FEDERAL ENERGY REGULATORY COMMISSION
Washington, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. AI11-1-000
February 16, 2011

TO ALL JURISDICTIONAL NATURAL GAS PIPELINE COMPANIES AND PUBLIC UTILITIES AND LICENSEES

Subject: Revision to Accounting Release No. 5, Capitalization of Allowance for Funds Used During Construction

The Commission has historically relied on the guidance issued by the Commission's Chief Accountant in Accounting Release No. 5 (Revised) (AR-5),[1] Capitalization of Interest During Construction, to address when a company may begin to accrue an allowance for funds used during construction (AFUDC).[2] Under this guidance, a natural gas pipeline company was allowed to accrue AFUDC beginning with the date it filed an application for a certificate of public convenience and necessity (certificate) with the Commission, provided that it incurred construction costs on a continuous, planned progressive basis.

The natural gas industry has undergone substantial changes since the issuance of AR-5 in 1968. Today, many natural gas pipeline companies seeking to construct pipeline facilities participate in the pre-filing process instituted by the Commission in 2001.[3] For

[1] *Accounting Release No. 5 (Revised), Capitalization of Interest During Construction*, effective January 1, 1968, FERC Stats. & Regs. ¶ 40,005.

[2] AR-5 uses the term "interest during construction" which is now referred to as AFUDC and as such we will use the term AFUDC in place of "interest during construction" in the revised AR-5.

[3] In 2001, the Commission instituted an optional pre-filing process and encouraged entities seeking authorization to construct new facilities to prepare and submit to the Commission conceptual design and engineering features of the proposed project, as well as extensive information about potential environmental, security and safety impacts prior to filing a certificate application. *See* Office of Energy Projects Gas Outreach Team, *Ideas for Better Stakeholder Involvement in the Interstate Natural Gas Pipeline Planning Pre-Filing Process*, December 2001, *available at* http://www.ferc.gov/legal/maj-ord-reg/land-docs/stakeholder.pdf.

the past ten years, natural gas pipeline companies participating in the pre-filing process have typically incurred significant project-related costs prior to filing a certificate application with the Commission. These changes required the Commission to reconsider its longstanding policy of limiting AFUDC accruals generally to those costs incurred on the date a certificate application was filed with the Commission.

On March 18, 2010, the Commission revised its policy for accruing AFUDC in *Southern Natural* and *Florida Gas*.[4] In these orders, the Commission concluded that the certificate application date was no longer an appropriate milestone for determining when to begin the accrual of AFUDC since many natural gas pipeline companies have been participating in the pre-filing process and have incurred significant project-related costs prior to filing a certificate application with the Commission.

The Commission found that it is important that the revised AFUDC policy achieve the following objectives: (a) be in harmony with the recent developments in the natural gas industry; (b) allow AFUDC capitalization on all prudent construction costs; (c) serve to promote infrastructure development by allowing for recovery of all monies invested in the construction of facilities; and (d) be directly correlated to the occurrence of construction project-related costs incurred to prepare the construction project for its intended use.

Based on the above objectives, the Commission revised its AFUDC accrual policy to allow natural gas pipeline companies to begin accruing AFUDC on construction projects when the following two conditions are met: (1) capital expenditures for the project have been incurred; and (2) activities that are necessary to get the construction project ready for its intended use are in progress (AFUDC policy conditions). The Commission explained that the term “activities” is to be construed broadly and includes all the actions, excluding preliminary survey and investigation activities, required to prepare the construction project for its intended use. In addition, the Commission found that the date that the Commission approves the request to initiate the pre-filing process is a strong indicator of the initiation of construction project-related activities.[5]

The Commission also directed applicants seeking a certificate for authorization to construct pipeline facilities to make a representation in their filing that AFUDC accruals included in the cost of the facilities are calculated in accordance with the Commission’s

[4] *Southern Natural Gas Co.*, 130 FERC ¶ 61,193 (2010) (*Southern Natural*); *Florida Gas Transmission Co. LLC*, 130 FERC ¶ 61,194 (2010) (*Florida Gas*).

[5] To accrue AFUDC prior or subsequent to the initiation of pre-filing, natural gas pipelines must be prepared to demonstrate that the AFUDC policy conditions have been met. *E.g.*, *Southern Natural*, 130 FERC ¶ 61,193 at P 36, 39; *Florida Gas* 130 FERC ¶ 61,194 at P 25, 28.

rules and regulations and pursuant to and consistent with the AFUDC policy conditions. Finally, the Commission emphasized that natural gas pipeline companies must retain records supporting the commencement of AFUDC accruals, and such AFUDC accruals will be subject to scrutiny through Commission audit or rate review, just as any other cost would.

Although the Commission established the revised AFUDC accrual policy in the context of when natural gas pipeline companies may begin AFUDC accruals, the revised policy is comparable with that currently used by public utilities and licensees. As a result, this revised AR-5 shall apply to all entities under the Commission's jurisdiction to which AFUDC is applicable. This revision will provide for consistency and uniformity in determining AFUDC.

Natural gas pipeline companies and public utilities and licensees may continue to accrue AFUDC for as long as the two conditions in the revised AFUDC policy continue to be met. However, AFUDC accruals must cease once the facility being constructed has been tested and is ready for, or placed in, service. This includes those portions of construction projects completed and put into service although the project is not fully completed. Finally, if construction is interrupted or suspended, AFUDC accruals must cease unless the company can justify the interruption as being reasonable under the circumstances.

The Commission delegated authority to act on this matter to the Director of the Office of Enforcement or his designee under 18 C.F.R. § 375.311 (2010). The Director has designated this authority to the Chief Accountant. This letter constitutes final agency action. Your company may file a request for rehearing with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713 (2010).

Sincerely,

Bryan K. Craig
Director and Chief Accountant
Division of Audits
Office of Enforcement

Enclosure

FEDERAL ENERGY REGULATORY COMMISSION

ACCOUNTING RELEASE NUMBER 5 (AR-5) (Revised)

Capitalization of Allowance for Funds Used During Construction

Question:

What is the proper period for capitalization of Allowance for Funds Used During Construction (AFUDC)?

Answer:

The capitalization period for AFUDC shall begin when two conditions are present: (1) capital expenditures for the project have been incurred; and (2) activities that are necessary to get the construction project ready for its intended use are in progress. AFUDC capitalization shall continue as long as these two conditions are present.

The term “activities” is to be construed broadly and includes all the actions required to prepare the construction project for its intended use, including activities prior to physical construction, such as the development of plans or the process of obtaining permits from governmental authorities. However, the term “activities” does not include preliminary survey and investigation activities. Activities occurring prior to the above two conditions being met would be considered preliminary in nature for the purpose of determining feasibility of projects under contemplation and would be included in Accounts 183, Preliminary Survey and Investigation Charges, or 183.2, Other Preliminary Survey and Investigation Charges, as appropriate. These preliminary activities would not be subject to AFUDC accruals until such a time as the two conditions are met and the amounts included in Account 183 or Account 183.2 are transferred to Account 107, Construction Work in Progress.

No AFUDC should be accrued during periods of interrupted construction unless the company can justify the interruption as being reasonable under the circumstances.

Capitalization of AFUDC stops when the facilities have been tested and are placed in, or ready for, service. This would include those portions of construction projects completed and put into service although the project is not fully completed. Should the test period exceed the allowable 30, 90, or 120 days, the company must submit full particulars and justification for an extension of such period to the Commission in accordance with Electric and Gas Plant Instruction 9(D) in the Uniform System of Accounts.

Bryan K. Craig
Director and Chief Accountant
Division of Audits
Office of Enforcement

Effective: March 18, 2010

Document Content(s)