obligations as follows:

11. An entity essentially recognizes a liability for the fair value of an asset retirement obligation at the time the asset is constructed, acquired, or when a change in the law creates a legal obligation to perform the retirement activities. Upon initial recognition of that liability, an entity also increases the cost of the related asset that gives rise to the legal obligation by the same amount. The liability is increased over time until the actual retirement activity commences. Additionally, the asset retirement cost capitalized is depreciated over the same life of the related asset giving rise to the obligation. An entity is required to re-measure the liability due to the passage of time and certain other changes in the estimate of the liability.

12. Entities will be required to recognize the liabilities for asset retirement obligations and the related costs as if the new standard had been in effect for all prior periods. The difference between the amounts at the date of adoption and the amounts previously recorded for these items are to be included in net income unless the criteria for recognition of regulatory

assets or liabilities are met under Order No. 552.⁹

III. Discussion

13. The Commission received 16 comments concerning various aspects of the proposed rule.¹⁰ The majority of the commenters were generally supportive of the Commission's effort to provide interpretative guidance on the application of generally accepted accounting principles to jurisdictional entities that presently file financial information with the Commission in Annual Report Forms 1, 1-F, 2, 2-A, and 6.¹¹

14. After careful consideration of the comments received, the Commission is adopting the changes and revisions as proposed with certain modifications and clarifications as discussed below.

A. Accounting for the Cumulative Effect Adjustment

15. Upon initial implementation of the new accounting requirements for asset retirement obligations the Commission proposed that jurisdictional entities establish in their accounts all of the amounts that would have been recorded therein had these new requirements always been in effect. The NOPR referred to the accounting entries required to implement this part of the proposal as "transition adjustments." In certain instances, the transition adjustments could result in a charge or credit to net income. This charge or credit is referred to as the "cumulative effect adjustment" because it represents the cumulative difference between all amounts charged to net income for asset retirement obligations in past periods under the prior accounting method and what would have been charged to net income in those periods had these new accounting requirements set forth in the NOPR always been in effect. For rate regulated entities the cumulative effect adjustment amounts will be recognized as a regulatory asset or liability if the requirements of Commission Order No. 552 are met.¹²

16. The Commission proposed to record the cumulative effect adjustment

⁶ The FERC Annual Reports bear the following OMB approval control numbers: Form 1 has OMB approval number 1902-0021; Form 1-F has OMB approval number 1902-0029; Form 2 has OMB approval number 1902-0028; Form 2-A has OMB approval number 1902-0030; and Form 6 has OMB approval number 1902-0022.

⁷ See *supra* note 1.

⁸ See Financial Accounting Standards Statement (FAS) No. 143, Accounting for Asset Retirement Obligations, issued in June 2001. The accounting publication may be obtained from FASB at <http://www.fasb.org/>. Appendix A, paragraphs A2 through A5, contains a discussion of legal obligations.

⁹ See Order No. 552, 58 FR 17982 (Apr. 7, 1993), FERC Stats. & Regs., Regulations Preambles January 1991-June 1996 ¶ 30,967 at pp. 30,823-26 (Mar. 31, 1993) for guidance on the recognition of regulatory assets and regulatory liabilities when certain conditions are met.

¹⁰ See Appendix A for Listing of Commenters.

¹¹ See Arkansas PSC at p. 2, Deloitte & Touche at p. 1, FirstEnergy at p. 2, NASUCA at pp. 2-3, NRECA at pp. 3-4, Progress Energy at p. 1 and Southern at p. 1.

¹² See Order No. 552, *supra* note 9, for guidance on the recognition of regulatory assets and regulatory liabilities when certain conditions are met.