

ACCOUNTING FOR REGULATORY ACTIVITY

Why Should You Care?

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Objectives

- ▶ Discuss the relationship between Regulatory and Accounting activities within the pipeline organization
- ▶ Understand accounting and other data relied on for regulatory purposes
- ▶ Appreciate the importance of maintaining accurate data

Introduction

Oil Pipeline Accounting

Introduction

Oil Pipeline Accounting

- ▶ Regulated US oil pipelines accounting requirements are governed by:
 - ▶ Generally Accepted Accounting Principles (GAAP / IFRS)
 - ▶ Internal Revenue Service
 - ▶ Federal Energy Regulatory Commission (FERC)
 - ▶ State Agencies
- ▶ Accounting data relied on for regulatory and commercial analysis:
 - ▶ Acquisitions / sales
 - ▶ Asset performance and management
 - ▶ Cost of Service - rate filings
 - ▶ Cost of Service - Page 700

Introduction

Oil Pipeline Accounting

Internal vs. FERC External Reporting

Internal	FERC External
Report level - discretion of management	Report at entity level
Revenue	Revenue
Expense	Expense
Depreciation	Depreciation
Income Taxes	Income Taxes
Accounting Adjustments	Accounting Adjustments
Net Income	Net Income
Non-Financial Metrics	Statistics of Operations

Understand the purpose and basis of each presentation

Introduction

Oil Pipeline Accounting

FERC Accounting Guidance

- ▶ Uniform System of Accounts (“USoA”) - 18 CFR §352
 - ▶ Accounting requirements for oil pipeline companies subject to the provisions of the Interstate Commerce Act
- ▶ FERC Reporting Instructions
 - ▶ Forms No. 6 and 6Q; Annual & Quarterly Reports for Oil Pipelines
- ▶ Oil Pipeline Industry Accounting Guideline
- ▶ FERC Oil Pipeline Audits

Regulatory Analysis

Tariff Rates

Regulatory Analysis

Tariff Rates - Overview

- ▶ Amount Charged for Pipeline Transportation & Services
- ▶ Company Operating Revenues
- ▶ Interstate Pipelines - Regulated by the FERC
- ▶ Intrastate Pipelines - Regulated by Various State Agencies
- ▶ Subject to Protest / Complaint

Regulatory Analysis

Tariff Rates - Overview

- ▶ FERC Ratemaking Methodology (18 CFR §342)
 - ▶ Index
 - ▶ Market-Based Rates
 - ▶ Cost-of-Service
 - ▶ Settlement
- ▶ State Ratemaking Methodology

Does the basis of tariff rates matter?

Regulatory Analysis

Tariff Rates - Overview

- ▶ Subject to FERC Audit
 - ▶ Transportation Rates on File
 - ▶ Non-Transportation Rates and Other Charges
 - ▶ Tariff Rules and Regulations

Regulatory Analysis

Tariff Rates - Cost of Service

- ▶ Means to justify transportation charges
 - ▶ Initial rate filings (18 CFR §342.2)
 - ▶ Rate increases - if substantial divergence test is met (18 CFR §342.4)
 - ▶ Filing requirements established in 18 CFR §346
- ▶ Methodology relied on in event of protest
- ▶ Oil Pipeline FERC Form 6, Page 700
 - ▶ Subject to FERC Audit
- ▶ Data must be accurate & defensible

Regulatory Analysis

Tariff Rates - Cost of Service

Cost of Service Elements

- ▶ Rate Base
 - ▶ Carrier Property history
 - ▶ Accumulated Depreciation
 - ▶ Working Capital
- ▶ Operating Expense
 - ▶ Operating & Maintenance
 - ▶ General & Administrative
 - ▶ Depreciation
- ▶ Tax Allowance (excluding MLP's)

Regulatory Analysis

Tariff Rates - Cost of Service

Simplified Cost of Service Calculation:

$$\begin{aligned} & \text{Computed Rate Base} \\ \times & \text{ Rate of Return} \\ = & \text{Return on Rate Base} \\ + & \text{ Operating Expenses } \\ = & \text{Cost of Service} \\ - & \text{ Operating Revenue } \\ = & \text{Headroom} \end{aligned}$$

Regulatory Use of Accounting Data

Cost of Service

Regulatory Use of Accounting Data

Cost of Service

- ▶ Rate Base
 - ▶ Carrier property activity
 - ▶ New construction
 - ▶ Acquisitions
 - ▶ Sales
 - ▶ Accumulated Depreciation
 - ▶ Depreciation rates - FERC approved
 - ▶ Sales (gains / losses)
 - ▶ Working Capital
 - ▶ Prepayments
 - ▶ Oil Inventory
 - ▶ Materials and Supplies

Regulatory Use of Accounting Data

Cost of Service

- ▶ Construction Work-in-Progress
 - ▶ Capital Projects
 - ▶ Timing of expenditures and monthly tracking
 - ▶ Identify Interest During Construction
 - ▶ Replace with Allowance for Funds Used During Construction
 - ▶ Asset identification
 - ▶ Close to Property, Plant and Equipment
 - ▶ Reimbursable Projects
 - ▶ Recovery of expenditures

Regulatory Use of Accounting Data

Cost of Service

- ▶ Operating Expense
 - ▶ Routine Operating & Maintenance
 - ▶ Major Maintenance Projects
 - ▶ General & Administrative
 - ▶ Depreciation

Regulatory Use of Accounting Data

Cost of Service

Cost of Service Tariff Rate Filing Includes:

- ▶ Base Period (18 CFR § 346.2)
 - ▶ Must consist of 12 consecutive months of actual experience adjusted to eliminate non-recurring items. Carrier may include appropriate normalizing adjustments in lieu of non-recurring items.
- ▶ Test Period (18 CFR § 346.2)
 - ▶ Must consist of a Base Period adjusted for changes in revenues and costs which are known and measurable with reasonable accuracy at the time of filing and will become effective within nine months of the Base Period.

Regulatory Use of Accounting Data

Cost of Service

- ▶ Key cost-of-service data issues
 - ▶ Certain historical records,
 - ▶ Original cost of property
 - ▶ Historical depreciation rates (FERC approved)
 - ▶ Ensure the costs are accurate and supported by appropriate documentation.
 - ▶ Cost allocations
 - ▶ Methodology documented
 - ▶ Reviewed routinely
 - ▶ Consistent
 - ▶ Defensible
 - ▶ Reconciliation of data used for cost-of-service to financial records and Form 6.

Regulatory Use of Accounting Data

Challenge exists for pipeline accounting to meet regulatory accounting and rate making requirements in addition to internal / external accounting and reporting requirements

What should you be aware of?

Regulated Pipelines Data Requirements

Operating Costs

Special circumstances

Regulated Pipelines Data Requirements

Operating Costs

- ▶ 18 CFR §352 General Instruction 1-14
 - ▶ Just, reasonable and not to exceed amounts necessary to the honest and efficient operations and management of carrier business
 - ▶ Not to exceed the FMV of goods and services acquired in an arms-length transaction
- ▶ 18 CFR §352 General Instruction 1-2 (a)
 - ▶ Keep supporting detailed information to readily furnish full information to any item in any account
- ▶ Opinion No. 154-B
 - ▶ Pipelines may recover their prudently incurred operating expenses

What Level of Detail is Available From Company Books?

Are you able to produce full information in the event of an audit, protest or complaint?

Regulated Pipelines Data Requirements

Operating Costs

- ▶ Carrier Property and Depreciation
 - ▶ Identification of assets (account and location)
 - ▶ Amount related to Interest During Construction
 - ▶ Supporting records (AFE / project details)
 - ▶ Identification and maintenance of original cost history
 - ▶ Approved depreciation rates
 - ▶ Cost of Reproduction New (“CRN”) / Valuation Report

Regulated Pipelines Data Requirements

Operating Costs

- ▶ Capitalization Policy (18 CFR §352.3-4)
 - ▶ Units of Property
 - ▶ Capitalization Threshold
 - ▶ Capital vs. Expense Decisions
 - ▶ Project (AFE) Approval Procedures
 - ▶ Approval of Expenditures
 - ▶ Project Monitoring
 - ▶ Project Close Procedures

Regulated Pipelines Data Requirements

Operating Costs

- ▶ Operations and Maintenance Expense
 - ▶ Routine operating costs
 - ▶ Fuel and Power
 - ▶ Asset Retirement Obligations
 - ▶ Major maintenance
 - ▶ Unusual / Non recurring items
 - ▶ Accruals for future costs
 - ▶ Prior period adjustments
 - ▶ Charges from affiliates

Regulated Pipelines Data Requirements

Operating Costs

- ▶ Charges from Affiliates (18 CFR §352, General Instruction 1-13)
 - ▶ Direct
 - ▶ Specific services provided
 - ▶ Fees
 - ▶ Supporting documentation / agreements
 - ▶ Allocations
 - ▶ To the regulated pipeline entity
 - ▶ Affiliate(s) providing services
 - ▶ Services provided
 - ▶ Methodology / Basis for allocation
 - ▶ Supporting documentation and agreements
 - ▶ Within the regulated pipeline entity (among pipeline systems)
 - ▶ Shared costs identified
 - ▶ Shippers have had some degree of success challenging allocations from affiliates to the pipeline and among pipeline systems
 - ▶ Changing allocations can have a significant impact on cost-of-service and rates

Regulated Pipelines Data Requirements

Operating Costs

- ▶ FAS 143
 - ▶ Governs Accounting for Asset Retirement Obligations
 - ▶ FERC Order 631, April 2003
 - ▶ More transparent, complete and consistent accounting and reporting
 - ▶ 18 CFR §346.3 governs ARO recovery in transportation rates

Must be identified for cost of service calculations

Regulated Pipelines Data Requirements

Special Circumstances

- ▶ Major Maintenance
 - ▶ Project schedule / cycle
 - ▶ Integrity Management costs
 - ▶ FERC Order AI05-1-000 (June 30, 2005) provides specific accounting guidance for Integrity Management costs
- ▶ Pipeline Rupture / Spills
 - ▶ Third party
 - ▶ Pipeline failure

Regulated Pipelines Data Requirements

Special Circumstances

- ▶ Hurricanes / Natural Disasters
 - ▶ Capital expenditures for reconstruction
 - ▶ Expense for cleanup and restoration
 - ▶ Insurance recovery
- ▶ ULSD Fuel
 - ▶ EPA standard requiring a major reduction in the sulfur content of diesel fuels beginning in 2006
 - ▶ Impact of converting pipelines for compliance

Regulated Pipelines Data Requirements

Special Circumstances

- ▶ Approaches to recover operating costs
 - ▶ Settlement Rates
 - ▶ Surcharges
 - ▶ Cost of Service Increases

What is used by your company?

Summary

- ▶ Accounting groups have a critical role in the pipeline business.
- ▶ Understanding the relationship between Ratemaking and Accounting activities is important in order to achieve regulated pipeline company goals and maintain compliance with all FERC requirements.
- ▶ Important for Accounting and Regulatory groups to communicate on an on-going basis.

FREQUENT COMMUNICATION IS CRITICAL

Questions ?