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KPMG Peat Marwick LLP

Federal Energy Regulatory Commission



Financial Statements
September 30, 1994 and 1993
(With Independent Auditors' Report Thereon)

MASTER

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FEDERAL ENERGY REGULATORY COMMISSION

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FEDERAL ENERGY REGULATORY COMMISSION

OVERVIEW

THE MISSION: Oversee America's natural gas and oil pipeline transportation systems, electric utilities, and hydroelectric projects; and ensure that Americans have an abundant supply of natural gas and electricity at just and reasonable rates.

THE COMMISSION IN BRIEF

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

Today FERC 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, inspection and administration of non-Federal hydroelectric projects; and oversight of related environmental matters.

The FERC's main legal authority is derived from:

- *Federal Power Act of 1920 (FPA)*
- *Natural Gas Act of 1938 (NGA)*
- *Natural Gas Policy Act of 1978 (NGPA)*
- *Public Utility Regulatory Policies Act of 1978*
- *Interstate Commerce Act*
- *Natural Gas Wellhead Decontrol Act*
- *Energy Policy Act of 1990*
- *Electric Consumers Protection Act*

The Commission consists of five members appointed by the President with the advice and consent of the Senate. 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. In April 1990 the President signed legislation that changed the length of the commissioners' terms to five-year staggered terms. 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. Commission meetings are open to the public under the provision of the *Government in the Sunshine Act*.

COMMISSION OPERATIONS

The FERC collects the full cost of its operations from annual charges and fees authorized by the FPA, the *Omnibus Reconciliation Act of 1986*, and other laws. Congress annually adopts a budget appropriation that provides the Commission with the authority to use funds from the treasury to meet operating expenses. The FERC must return to the Treasury all revenue from charges and fees when received. Therefore, no taxpayer money is used to directly fund the Commission.

HYDROPOWER REGULATION

Hydropower Regulation Mission: Support the Federal Energy Regulatory Commission in its regulation of non-Federal hydropower for the benefit of the public, considering all resources and beneficial uses of the nation's waterways.

The Commission's hydroelectric power (hydropower) activities are administered by the Office of Hydropower Licensing (OHL) and address several areas.

- Project Licensing,
- Dam Safety and Inspections,
- Project Compliance and Administration, and
- Investigation and Assessment of Headwater Benefits.

The FERC also decides charges for a licensee's use of Federal dams, Federal lands, and Indian reservations.

Under FPA, the FERC regulates the development of non-Federal hydropower projects whose primary purpose is the production of hydroelectric power. Other statutory authorizations for regulating water-resource development include:

- *Electric Consumers Protection Act,*
- *Public Utility Regulatory Policies Act (PURPA),*
- *Flood Control Act,*
- *Energy Security Act,* and
- *Numerous Environmental Acts*

Part I of the FPA is primarily a water resource development law. It requires that the Commission consider such development in a broad context. Major uses for projects the Commission regulates include power production, water supply, irrigation, flood control, navigation, fisheries, wildlife and, recreation. There are more than 80 million recreation visitor days annually at FERC-licensed projects.

Hydropower is a domestic, renewable resource that offers an abundant, clean source of electrical energy. The 1,700 hydropower projects the Commission regulates represent approximately one-half of the nation's hydropower energy generation. Hydropower plants supply almost 10% of America's electrical energy and make up 96% of our total renewable energy projection, about 282 billion kilowatt-hours of energy annually. This is equivalent to 482 million barrels of oil per year. Hydropower also makes a significant environmental contribution by preventing the discharge of 6.2 billion tons of particulates into the atmosphere each year. The Commission's hydropower regulation ensures that the water resource developments:

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

Project Licensing

The Commission's Division of Project Review recommends or takes action on three types of authorizations to applicants seeking to develop hydropower:

1. *Permit:* Allows holders to study site development potential for up to three years. During the term, a permit holder has exclusive right to apply for a license or exemption.
2. *License:* Issued for up to fifty years.
3. *Exemption:* Issued in perpetuity. Does not confer power of eminent domain on the holder and is subject to fish and wildlife conditions imposed by Federal and state agencies.

Dam Safety and Inspections

The Commission's Division of Dams Safety and Inspections (D2SI) inspects approximately 2,100 dams. These include dams that are under license or exemption and those at projects for which the FERC has found that a license or exemption is required. Over two-thirds of the dams under FERC's jurisdiction are over 50 years old. Project safety oversight and a periodic inspection program are essential as dams age and safety becomes a greater concern.

The Commission's dam safety and inspection program ensures that dams under its jurisdiction (an important part of the nation's infrastructure) are properly constructed, operated, and maintained according to approved plans, sound engineering practices and terms and conditions of licenses or exemptions. The dam safety program complies with *Federal Guidelines for Dam Safety*.

Periodic inspections verify the structural integrity of dams by identifying necessary maintenance and remedial modifications. Inspections during project construction seek to ensure that projects:

- as actually built are consistent with the design the FERC approved;
- receive the maintenance they require; and
- operate according to license provisions.

Inspections attempt to detect safety problems at projects *before* they lead to dam failure or jeopardize public safety.

There are seven types of inspections conducted from the time the Commission receives an application for a proposed project through project operation:

- Prelicense,
- Construction,
- Operation,
- Exemption,
- Public Safety,
- Special, and
- Independent Consultant.

Unscheduled inspections are made to investigate:

- dam safety problems,
- compliance violations,
- complaints about project construction and operation, and
- safety concerns related to natural disasters.

Project Compliance and Administration

The Commission's Division of Project Compliance and Administration (DPCA) monitors and investigates compliance with:

- *Federal Power Act*,
- Commission rules and regulations, and
- terms and conditions of more than 1,900 licenses, exemptions, and preliminary permits.

DPCA also investigates alleged instances of noncompliance; and takes necessary action to resolve instances of noncompliance. The division also conducts technical environmental and engineering analyses.

DPCA is also involved in other activities:

- Evaluating project compliance to determine the conditions or changes to existing hydropower licenses that are necessary during the term of the license and during relicensing to reduce compliance problems;
- Determining and accessing headwater benefits charges;
- Evaluating non-hydropower interests in Federal power-site lands; and
- Investigating unlicensed projects to determine if they are jurisdictional.

Hydropower Performance Measurements

The Office of Hydropower Licensing has decided on three measurements for the office, one for each division. They measure important activities which are conducted by the divisions and are significant to FERC's mission of the FERC.

1. Division of Project Review

Measurement: Reduce by 10% the issuance rate of second additional information requests on pending license and exemption applications.

Method: The Commission issued 34 second requests for additional information over an average of 263 pending license, relicense and exemptions in fiscal year 1994.

At the end of fiscal year 1995, the number of second additional information requests (number of second requests for additional information divided by the yearly average number of pending license, relicense, and exemption applications) will be determined and compared with those of fiscal year 1994 and the percentage of change determined.

Benefits: Reduction in the number of requests will:

- reduce disruption of and prolonging the licensing and exemption processes,
- reduce costs to the applicants, and
- reduce staff time in reviews of submitted material.

2. Division of Dam Safety and Inspections

Measurement: Reduce by 10% the ratio of the number of supplements to Part 12D reports that are required. The Commission requires that an independent consultant inspect and evaluate all major licensed and exempted dams every five years (Part 12D reports). The supplements are in response to staff requests for follow-up information.

Method: The Commission received 121 supplements in fiscal year 1994 resulting primarily from 128 Part 12D reports received in fiscal year 1993.

At the end of fiscal year 1995, the number of supplements received will be compared with the number of Part 12D reports received in fiscal year 1994. The ratio of supplement to reports will be compared to the previous fiscal year ratio, and the percentage reduction of the ratio will be calculated.

Benefits:

Reduction in the number of supplements will:

- reduce the funds and effort required by the project owners,
- reduce the time required by staff to review engineering reports and analyses, and
- reduce the time required to resolve dam safety problems resulting in better protection for the public by Commission-licensed projects.

3. Division of Project Compliance and Administration

Measurement:

Reduce by 5% the number of compliance investigations regarding engineering-related discrepancies at licensed and exempted projects. (These exclude investigations initiated by DPCA.)

Method:

The Commission initiated 56 compliance investigations regarding engineering-related discrepancies at licensed and exempted projects in fiscal year 1994.

At the end of fiscal year 1995, the number of investigations performed will be compared with those performed in fiscal year 1994 and the percentage change determined.

Benefits:

Engineering discrepancies generally are differences in authorized versus installed capacity and differences in project features as authorized versus as-built.

By concentrating of these discrepancies, the FERC can:

- identify major problem areas and begin preventive programs instead of waiting for reports of non-compliance;
- reduce the expense to project owners;
- reduce the time required by staff to review the investigation; and
- reduce potential adverse affect the projects' compliance history.

For fiscal year 1994, the Office of Hydropower Licensing (OHL) selected the jurisdictional reviews category of workload to measure its performance. The OHL determines, under the provisions of section 23(b) of the Federal Power Act, if existing unlicensed projects are required to be licensed. After determining a projects's jurisdictional status, the Commission issues an order requiring, or not requiring the owner to file a license or exemption application.

Performance was to be measured in terms of the number of completed jurisdictional reviews. Projected completions scheduled for fiscal year 1994 was 10; however, there was only one completion in fiscal year 1994. The difference between projected and actual is explained by the almost total absence of projects that met the criteria of projects to be worked on (significant or high hazard potential or environmental complaints). As stated in our fiscal year 1993 financial statements in 1986 the Commission established a policy of only processing those unlicensed projects that met those criteria (hazard level and environmental problems). Had more of the projects reviewed in fiscal year 1994 met the criteria for complete processing, the 10 expected completions could have been accomplished.

Therefore, the target number of completions in fiscal year 1994 was not met because policy considerations affected the OHL's number of completions in this workload category.

ELECTRIC POWER REGULATION

Electric Power Regulation Mission: Ensure that the activities of the regulated entities serve the public interest. This is accomplished by encouraging and relying 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 primary areas of focus include rates for electric transmission and sales for resale in interstate commerce primarily by investor owned utilities, other associated matters relating to interconnection, wheeling, pooling, corporate regulation, and certain special regulatory functions over transmitting utilities, small power producers, cogenerators, federal power marketing agencies, and electric wholesale generators.

The Office of Electric Power Regulation (OEPR) continues to meet statutory deadlines and achieve the Commission's goal of developing policies to implement the *Energy Policy Act (the EPAAct) of 1992*. OEPR is accomplishing this without additional staffing or increased budget and is continuing to process workload in the statutorily required time.

The EPAAct is the most far-reaching electric industry legislation in the last 50 years. Provisions of the EPAAct expanded the Commission's authority to compel a utility to provide transmission service.

Ongoing Workload

The Commission continued to receive statutory workload covering a broad scope. OEPR analyzed and acted on filings involving:

- Interstate wholesale power sales and rates for transmission of electric energy in interstate commerce;
- Applications to order transmission;
- Exempt wholesale generators;
- Small power producers and cogenerators;
- Corporate mergers and acquisitions;
- Security issuances and assumptions of liability;
- Interlocking directorates;
- Power marketing from Federal projects; and
- Accounting and financial reporting issues.

Other Initiatives

All the transmission rate schedules now on file are voluntary transmissions by the utilities that own transmission systems. Implementation of EPAct has resulted in increases in the number and complexity of transmission related filings, including:

- Applications requesting the Commission to order transmission;
- Disputes about transmission system reliability as existing capacity becomes more fully used and more frequently constrained;
- Customer complaints about terms, conditions, and prices;
- Disputes involving the rights of existing transmission customer, including native-load, vis-a-vis new third party customers seeking transmission access;
- Questions of cost responsibility when new transmission capacity must be constructed;
- Issues related to stranded investment in generating plants as a utility's existing wholesale customers use transmission access to purchase power and energy from other sources;
- Allocation of transmission cost responsibility in holding company systems and tight (i.e., centrally dispatched) power pools;
- Rules implementing transmission information requirements under Section 213(b) of EPAct;
- Proposals for voluntary transmission associations (regional transmission groups) to deal with technical aspects of transmission access, dispute resolution, and system planning; and
- New pricing schemes that reflect actual use of the system more accurately (e.g., pricing parallel path flow) may be developed.

Electric Power Regulation Performance Measurements

Performance factors reflect OEPR's principal focus for the next few years--implementation of the electric provisions of the *Energy Policy Act*. We must ensure that increased competition and new ways of doing business provide benefits to consumers. In many ways, this will require more effort and sophistication than is required to process traditional filings. We believe that successful implementation of the EPAct, which reflects Congress' goal to encourage a competitive bulk power market, will be the mark by which the Electric Program will and should be judged.

While these represent the most pressing efforts in the next one to two years, there is no way to establish definitive quantitative goals to measure results in these areas at this time. Additionally, traditional caseload has grown and must continue to be processed. Therefore, in recognition that the filings resulting from our rulemaking and policy efforts must be processed simultaneously with traditional cases OEPR is establishing performance goals to reflect the processing of all caseloads. These goals reflect improvement in the processing of all cases even though an extraordinary amount of staff effort will be spent in rulemaking/policy endeavors.

1. Division of Applications

Measurement: Reduce by 5% the number of electric rate applications pending by more than 180 days.

Method: During fiscal year 1994, the average number of electric rate applications that had not been acted upon by the Commission, delegated authority, set for hearing or withdrawn was 146. Cases

take more than 180 days to complete primarily because they are deficient. The goal is to improve communication with the industry in advance of the filings where possible and, when deficient filings are tendered, to initiate communications promptly and to minimize the time taken to cure the deficiency.

At the end of fiscal year 1995, the number of electric rate applications requiring more than 180 days to complete will be determined and compared with that of fiscal year 1994 and the percentage of change determined.

Benefits: Reduction on the number of applications requiring more than 180 days to process will:

- reduce staff time required to process applications;
- reduce time and effort required by applicants; and
- assist applicants in submission of future applications through better communication of the requirements for complete cases.

2. Division of Investigations

Measurement:

- Process uncontested settlements within 45 days of certification by the Administrative Law Judge (ALJ).
- Maintain a settlement rate of 70% of cases set for hearing.
- Process uncontested refund reports within 60 days after the close of the comment period.

Method: At the end of fiscal year 1995:

- the number of uncontested settlements completed with 45 days of certification by the ALJ will be determined;
- the settlement rate of cases set for hearing will be determined; and
- the number of uncontested refund reports processed within 60 days after the close of the comment period will be determined.

The processing times and settlement rates will be calculated and compared with those of fiscal year 1994. The Key Indicator Case Tracking System (KICTS) and internal tracking systems will be used in the determinations.

Benefit: As the time required for processing cases is reduced the cost in resources per case for both the public and the Commission is reduced.

3. Division of Opinions and Systems Analysis

Measurement:

- Reduce by 5% the number of cases still active 2.5 years or more after filing.
- Reduce by 10% the number of formal cases pending without an opinion being issued where the initial decision was issued more than twelve months earlier.

Method:

- At the end of fiscal year 1994, there were 34 cases 2.5 years or older pending . At the end of fiscal year 1995 the number of cases in this category will be determined, compared with that of fiscal year 1994, and the percentage of change determined.
- At the end of fiscal year 1994, there were 15 formal cases where the initial decision was issued more than twelve months earlier. At the end of fiscal year 1995 the number of cases in this category will be determined, compared with that of fiscal year 1994, and the percentage of change determined.

The processing times and settlement rates will be calculated and compared with those of fiscal year 1994. KICTS and internal tracking systems will be used in the determinations.

Benefits:

Reducing the number of older cases pending and initial decision pending more than twelve months puts emphasis on the cases that have been process longest and represent the greatest regulatory delay. Other cases will tend to require less processing time. The processing times and settlement rates will be calculated and compared with those of fiscal year 1994. The Key Indicator Case Tracking System (KICTS) and internal tracking systems will be used in the determinations.

Fiscal year 1994 performance in the electric power regulation area is presented in the following chart:

| ELECTRIC POWER WORKLOAD | | | | | | |
|-----------------------------------|---------------------|------------------------------|---------------------|------------------------------|---------------------|------------------------------|
| CATEGORY | FY 1992 Receipts | FY 1992 Comple- -tions | FY 1993 Receipts | FY 1993 Comple- -tions | FY 1994 Receipts | FY 1994 Comple- -tions |
| Rate Filings | 820 | 829 | 943 | 896 | 1646 | 1356 |
| Formal Investigations--Rate level | 44 | 49 | 49 | 56 | 22 | 16 |
| Compliance Filings | 129 | 106 | 147 | 148 | 140 | 132 |
| Formal Investigations--Other | 38 | 15 | 12 | 28 | 14 | 15 |
| Small Power | 139 | 138 | 172 | 197 | 127 | 137 |
| Cogeneration | 209 | 221 | 175 | 169 | 175 | 175 |
| Corporate Applications | 25 | 23 | 23 | 20 | 29 | 28 |
| Interlocking Positions | 140 | 182 | 75 | 80 | 89 | 86 |
| Transmission Service Requests | 0 | 0 | 4 | 1 | 11 | 2 |
| EWG | 0 | 0 | 81 | 62 | 108 | 99 |
| Federal Rate Filings | 10 | 12 | 12 | 11 | 18 | 16 |
| Declaratory Orders | 10 | 13 | 27 | 16 | 50 | 37 |
| Complaints | 16 | 26 | 17 | 19 | 25 | 14 |
| TOTALS | 1580 | 1612 | 1720 | 1659 | 2454 | 2113 |

NATURAL GAS AND OIL PIPELINE REGULATION

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

The Office of Pipeline Regulation(OPR) provides expert policy advice and technical support that enables the Commission to carry out its statutory responsibilities for regulating natural gas and oil pipelines.

The *Natural Gas Act*, *Natural Gas Policy Act*, *Outer Continental Shelf Lands Act*, *Interstate Commerce Act*, and the *Natural Gas Wellhead Decontrol Act* are the primary laws the Commission administers to oversee America's pipeline industries.

Programs for the natural gas industry seek to ensure that interstate transportation can occur at the lowest reasonable rates, consistent with reliable, long-term service, and protection of the environment. Under the NGA, the FERC regulates the transportation and sale for resale of natural gas in interstate commerce. The Commission regulates approximately 140 interstate natural gas pipelines, which are the backbone of an integrated, diverse, and increasingly competitive natural gas industry. Thirty-eight of the lower 48 states receive most of their natural gas through the interstate market. Even in producing states, the interstate pipeline network transports a significant portion of available gas supplies.

Formerly, NGPA's wellhead pricing program required the Commission to administer ceiling prices for certain categories of natural gas production in interstate and intrastate commerce. The Natural Gas Wellhead Decontrol Act, however, totally deregulated gas prices at the wellhead as of January 1, 1993, and eliminated NGA producer requirements.

Under the Interstate Commerce Act, the Commission also regulates tariffs for about 150 common-carrier oil pipelines, with revenues in excess of \$5.5 billion, that transport crude oil or refined petroleum products in interstate commerce. FERC does not oversee the construction of oil pipelines or regulate the supply or price of oil and oil products.

Natural Gas Pipeline Certificates

The future of the natural gas industry and its contribution to a nation with a cleaner and more secure energy future depends upon building new pipelines and expanding and replacing existing pipelines when necessary. Under the Natural Gas Act, companies providing services and constructing and operating interstate pipeline facilities must first obtain Commission certificates of public convenience and necessity.

Prior to granting any certificate, the Commission, must: (1) evaluate the need for a construction project by determining whether customers have contracted for a substantial amount of the proposed capacity or whether the facility is needed for system flexibility; (2) make findings on initial rates and financing for the project; (3) determine the effect of the project on the environment and order changes or place mitigating conditions on the proposed construction; and (4) verify that the proposed facilities are appropriately designed and sized pursuant to sound engineering principles.

After the Commission issues a certificate, the OPR staff must undertake significant compliance activities, including monitoring construction reports and making site visits, to ensure that the pipeline complies with all certificate conditions. The FERC also must approve abandonment of facility use and services, and authorize service changes in some cases where new construction is not required.

Natural Gas Pipeline Rates

The Natural Gas Act requires that the Commission ensure that tariff rates and charges are just and reasonable and not unduly discriminatory. This protects consumers from excessive prices and abuses of market power and ensures that pipelines receive compensation for prudent and necessary service costs -- including a fair return on investment.

Competition and market forces have changed the Commission's approach to ratemaking. The primary role of most pipelines is now natural gas transportation, not traditional natural gas marketing. Local distribution companies and other customers are acquiring their natural gas from competing suppliers and becoming shippers rather than customers of interstate pipelines. FERC continues to make major changes in its gas program to create a more free and open regulatory environment with less pricing regulation but with significantly more oversight and compliance activities. This is in keeping with the Commission's goal of shifting from the rigid, price-controlled practices of the past to a flexible, market-based approach for the natural gas industry.

Oil Pipeline Rates

The FERC's objective is to establish just and reasonable rates to encourage maximum efficient use of oil pipelines. Oil pipelines are a relatively inexpensive means of bringing oil to market, but the Commission must protect shippers and consumers against unjustified costs. The Commission also ensures shippers equal access to pipeline transportation and equal service conditions on oil pipelines.

During FY 1994, the Commission's efforts to streamline and modernize its rules, regulations, and oversight of oil pipeline reached fruition. With the issuance of Order Nos. 561, 571, and 572, the Commission established a generally applicable indexing methodology which allows for greater efficiency and ease in filing rate changes. In addition to establishing the indexing methodology, these orders also delineated three alternatives to that methodology and the conditions under which they may be implemented. The three alternatives are: traditional cost-of-service; market-based rates; and, negotiated or settlement rates.

Goals And Objectives

Goal 1: We will meet our customers' needs.

Objectives:

- We will assist the Commission in carrying out its statutory responsibilities.
- We will respond to the pipelines' need for timely decision and rate certainty.
- We will reduce the regulatory burden on the industry.
- We will formulate guidelines for pursuing alternatives to traditional regulation.
- We will protect consumers.

Goal 2: We will protect the environment.

Objectives:

- We will conduct pre- and post-certification site inspections.
- We will ensure that all construction certificates have appropriate conditions for environmental compliance.
- We will increase voluntary environmental compliance by pipelines through our monitoring programs.
- We will carry out proper yearly LNG site inspections and communicate any deficiencies to plant personnel.
- We will calculate needed capacity for pipeline proposals using proper engineering techniques and models to avoid unnecessary expenditures and over-building of facilities.
- We will develop policies and programs that remove regulatory constraints to the use of natural gas as a fuel source.

Goal 3: We will maintain a knowledgeable, experienced and effective staff with high morale and pride in its work.

Objectives:

- We will involve staff in discussion of issues and in formulating regulatory policy and procedures.
- We will continue education and training to develop a diversified staff.
- We will provide analysts with opportunities to realize their potential and pursue areas of individual interest when in the best interest of the organization.
- We will recognize achievement and reward it appropriately.
- We will encourage and reward ideas that lead to time and material savings in OPR work processes.
- We will ensure that OPR staff are equipped with adequate ADP hardware and software, technical support and training to use automation to do their jobs more efficiently.
- We will maintain databases and provide automated analytical tools and support for the Commission and staff to better use the data that pipelines file.
- We will take advantage of any special hiring techniques and employment programs to acquire quality entry-level personnel.

Natural Gas and Oil Pipeline Regulation Performance Measurements

Fiscal year 1995, the following performance measure has been established:

- Measurement:** Reduce the processing time for those processes and activities that are solely under the control of OPR by five percent (5%) per year, while ensuring that the quality of work remains excellent and that all significant issues are addressed in the proper forum.
- Method:** Continue to use internal tracking systems to monitor the progress and status of cases and track compliance with environmental conditions in construction-related certificates.
- Benefits:** Greater regulatory certainty for pipelines and rate payers; and protection of the environment balanced against the need for increased service.

The Office of Pipeline Regulation implemented a major reorganization in April, 1994, in order to (1) respond to the changes and challenges resulting from Order No. 636, (2) increase the overall skills, productivity and efficiency of staff, and (3) reallocate staff assigned to functions that were no longer required, either as a result of Order No. 636 or producer deregulation. During FY 1994, OPR also reduced its staff from 316 to 289 employees -- a reduction of 8.5 percent, achieved through normal attrition, retirements, position abolishments, and buyouts.

In FY 1994, OPR completed work on 847 certificate cases, including 42 major (>\$1 million) construction projects involving 493 miles of pipeline, 2.3 billion cubic feet per day of capacity, and \$570 million in potential investment. While this represents about the same number of major projects as in FY 1993, the projects were smaller on average. The Commission did achieve a significant reduction of almost 10 percent in average processing time for major construction applications -- from 308 days in FY 1993 to 279 days in FY 1994. OPR continued to use preliminary determinations to expedite action on the nonenvironmental aspects of proposed major construction projects. The Commission issued nine preliminary determinations in FY 1994 -- an increase of five over FY 1993.

OPR also completed 288 prior notice proceedings under pipelines' blanket certificates. The prior notice procedure allows pipelines to undertake certain minor construction activities without formal Commission action unless there is a protest filed in response to the prior notice.

Environmental assessments and site inspections are not reflected in the workload completion totals, but are an integral part of OPR's review and compliance responsibilities. In FY 1994, OPR's environmental staff completed:

- 92 environmental assessments and one final environmental impact statement; and
- 160 on-site environmental inspections to ensure compliance with certificate conditions,

In the environmental area, the Commission's finding that a project will have no significant impact is based on compliance with various mitigation measures. Thus, it is vitally important that compliance with those mitigation measures occurs.

For that reason OPR placed particular emphasis on ensuring compliance. It uses a two-pronged approach. First, OPR works with project applicants and their contractors in a variety of forums to help them understand the mitigation required and how to comply. Second, in the absence of voluntary compliance, OPR has increased its efforts to find out whether compliance has occurred, and if not, order it.

OPR has used a variety of methods to increase the pipelines' understanding of the mitigation ordered and obtain voluntary compliance. First, OPR includes in every certificate a requirement that the pipeline company submit a plan for review and approval before construction. This plan must contain a description of how the company intends to implement all of the required mitigation measures. It also requires the company to describe how it will ensure that its construction contractor is fully informed of the environmental mitigation measures.

Second, pipeline companies must include on construction drawings the location of environmentally sensitive areas and required mitigation measures for those areas. These drawings are used by construction personnel and equipment operators in the field.

Third, environmental training sessions are required for company personnel, environmental inspectors, and contractor personnel involved in the project.

Fourth, OPR continues to hold training seminars on a variety of topics including erosion control, revegetation and maintenance, procedures for crossing wetland and water bodies, and the guidelines for reporting on cultural resources investigations. Staff conducted eight training sessions during the last two fiscal years, and plans several more this year.

However, in some cases pipelines do not comply on a voluntary basis and OPR must take appropriate action. OPR has instituted the following procedures and requirements to ensure compliance with certificate conditions:

- Pipeline companies are required to file weekly or bi-weekly reports, depending on the size of the project, describing the status of construction.
- Any environmental problems identified by other federal, state, or local agencies must be reported immediately to OPR's environmental staff.



Independent Auditors' Report on Financial Statements

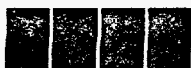
The Federal Energy Regulatory Commission
United States Department of Energy:

We have audited the statements of financial position of the Federal Energy Regulatory Commission (the Commission) as of September 30, 1994 and 1993, and the related statements of operations and changes in net position, cash flows, and budget and actual expenses 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.

Except as described in the fourth paragraph of this report, we conducted our audits in accordance with generally accepted auditing standards; *Government Auditing Standards* (1988 revision), issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in note 2, the 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.

We were previously engaged to audit the statement of financial position of the Commission as of September 30, 1993, and the related statements of operations, cash flows, and budget and actual expenses for the year then ended. Our report, dated December 23, 1993, stated that the scope of our work was not sufficient to enable us to express an opinion on the statements of operations and changes in net position, cash flows, and budget and actual expenses for the year ended September 30, 1993. During the year ended September 30, 1993, accounting adjustments were made to correct financial statement balances that were not auditable as of September 30, 1992. However, we were unable to determine the allocation of these adjustments between fiscal year 1993 and prior year activity. We were also unable to determine whether the 1993 statement of cash flows was correctly reconciled to the changes in the Commission's fund balances with treasury and cash. Adequate accounting records were not maintained to support reported reconciling amounts that affect the net change in cash for fiscal year 1993.



Because of the matters discussed in the fourth paragraph of this report, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying statements of operations and changes in net position, cash flows, and budget and actual expenses for the year ended September 30, 1993.

In our opinion, the statements of financial position present fairly, in all material respects, the financial position of the Commission as of September 30, 1994 and 1993, and the related statements of operations and changes in net position, cash flows, and budget and actual expenses the Commission for the year ended September 30, 1994, present fairly, in all material respects, the results of its operations and changes in net position, its cash flows, and its budget and actual expenses for the year then ended, all on the basis of accounting described in note 2.

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

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

KPMG Peat Marwick LLP

December 30, 1994

FEDERAL ENERGY REGULATORY COMMISSION

Statements of Financial Position

September 30, 1994 and 1993

| Assets | 1994 | 1993 |
|--------------------------------------|-----------------------|--------------------|
| Entity assets: | | |
| Intragovernmental assets: | | |
| Fund balances with Treasury (note 3) | \$ 73,428,717 | 61,764,739 |
| Governmental assets: | | |
| Accounts receivable, net (note 4) | 18,741,284 | 9,628,685 |
| Unbilled receivables (notes 5 and 6) | - | 46,143,255 |
| Employee travel advances | 112,698 | 119,034 |
| Cash | 10,000 | 10,000 |
| Property and equipment, net (note 7) | 8,075,683 | 6,248,570 |
| Total entity assets | 100,368,382 | 123,914,283 |
| Non-entity assets: | | |
| Intragovernmental assets: | | |
| Fund balances with Treasury (note 3) | 2,635,663 | 2,308,981 |
| Accounts receivable | 12,625 | 46,795 |
| Governmental assets: | | |
| Accounts receivable, net (note 5) | 1,823,743 | 1,132,915 |
| Total non-entity assets | 4,472,031 | 3,488,691 |
| Total assets | \$ 104,840,413 | 127,402,974 |

The accompanying notes are an integral part of these statements.

FEDERAL ENERGY REGULATORY COMMISSION

Statements of Financial Position

September 30, 1994 and 1993

| Liabilities and Net Position | 1994 | 1993 |
|---|-----------------------|--------------------|
| Liabilities | | |
| Liabilities covered by budgetary resources: | | |
| Intragovernmental liabilities: | | |
| Accounts payable | \$ 1,752,301 | 1,963,473 |
| Collections due to states | 2,514,841 | 2,279,627 |
| Resources transferable to Treasury (note 5) | 1,823,743 | 47,276,170 |
| Government liabilities: | | |
| Accounts payable | 3,504,576 | 5,785,102 |
| Lease liabilities (note 8) | 329,974 | 481,167 |
| Accrued payroll and benefits | 3,816,605 | 3,392,346 |
| Revenue collected under protest | 6,268,145 | 12,069,012 |
| Total liabilities covered by budgetary resources | 20,010,185 | 73,246,897 |
| Liabilities not covered by budgetary resources: | | |
| Accrued leave | 7,460,863 | 7,243,791 |
| Lease liabilities (note 8) | - | 76,829 |
| Total liabilities | 27,471,048 | 80,567,517 |
| Net position | | |
| Unexpended appropriations: | | |
| Unobligated and available | 30,501,289 | 26,289,577 |
| Undelivered orders | 27,515,499 | 12,003,957 |
| Invested capital | 8,075,683 | 6,248,570 |
| Cumulative results of operations | 18,737,757 | 9,613,973 |
| Future funding requirements | (7,460,863) | (7,320,620) |
| Total net position | 77,369,365 | 46,835,457 |
| Total liabilities and net position | \$ 104,840,413 | 127,402,974 |

FEDERAL ENERGY REGULATORY COMMISSION

Statements of Operations and Changes in Net Position

Years ended September 30, 1994 and 1993

| | 1994 | (Unaudited) 1993 |
|---|----------------------|---------------------|
| Revenue and financing sources: | | |
| Appropriated capital used: | | |
| Commission | \$ 144,735,202 | 136,314,210 |
| General Services Administration utility allotment received | 711,773 | 691,743 |
| Department of Energy Dam Safety allotment received | 37,176 | 101,939 |
| Collections for states | 2,514,841 | 2,279,627 |
| Revenue from public sources: | | |
| Annual charges and filing fees | 206,078,365 | 184,246,705 |
| Interest and penalties | 113,037 | 1,196,290 |
| Other revenue and financing sources - reimbursable work agreements: | | |
| Taiwan | 17,009 | 7,153 |
| Intragovernmental - Nuclear Regulatory Commission | 107,675 | 46,609 |
| | 354,315,078 | 324,884,276 |
| Less - receipts returned to Treasury and other agencies | (196,295,755) | (179,148,267) |
| Total revenue and financing sources | 158,019,323 | 145,736,009 |
| Expenses: | | |
| Operating expenses: | | |
| Commission (note 9) | 142,998,827 | 135,430,336 |
| General Services Administration utility allotment used | 711,773 | 691,743 |
| Department of Energy Dam Safety allotment used | 37,176 | 101,939 |
| Payments to states | 2,514,841 | 2,279,627 |
| Cost of services provided: | | |
| Taiwan | 17,009 | 7,153 |
| Intragovernmental - Nuclear Regulatory Commission | 107,675 | 46,609 |
| Depreciation | 1,736,374 | 883,874 |
| Provision for bad debts | 771,864 | 371,885 |
| Accrued leave, unfunded | 217,072 | 576,118 |
| Total expenses | 149,112,611 | 140,389,284 |
| Excess of revenue and financing sources over total expenses | 8,906,712 | 5,346,725 |
| Add unfunded expenses - accrued leave | 217,072 | 576,118 |
| Excess of revenue and financing sources over funded expenses | \$ 9,123,784 | 5,922,843 |
| Net position, beginning of year | \$ 46,835,457 | 14,425,419 |
| Excess of revenue and financing sources over funded expenses | 9,123,784 | 5,922,843 |
| Add nonoperating changes (note 10) | 21,410,124 | 26,487,195 |
| Net position, end of year | \$ 77,369,365 | 46,835,457 |

The accompanying notes are an integral part of these statements

FEDERAL ENERGY REGULATORY COMMISSION

Statements of Cash Flows

Years ended September 30, 1994 and 1993

| | 1994 | (Unaudited) 1993 |
|---|----------------------|----------------------|
| Cash flows from operating activities: | | |
| Excess of revenue and financing sources over total expenses | \$ 8,906,712 | 5,346,725 |
| Adjustments affecting cash flows: | | |
| Appropriated capital used | (147,998,992) | (139,387,519) |
| Accrued leave - unfunded | 217,072 | 576,118 |
| Decrease (increase) in accounts and unbilled receivables | 35,602,134 | (8,610,508) |
| Decrease in advances and prepayments | 6,336 | 6,886 |
| Increase (decrease) in accounts payable | (2,573,347) | 570,650 |
| Increase (decrease) in accrued payroll and benefits | 424,259 | (2,916,084) |
| Decrease in revenue collected under protest | (5,719,217) | (13,082,732) |
| Increase (decrease) in collections due to states | 235,214 | (669) |
| Decrease in other funded liabilities | (45,452,428) | (1,175,003) |
| Depreciation | 1,736,374 | 883,874 |
| Provision for bad debts | 771,864 | 371,885 |
| Loss on disposal of property and equipment | 26,801 | - |
| Net cash used by operating activities | (153,817,218) | (157,416,377) |
| Cash flows from investing activities: | | |
| Purchases of equipment | (3,590,287) | (2,961,691) |
| Cash flows from financing activities: | | |
| Appropriations (current year warrants) | 165,375,000 | 158,639,000 |
| Recoveries of prior year appropriations | 1,126,700 | 886,504 |
| Transfers of cash from others | 3,263,790 | 3,127,740 |
| Principal payments on capital leases | (228,022) | (744,693) |
| Other changes | (139,303) | - |
| Net cash provided by financing activities | 169,398,165 | 161,908,551 |
| Net cash provided by operating, investing and financing activities | 11,990,660 | 1,530,483 |
| Unreconciled balance (note 13) | - | 3,797,588 |
| Fund balances with Treasury and cash, beginning of year | 64,083,720 | 58,755,649 |
| Fund balances with Treasury and cash, end of year | \$ 76,074,380 | 64,083,720 |
| Noncash activities: | | |
| Equipment acquired under capital lease obligations | \$ - | 1,302,688 |

The accompanying notes are an integral part of these statements.

FEDERAL ENERGY REGULATORY COMMISSION

Statements of Budget and Actual Expenses

September 30, 1994 and 1993

| | 1994 Budget | | (Unaudited) 1993 Budget | | 1994 Actual Expenses | (Unaudited) 1993 Actual Expenses |
|--|-----------------------|--------------------|----------------------------|--------------------|-------------------------|--|
| | Resources | *Obligations | Resources | *Obligations | | |
| Expenses: | | | | | | |
| Commission | \$ 192,791,277 | 162,289,987 | **165,978,881 | 139,689,304 | 145,724,137 | 137,262,213 |
| General Services Administration utility allotment | 711,773 | 711,773 | 691,743 | 691,743 | 711,773 | 691,743 |
| Department of Energy - Dam Safety allotment | 100,000 | 37,176 | 100,000 | 99,809 | 37,176 | 101,939 |
| Collections for states | 2,514,841 | 2,279,627 | 2,279,627 | 2,280,296 | 2,514,841 | 2,279,627 |
| Taiwan reimbursement agreement | 15,000 | 11,394 | 50,000 | 35,557 | 17,009 | 7,153 |
| Nuclear Regulatory Commission reimbursement agreement | 326,000 | 113,648 | 190,000 | 46,607 | 107,675 | 46,609 |
| Total | \$ 196,458,891 | 165,443,605 | **169,290,251 | 142,843,316 | 149,112,611 | 140,389,284 |
| Budget Reconciliation: | | | | | | |
| Total expenses | | | | | 149,112,611 | 140,389,284 |
| Add - capital acquisitions | | | | | 3,590,287 | 2,961,691 |
| Less: | | | | | | |
| Depreciation | | | | | (1,736,374) | (883,874) |
| Unfunded annual leave expense | | | | | (217,072) | (576,118) |
| Provision for bad debts | | | | | (771,864) | (371,885) |
| Net expense accrual adjustments | | | | | (1,262,136) | (36,821) |
| Reimbursements and other expenses not included on the SF-133, Report on Budget Execution | | | | | (3,388,474) | (3,127,077) |
| Accrued expenditures, per the SF-133, Report on Budget Execution | | | | | \$ 145,326,978 | 138,355,200 |

* These represent direct obligations

** Fiscal year 1993 commission (and column total) balances were incorrect as stated in the fiscal year 1993 financial statements.

The accompanying notes are an integral part of these statements.

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

September 30, 1994 and 1993

(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 C.F.R. Part 11. Costs are prorated based on capacity (municipal projects), on capacity and generation (nonmunicipal projects), or on a flat rate per horsepower under 1000 (minor projects).

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(1) Continued

Gas, Electric, and Oil

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

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

Filing Fees

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

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

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

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

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

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, as required by the *Chief Financial Officers (CFO) Act of 1990*.

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 appropriation (89X0212), including the budget authority allotted by the Department of Energy (DOE) to other DOE agencies.

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 uses 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 keep track of its budget authority at the various stages of execution, including allotment, obligation, and eventual outlay.

The financial statements are prepared in accordance with the following hierarchy which constitutes 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 OMB Bulletin 94-01, dated November 6, 1993, and subsequent issuances.

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

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

Revenue and Other Financing Sources

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

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

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(2) Continued

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

Fund Balances with Treasury and Cash

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

Cash balances advanced to imprest fund cashiers totaled \$10,000 as of September 30, 1994 and 1993.

Allowance for Doubtful Accounts

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

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation. The Commission capitalizes property and equipment purchases with a cost greater than \$5,000, and a total useful life exceeding two or more years. Depreciation is calculated based on an estimated useful life of seven years for all assets, except the local area computer network system and software, which is depreciated over three years. 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

Revenue collected under protest represents amounts paid to the Commission under protest until a legal determination can be made. These amounts are recorded as a liability.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(2) Continued

Collections for States and Other Agencies

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

Accrued Leave

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

Net Position Accounts

Net position account balances consist of the following components:

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

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

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

Future funding requirements represent 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.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(2) Continued

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.

Reclassifications

Certain amounts in the 1993 financial statements have been reclassified to conform to the 1994 presentation.

(3) Fund Balances with Treasury

Fund balances with Treasury at September 30, 1994 and 1993, consisted of :

| | 1994 | 1993 |
|--|----------------------|-------------------|
| Entity intragovernment assets: | | |
| Appropriated fund balance | \$ 67,160,572 | 49,695,922 |
| Revenue collected under protest | 6,268,145 | 11,944,231 |
| Miscellaneous receipts held in suspense | — | 124,586 |
| Total | 73,428,717 | 61,764,739 |
| Non-entity intragovernment assets: | | |
| Appropriated fund balance | 120,822 | 29,353 |
| Collections due to states | 2,514,841 | 2,279,628 |
| Total | 2,635,663 | 2,308,981 |
| Total fund balances with Treasury | \$ 76,064,380 | 64,073,720 |

(4) Entity Governmental Accounts Receivable

Entity governmental accounts receivable at September 30, 1994, consisted of:

| | Annual Charges | Other | Total |
|--------------------------------------|----------------------|--------------|-------------------|
| Uncollected billings | \$ 19,890,852 | 228,089 | 20,118,941 |
| Allowance for doubtful accounts | (1,153,095) | (224,562) | (1,377,657) |
| Total net accounts receivable | \$ 18,737,757 | 3,527 | 18,741,284 |

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(4) Continued

Entity governmental accounts receivable at September 30, 1993 consisted of:

| | Annual Charges | Other | Total |
|--------------------------------------|---------------------|---------------|------------------|
| Uncollected billings | \$ 9,995,204 | 271,835 | 10,267,039 |
| Allowance for doubtful accounts | (381,231) | (257,123) | (638,354) |
| Total net accounts receivable | \$ 9,613,973 | 14,712 | 9,628,685 |

(5) Resources Transferable to Treasury

Resources transferable to Treasury reflect the amount of non-entity accounts receivable that are outstanding as of September 30, 1994 and 1993 and the amount of unbilled Commission receivables. Resources transferable to Treasury consist of:

| | 1994 | 1993 |
|---|---------------------|-------------------|
| Unbilled receivables (see note 6) | \$ — | 46,143,255 |
| Non-entity receivables | 2,517,157 | 1,136,430 |
| Allowance for doubtful non-entity accounts | (693,414) | (3,515) |
| Total resources transferable to Treasury | \$ 1,823,743 | 47,276,170 |

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

(6) Unbilled Receivables

On March 18, 1993, the Commission issued Order No. 551, in which it revised the billing procedures for assessing annual charges for administering the hydropower program (Part I of FPA).

Under the revised procedures, the assessment of hydropower annual charges is based on an estimate of the costs that will be incurred by the Commission during the same fiscal year derived from the Commission's appropriation for that year. After the end of the fiscal year, the assessment will be recalculated based on the actual costs incurred during that fiscal year. The actual costs will be compared to the estimated costs, and the difference between the actual and estimated costs will be carried over as an adjustment to the assessment for the subsequent fiscal year. To avoid undue burden in the transition period, the costs incurred by the Commission in administering Part I of FPA during fiscal year 1992 were billed in fiscal year 1994, but, at the request of each licensee, may be payable in three equal installments in fiscal years 1994, 1995, and 1996, with interest assessed from 1994.

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(6) Continued

At September 30, 1993, unbilled hydropower receivables for fiscal year 1992 reimbursable costs amounted to \$46,143,255. There were no such unbilled receivables as of September 30, 1994.

(7) Property and Equipment, Net

Property and equipment, and related accumulated depreciation at September 30, 1994, consisted of:

| | Depreciation Method | Service Life | Acquisition Value | Accumulated Depreciation | Net book Value |
|--|---------------------|--------------|----------------------|--------------------------|------------------|
| Equipment | Straight-line | 7 years | \$ 5,305,088 | 3,095,828 | 2,209,260 |
| Assets under capital lease | Straight-line | 7 years | 1,302,689 | 619,386 | 683,303 |
| Local area network | Straight-line | 3 years | 3,786,107 | 1,226,437 | 2,559,670 |
| ADP software under development by contractor | — | — | 2,623,450 | — | 2,623,450 |
| Total | — | — | \$ 13,017,334 | 4,941,651 | 8,075,683 |

Property and equipment, and related accumulated depreciation at September 30, 1993 consisted of:

| | Depreciation Method | Service Life | Acquisition Value | Accumulated Depreciation | Net book Value |
|--|---------------------|--------------|---------------------|--------------------------|------------------|
| Equipment | Straight-line | 7 years | \$ 5,330,144 | 2,749,776 | 2,580,368 |
| Assets under capital lease | Straight-line | 7 years | 1,302,689 | 433,288 | 869,401 |
| Local area network | Straight-line | 3 years | 1,653,637 | 278,653 | 1,374,984 |
| ADP software under development by contractor | — | — | 1,423,817 | — | 1,423,817 |
| Total | — | — | \$ 9,710,287 | 3,461,717 | 6,248,570 |

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(8) Leases

Capital Leases

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

Operating Leases

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

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

| Fiscal year ending September 30 | Operating Leases | Capital Leases | Total |
|--|---------------------|-------------------|----------------|
| 1995 | \$ 255,473 | 152,693 | 408,166 |
| 1996 | 142,322 | 106,952 | 249,274 |
| 1997 | 57,480 | 61,386 | 118,866 |
| 1998 | 8,274 | 8,943 | 17,217 |
| Total future payments | \$ 463,549 | 329,974 | 793,523 |
| | | 1994 | 1993 |
| Total capital lease liability: | | | |
| Funded (leases entered into after October 1, 1992) | | \$ 329,974 | 481,167 |
| Unfunded (leases entered into prior to October 1, 1992) | | - | 76,829 |
| Total capital lease liability | | \$ 329,974 | 557,996 |

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

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

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.

(9) Commission Operating Expenses

Commission operating expenses for fiscal years 1994 and 1993 by object classification were as follows:

| | 1994 | (Unaudited) 1993 |
|--|-----------------------|---------------------|
| Personal services and benefits | \$ 100,216,710 | 96,490,823 |
| Travel and transportation | 2,158,050 | 2,139,930 |
| Rental, communications, and utilities | 13,901,684 | 12,778,299 |
| Printing and reproduction | 1,470,225 | 1,916,726 |
| Contractual services | 20,800,370 | 17,932,102 |
| Supplies and materials | 3,135,105 | 1,473,398 |
| Insurance claims and indemnities | 82,892 | 58,043 |
| Expenses incurred by other DOE agencies | 1,233,791 | 2,641,015 |
| Total Commission operating expenses | \$ 142,998,827 | 135,430,336 |

(Continued)

FEDERAL ENERGY REGULATORY COMMISSION

Notes to Financial Statements

(10) Nonoperating Changes

Nonoperating changes that affected the net position for fiscal years 1994 and 1993 were:

| | 1994 | (Unaudited) 1993 |
|---|----------------------|----------------------|
| Increases: | | |
| Transfers-in: | | |
| Current year appropriations | \$ 165,375,000 | 158,639,000 |
| Transfers of cash from others (allotments received) | 3,263,790 | 3,127,740 |
| Recoveries of prior year appropriations | 1,126,700 | 886,504 |
| Other increases | — | 3,797,588 |
| Total increases | 169,765,490 | 166,450,832 |
| Decreases: | | |
| Transfers-out: | | |
| Appropriated capital used | (147,998,992) | (139,387,519) |
| Change in future funding requirements | (140,243) | (576,118) |
| Other decreases | (216,131) | — |
| Total decreases | (148,355,366) | (139,963,637) |
| Net nonoperating changes | \$ 21,410,124 | 26,487,195 |

The other increases for the year ended September 30, 1993, primarily represent adjustments to net position to correct errors in the balances of accounts receivable; property and equipment; accounts payable; and revenue collected under protest. Management was unable to determine the allocation of these adjustments between fiscal year 1993 and prior year activity (see note 13).

(11) 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

(11) 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 for both plans for fiscal years 1994 and 1993 was approximately \$8.3 and \$7.9 million, respectively.

(12) 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.

(13) Unreconciled Balance on Statement of Cash Flows

In fiscal year 1993, the Commission completed an extensive reconciliation of its general ledger accounts. During this process, the Commission made adjustments to the balances of its asset, liability, and equity accounts. Although adjustments may have represented the correction of prior year activity, they were recorded in fiscal year 1993. It was not feasible for the Commission to identify the specific effects of these adjustments on each of the components of cash flow, as presented in the accompanying 1993 Statement of Cash Flows. Therefore, they are presented as an unreconciled balance.



Independent Auditors' Report on Internal Control Structure

The Federal Energy Regulatory Commission
United States Department of Energy:

We have audited the financial statements of the Federal Energy Regulatory Commission (the Commission) as of and for the year ended September 30, 1994, and have issued our report thereon dated December 30, 1994.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards* (1988 Revision), issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of the Commission for the year ended September 30, 1994, we considered its internal control structure in order to determine our auditing procedures for the purposes of expressing our opinion on the financial statements and to determine whether the internal control structure meets the objectives identified in the following paragraph. Our consideration included obtaining an understanding of the significant internal control policies and procedures and assessing the level of control risk relevant to (1) all significant cycles, classes of transactions, or account balances; and (2) the performance information control objectives described in the following paragraph.

The management of the Commission is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that transactions, including those related 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 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 properly recorded and accounted for to permit the preparation of reliable financial statements in accordance with applicable accounting principles described in note 2 to the financial statements and to maintain



accountability over the assets; and data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- Treasury
- Billing and collections
- Purchases and disbursements
- Payroll
- Financial reporting

For all of the internal control structure categories listed above we obtained an understanding of the design of relevant policies and procedures, determined whether they had been placed in operation, assessed control risk, and performed tests of the control structure.

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 objectives, we obtained an understanding of relevant internal control structure policies and procedures designed to permit the preparation of reliable and complete performance information, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB Bulletin No. 93-06. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure which in our judgment could adversely affect the Commission's ability to ensure that the objectives of the internal control structure, as previously defined, are being achieved. The conditions that we consider to be reportable conditions are included in Exhibit II of this report.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material 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 the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. The conditions we consider to be material weaknesses are included in Exhibit I of this report.

These conditions were considered in determining the nature, timing, and extent of audit tests applied in our audit of the September 30, 1994 financial statements, and this does not affect our report dated December 30, 1994 on these financial statements.

We also noted other matters involving the Commission's control structure and its operation that we have reported to the management of the Commission in a separate letter dated December 30, 1994.

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

KPMG Peat Marwick LLP

December 30, 1994

FEDERAL ENERGY REGULATORY COMMISSION

Material Weaknesses

September 30, 1994

Property and Equipment

Audit Comment

During fiscal year 1994, the Commission did not:

- Follow a reasonable depreciation policy. Currently, the Commission depreciates almost all capital assets over a seven year period, regardless of expected life. This policy misstates depreciation expense and the net value of property and equipment. An audit adjustment of approximately \$235,000 was made to depreciate certain computer and related assets over three, versus seven, years.
- Maintain adequate supporting documentation for certain property and equipment purchases. During our testwork of the Commission User Profile System (CUPS) inventory system maintained by the Management Services Branch (MSB), for three out of ten items tested, one of which was acquired after 10/1/88 (the date at which supporting documentation began to be maintained) and two acquired prior to 10/1/88; adequate supporting documentation for purchases could not be provided. This condition resulted because of inadequate storage of source documents, and a lack of a proper record retention policy.
- Write off property and equipment that had been identified as no longer usable by the MSB. When MSB identifies an asset as no longer usable, it is included on an excess report, which is sent to the General Services Administration (GSA). The Division of Financial Services (DFS), responsible for proper recording of the asset, does not receive this report. It is GSA's responsibility to determine if the asset will be transferred to another agency or destroyed. After receiving permission to dispose of the asset from GSA, MSB sends the disposal report to DFS. Currently, DFS intends to write off assets when it receives the disposal report rather than at the time the assets are identified as unusable. However, as of September 30, 1994, this entry was not made. The assets that were identified as unusable but not yet written off as of September 30, 1994, had an approximate cost of \$280,000 and accumulated depreciation of \$255,000. An audit adjustment was made to remove these assets from the Commission's September 30, 1994 financial statements.
- Maintain an accurate listing of asset information (purchase order number, acquisition date, dollar amount, description, etc.) for two of the ten assets tested in the CUPS detailed inventory system. This is the responsibility of the MSB.

FEDERAL ENERGY REGULATORY COMMISSION

Material Weaknesses

- Maintain accurate acquisition dates for 5 out of 18 assets tested from the detailed listing of all property and equipment (subsidiary ledger) maintained by the Commission.
- Reconcile the results of the physical inventory of property and equipment taken by MSB to its CUPS inventory system and to the detail of property and equipment in the general ledger (subsidiary ledger). We noted numerous differences between amounts on the subsidiary ledger and the CUPS inventory report. This resulted in an audit adjustment to capitalize assets with cost and related accumulated depreciation of approximately \$1.2 million and \$250,000, respectively.

The first four comments above are similar to findings in our fiscal years 1993 and 1992 reports. To address the above issues, the Commission developed a policies and procedures guide for property and equipment that was implemented in fiscal year 1994. Based on our review of the guide during the prior year audit, we noted several inconsistencies and ambiguities which were brought to the attention of the Commission's management. During the fiscal year 1994 audit, we noted that these inconsistencies and ambiguities have not been addressed.

The inconsistencies and ambiguities that need to be addressed include the following items:

- How review procedures will be documented
- Who is going to perform the reviews
- Which leased assets should be capitalized
- Lack of definitions for acronyms

These inconsistencies and ambiguities resulted from the absence of a centralized review process to ensure appropriateness and consistency. These conditions prevent the document from providing clear and correct guidance over property financial management.

Audit Recommendations:

We recommend that the Commission:

- Depreciate assets based on the assets' reasonable life expectancy, as described in the Commission's Administrative Directive (AD) 7-2B.

FEDERAL ENERGY REGULATORY COMMISSION

Material Weaknesses

- Implement procedures to maintain supporting original source documentation for asset purchases until such assets are disposed. The supporting documentation should be filed in an organized manner and proper control should be maintained to prevent lost or misfiled documents. These procedures should be documented in a formal record retention policy statement which should be distributed to all appropriate personnel.
- Write off property and equipment when it is identified as unusable rather than at the time the disposal of assets occurred. This information can be accessed on-line from the CUPS inventory system.
- Implement policies and procedures to ensure that disposed assets are written off. This information can be accessed on-line from the CUPS inventory system.
- Maintain an accurate listing of asset information on both the CUPS inventory report and the subsidiary ledger property detail.
- Reconcile physical inventory and detail property and equipment records maintained by MSB and DFS, verifying amounts recorded on the subsidiary ledger.
- Edit its current property and equipment procedures guide to eliminate inconsistencies and clarify ambiguities.

Auditee Response

During FY 1995, the Commission plans on addressing all the issues presented with respect to Property, Plant and Equipment. Cross functional groups will be formed to address all the problems, and corrective action will be taken. As the Commission moves into the new building, policy and procedures will be in place to compile and maintain an accurate listing of the Commission's assets, reconcile on a monthly basis the property, plant and equipment between the Departmental Integrated Standardized Core Accounting System (DISCAS) and CUPS systems, and ensure the property and equipment procedures guide is consistent and distributed to all appropriate personnel.

FEDERAL ENERGY REGULATORY COMMISSION

Material Weaknesses

Recording Accounts Payable

Audit Comment

Accounts payable liabilities should represent transactions for which goods or services have been received or performed that have not yet been paid. However, we noted that the Commission records liabilities when an obligation is established, rather than when goods are received or services are performed. This resulted in an overstatement of both liabilities and expenses at September 30, 1994, and an audit adjustment of approximately \$224,000 to the financial statements.

In addition, we noted that the Commission did not properly accrue for and record expenses incurred in fiscal year 1994, but paid for in fiscal year 1995. As a result, fiscal year 1994 and 1995 expenses were initially understated and overstated, respectively. This resulted in a fiscal year 1994 audit adjustment of approximately \$2.7 million.

Audit Recommendations

As recommended in our fiscal year 1993 report, we again recommend that the Commission make separate entries to record obligations and to record accounts payable. Obligations should be recorded when goods or services are ordered. Liabilities for accounts payable should be recorded only when goods are received or services are performed.

Additionally, we recommend that the Commission identify and accrue for services and goods received as of year-end, but not paid for until the next fiscal year, to ensure that expenses are reported in the proper accounting period for financial reporting purposes.

Auditee Response

Approximately midway through FY 1994, the Commission changed their method of recording accounting transactions related to accounts payable. The current process requires separate entries for the recording of obligations and of accounts payables. Obligations are recorded at the time good and/or services are ordered and accounts payable are established at the time goods and/or services are received and/or performed. The new standard operating procedures completed during FY 1994 reflect this process. In addition, a more detailed analysis and review by all Commission office's having outstanding obligations will be performed prior to year-end. This review will allow us to properly accrue for any goods and/or services received by year-end, and not paid for, as well as, ensure expenses are reported in the proper accounting period.

FEDERAL ENERGY REGULATORY COMMISSION

Reportable Conditions

September 30, 1994

Automated Data Processing (ADP) Matters

Audit Comment

We have the following observations related to ADP matters:

- The Commission does not have an Uninterruptible Power Supply (UPS) or an Emergency Power Supply (EPS) generator for the HP3000 system. Thus, if a power outage were to occur to the computer room, the HP3000 minicomputer would immediately shut off causing a loss of data.
- The costs of the HP3000 system operations are currently not charged back to the end-users (e.g., programs) through a charge back system. The lack of a system to appropriately allocate cost of data processing operations back to the end-user facilitates an environment for cost over-runs and inefficient use of data processing assets.
- The full volume weekly backups are stored on-site (in the same room) for one week prior to being moved to an off-site storage facility the following Monday. In the event of a disaster significant data could be lost.
- There are no procedures for incremental (e.g., daily versus weekly) backup storage. In the event of a disaster, incremental data could be lost. The lost data would have to be re-input into the system.
- The disaster recovery plan for the HP3000 has not been tested. In addition there is no disaster plan for the Local Area Network (LAN). Testing a contingency plan provides management the assurance that critical files and operations can be recovered within an acceptable time frame. Developing a contingency plan that encompasses the LAN operations will provide management input as to how the agencies would recover critical data processing functions in the event of a disaster.
- There is no enforcement of password expiration and there is no requirement for a minimum password length. The system is also not set to track a password's history, thus passwords can be used indefinitely without being changed. Without proper access controls, there is a potential for unauthorized access to the minicomputer.

FEDERAL ENERGY REGULATORY COMMISSION

Reportable Conditions

Audit Recommendations

- a. We recommend the Commission implement an EPS system (generators) and a UPS for the HP3000 processing environment in the new data center currently being constructed.
- b. We recommend the Commission implement an activity based system to distribute the full cost of providing services to all users.
- c. We recommend the HP3000 full volume weekly backup tapes be rotated off-site following on the completion of the backup.
- d. We recommend the HP3000 daily incremental backup tapes be rotated off-site on a daily basis.
- e. We recommend that ADP management plan and conduct a contingency plan test based on the procedures contained in the FERC ADP Contingency Plan. The Commission should also implement a disaster plan for the LAN, which should provide assurance that communications at the headquarters and regional offices can be continued during a recovery of the LAN at an alternative site.
- f. We recommend that the Commission establish data security policies, procedures and standards for the minicomputer that address password expiration period, password minimum length and reuse of prior passwords. Furthermore, the Security/3000 data security package should require users to periodically change passwords.

Auditee Response

- a. Concur. At the time of the audit, the FERC's HP 3000 model 935 system had a battery backup. Since then the system has been upgraded to a model 928RX which has an UPS that provides up to 15 minutes of uninterrupted power after an AC power interruption. The HP system has a 15 minute window to allow the system to come down properly in the event of power interruption. No further action is required on this finding.
- b. Concur. The FERC's HP 3000 mini computer is a centrally funded resource. The primary systems housed on the HP 3000 model 928RX are the commission-wide line-of-business applications DISCAS and Virginia Tech. Library System (VTLS). VTLS is available to all commission staff. Read access to the DISCAS system is provided to all money managers throughout FERC offices. Given the limited number of government data processing staff, it would probably cost more to develop, implement, maintain and administer a cost accounting or charge-back system than it would save, therefore no further action is required on this finding.
- c. Concur. Procedures have been changed to have the HP weekly backups transported off-site the following Monday after they are performed. No further action is required on this finding.

FEDERAL ENERGY REGULATORY COMMISSION

Reportable Conditions

Auditee Response

- d. Concur. FERC currently stores its daily incremental backups in the tape library, this facility is not in the data center. Incremental backups are used regularly to restore databases between the production and test accounts. If these backups were kept at the off-site facility, FERC would be charged for the early return of these backups, therefore this option is not cost effective. The recommendation to store the backups in another FERC business office will be moot after FERC moves into their new building. Because of the frequent use of these daily incremental backups the FERC cannot justify taking the tapes off-site further than current procedures. No further action is required on this finding.
- e. Concur. The ADP & Telecommunications Services Division (ATSD) is coordinating with the Deputy Chief Financial Officer's staff on this effort. The alternate processing site (i.e., Department of Energy) has indicated that testing will most likely commence during normal business hours. ATSD will coordinate the testing and activities accordingly. Current plans are to conduct a test by the end of March 1995.

The FERC does not have a formal disaster recovery plan for the FERC LAN. The FERC does have procedures for backing up all servers daily, with full backups performed weekly. The weekly backups are kept at an off-site storage facility. The FERC LAN design includes the use of the Simple Network Managements Protocol (SNMP) allowing consistent management of the network. The FERC also maintains backup hardware equipment such as servers in case of failures. The FERC will develop and implement a comprehensive disaster recovery plan for its Local Area Network by July 1, 1995.

- f. Concur. Some activities have been done on this finding. The newly installed HP 3000's password policy includes the same parameters for password obsolescence, length, and reuse as is established on the IBM mainframe. The HP 3000 users have been notified of the changes to the password policy. Security 3000 is being used to enforce these policies. A test of the new password policy has been conducted and the FERC is working with the security software vendor to correct problems discovered during testing. Currently plans are to fully implement password policy changes by March 31, 1995.

Receiving Reports

Audit Comment

The Commission's DFS does not match receiving reports of items delivered to the Commission to the corresponding invoices because the DFS does not receive copies of all receiving reports when items are received. Of six purchase documents examined, we noted five instances in which a receiving report was not attached or that the receiving report was not complete. Since the DFS does not receive these reports on a routine and timely basis, invoices for goods not received may be improperly paid.

FEDERAL ENERGY REGULATORY COMMISSION

Reportable Conditions

Audit Recommendation

As in our 1993 report, we again recommend that the DFS obtain and match receiving reports to the original invoices to ensure that disbursements are for goods actually received and are invoiced at the agreed-upon price.

Auditee Response

During FY 1994 the Commission began requiring receiving reports to be completed. This procedure is beginning to take hold. Those receiving reports received in the Division of Financial Services are matched against the obligating documents and invoices. The Commission will strive in FY 1995 to implement a formal process which will ensure receipt of all receiving reports. Procedures will be written delineating policy and procedures on the responsibilities and required documentation for all offices within the Commission. In lieu of receiving reports the Commission has the Contracting Officer's Technical Representative or Authorizing Official certify that all goods and/or services have been received and accepted prior to payment of any invoice.

Review of Payroll Records

Audit Comment

The Commission's payroll is processed centrally by the Department of Energy (DOE) based on the number of hours each employee works. The number of hours is certified by an authorizing official before the information is sent to DOE. After processing the payroll, DOE sends each certifying official a biweekly Premium Hours and Leave Report, which details the hours processed per employee. DOE requires certifying officials to review this report to ascertain that the biweekly payroll was processed accurately. Currently, the Commission does not review the report, which could result in inaccurate payroll processing. For one employee out of the five tested, the Premium Hours and Leave Report was not maintained. Further, for one employee out of five we tested, we noted that the overtime hours reported on the Premium Hours and Leave Report did not agree to the original Time and Attendance Report. Payroll expense represents approximately 70 percent of total operating expenses in fiscal year 1994.

Audit Recommendation

As in our 1993 report, we again recommend that the Commission implement formal procedures requiring timely review of the DOE biweekly Premium Hours and Leave Report. This report should be signed by the certifying officer.

FEDERAL ENERGY REGULATORY COMMISSION

Reportable Conditions

Auditee Response

The Commission has drafted formal procedures on reviewing the time and attendance data submitted to the Department of Energy against the biweekly Premium Hours and Leave Report. The procedures require review and signature by an authorized certifying official, and incorporate record retention responsibilities. The procedures will be distributed to all Commission offices for implementation.

Budgetary Control

Audit Comment

The Commission's accounting system, Departmental Integrated Standardized Core Accounting System (DISCAS), allows funds that exceed the obligation limits established by the Division of Budget to be obligated, expensed, and paid. These obligations are maintained within the system by Budget and Reporting Numbers (BRN).

The DFS runs an override report weekly listing all entries that have exceeded the BRN limit and makes necessary corrections. This override report is also reviewed by the Division of Budget, which makes adjustments to the BRN limits to eliminate obligations exceeding the originally established limits.

Audit Comment

We noted that neither DFS nor the Division of Budget sign the override report indicating its review and approval of any corrections.

Audit Recommendation

As in our 1993 report, we recommend that the accounting system be programmed to prevent the obligation, expending, and paying of amounts above budgetary limits. However, at a minimum, we recommend that both DFS and the Division of Budget implement formal review procedures, including dual signing of the report, which would verify that all appropriate corrections have been made.

Auditee Response

Procedures on reviewing the "Override" report are being drafted and include the requirement for authorized signatures by the Division of Budget and Division of Financial Services.



Independent Auditors' Report on Compliance with Laws and Regulations

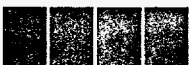
The Federal Energy Regulatory Commission
United States Department of Energy:

We have audited the financial statements of the Federal Energy Regulatory Commission (the Commission) as of and for the year ended September 30, 1994, and have issued our report thereon dated December 30, 1994.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards* (1988 Revision), issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement.

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

As part of our audit, we also obtained an understanding of management's process for evaluating and reporting on internal control and accounting systems as required by FMFIA and compared the Commission's fiscal year 1994 FMFIA reports with the evaluation we conducted of the Commission's internal control structure.



The results of our tests of compliance indicate that for the items tested, the Commission complied, in all material respects, with the provisions referred to in the third paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that the Commission had not complied, in all material respects, with those provisions. However, we noted one item we believe should be highlighted:

Performance Measures

Audit comment:

OMB Bulletin 94-01 requires that "the performance measures presented in the Overview should be limited to the most significant financial and program performance measures for the reporting entity." OMB Bulletin 94-01 provides guidance that for performance measures to be useful they must be "clearly set forth; present the significant results achieved by the reporting entity during the past year in relation to the mission and objectives of the reporting entity; and provide other explanatory information that would help readers understand the significance of the measures and the results". We noted that the Commission has not reported financial management performance measures in the Overview.

Audit recommendation:

We recommend that the Commission develop its internal financial management performance measures and address them in the Overview. The Commission should ensure that the performance measures are easily understood and compatible with its financial information included in the financial statements.

Auditee response:

We agree that the financial management performance measures were not addressed in the overview to the financial statements. However, this was an oversight. The main focus of the Commission for the past four years has been to achieve an "Unqualified" opinion on the financial statements. This was our main financial management performance measurement for FY 1994. We began significant work on the Performance Measurement aspect of the CFO Act this year. Our FY 1995 financial statement overview will report more thoroughly developed measurements and results. Additionally, we are working intensely with the Commission program offices to provide more definition and outcome basis to overall Commission performance measurements. We consider this an evolutionary, not a revolutionary process and believe significant progress from FY 1993 has been achieved.

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

KPMG Seat Marwick LLP

December 30, 1994



The Federal Energy Regulatory Commission

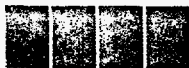
We have audited the financial statements of the Federal Energy Regulatory Commission (the Commission) as of and for the year ended September 30, 1994, and have issued our report thereon dated December 30, 1994. In planning and performing our audit of the financial statements of the Commission, we considered its internal control structure 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 control.

However, we noted certain matters involving internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions are matters coming to our attention that, in our judgment, relate to significant deficiencies in the design or operation of internal control and could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Our consideration of internal control would not necessarily disclose all matters in the internal control structure that might be reportable conditions.

A material weakness is a reportable condition in which the design or operation of specific internal control does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to the financial statements of the Commission may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. In our Independent Auditors' Report on the Internal Control Structure, dated December 30, 1994, we have reported matters involving internal control and its operation that we consider to be material weaknesses.

Other reportable conditions, all of which have been discussed with the appropriate members of management, are also presented in our Independent Auditors' Report on the Internal Control Structure, dated December 30, 1994.

These conditions were considered in determining the nature, timing, and extent of the audit tests applied in our audit of the Commission's 1994 financial statements, and this report does not affect our report on those financial statements dated December 30, 1994. We have not considered internal control since the date of our report.



Although not considered to be reportable conditions, we noted certain matters involving the internal control structure and other operational matters that are presented herein for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve the internal control structure or result in other operating efficiencies and are summarized in Exhibit 1.

We would like to take this opportunity to acknowledge the courtesy and assistance extended to us by the management of the Commission during the course of our audit.

This report is intended solely for the information and use of the Commission's management, and others within the Commission.

KPMG Seat Marwick LLP

December 30, 1994

Performance Measures

Audit Comment

The CFO Act of 1990 requires Federal entities to develop performance measures to assist managers in evaluating the efficiency and effectiveness of their programs, and communicate how the reporting entity is accomplishing its mission through its programs. The Overview, which includes program performance, "should provide a clear and concise description of the reporting entity, its mission, activities, accomplishments, and overall financial results and conditions." We noted that the Commission has improved its reporting of performance measures from FY 1993 to FY 1994, however, the performance measures are not reader friendly and are often confusing.

Audit Recommendation

We recommend that the Commission continue to evaluate and refine its performance measurement process and report its results in a clear and concise manner.

Auditee Response

We began significant work on the Performance Measurement aspect of the CFO Act this year. The Commission has prepared a Strategic Plan for the Office of the Executive Director and Chief Financial Officer. Our FY 1995 financial statement Overview will report more thoroughly developed measures and results. Additionally, we are working intensely with the Commission program offices to provide more definition and outcome basis to overall Commission performance measurements. We consider this an evolutionary, not a revolutionary process and believe significant progress from FY 1993 has been achieved.

Interest and Penalty Accruals

Audit Comment

We noted that the Commission properly waived interest charges (in compliance with the Debt Collection Act of 1982) related to a hydro bill and properly established a payment plan. However, the interest rate used to calculate amounts due for the bill was not changed in the system to the agreed upon interest rate under the payment plan.

Audit Recommendation

We recommend that the Commission implement policies and procedures to ensure that interest is properly accrued for all items where a payment plan has been established.

Auditee Response

Procedures have been drafted and are being tested on the establishment of payment plans. Incorporated in this procedure is the requirement to input and verify the agreed upon interest rate established in the plan.

Aging of Accounts Receivable

Audit Comment

We noted that when a delinquent receivable is forwarded to the contract collection agency, the Commission's system automatically changes the due date of the delinquent bill to the date that the bill is forwarded to the collection agency. Since this due date is used to age accounts receivable and to determine the estimate of the allowance for doubtful accounts, the allowance for doubtful accounts could be understated if the original due date is not maintained.

Audit Recommendation

We recommend that the Commission modify the computer system to maintain original due dates for accounts receivable.

Auditee Response

Procedures on forwarding delinquent receivables to the collection agency have been updated to include the modification of the due date back to the original due date. The procedures have been tested and incorporated into the existing procedures manual.

Disbursements

Audit Comment

The Commission does not have procedures to cancel all invoices once they have been paid by stamping them "PAID" to ensure that invoices are not paid more than once. During our fiscal year 1994 testwork, we noted that 5 of the 25 items were not stamped "PAID".

Audit Recommendation

We recommend that the Commission implement procedures to cancel all invoices once they have been paid by stamping them "PAID".

Auditee Response

Procedures are currently in place to require all invoices to be stamped "PAID." Review procedures will be implemented to ensure all invoices are marked "PAID."