FEDERAL ENERGY REGULATORY COMMISSION
Washington, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. AI19-1-000
December 27, 2018

TO ALL JURISDICTIONAL PUBLIC UTILITIES AND LICENSEES, NATURAL GAS COMPANIES, AND CENTRALIZED SERVICE COMPANIES

Subject: Accounting and Financial Reporting for Leases

The Financial Accounting Standards Board (FASB) has issued Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842).* ASU No. 2016-02 amends FASB Accounting Standards Codification, Topic 840, *Leases,* with the intent to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Under the FASB's new guidance, lessees are required to recognize on the balance sheet the assets and liabilities for the rights and obligations created by lease arrangements for operating leases with terms of more than 12 months. ASU No. 2016-02 is generally effective January 1, 2019 for generally accepted accounting principles (GAAP) purposes. Commission staff received a number of inquiries from industry participants regarding clarification on how to apply this ASU for purposes of regulatory accounting and reporting to the Commission. The commenters sought clarity on how to implement FASB's new lease accounting guidance within the framework and regulatory intent of the Commission's existing requirements for lease accounting.

As discussed herein, jurisdictional entities will be permitted to record operating leases that may be capitalized under ASU No. 2016-02 in the FERC balance sheet accounts that have already been established for capital lease assets and liabilities. All other provisions of lease accounting are not affected by this accounting guidance. This accounting guidance is intended to have no impact on the existing ratemaking treatment or practices.

The Commission's accounting requirements are not intended to mirror changes in FASB's Accounting Standards Codification, and the FASB updates should not be construed as required for regulatory accounting and reporting to the Commission. However, upon analysis, the Commission may issue accounting guidance to clarify how provisions of an ASU can be reflected within the Commission's existing accounting and financial reporting requirements. Accordingly, this accounting issuance is intended to provide clarity and certainty on how jurisdictional entities should apply the

Commission's accounting and reporting requirements related to lease arrangements in response to ASU No. 2016-02.[1]

ACCOUNTING FOR LEASES ON THE BALANCE SHEET AS A LESSEE

Based on the accounting regulations, Commission jurisdictional public utilities and licensees, natural gas companies, and centralized service companies classify all leases as either a capital lease or an operating lease. The Commission's accounting regulations state that capital leases are recognized on the balance sheet in Account 101.1 (Property Under Capital Leases), Account 227 (Obligations Under Capital Leases- Noncurrent), and Account 243 (Obligations Under Capital Leases – Current).[2] The Commission's accounting regulations do not require operating leases to be capitalized on the balance sheet. Under ASU No. 2016-02, all leases including operating leases must be capitalized if the lease term is more than 12 months.

1. **Question:** How should jurisdictional entities account for operating leases on the balance sheet for Commission accounting and reporting purposes?

Response: Under the Commission's accounting regulations, operating leases are not required to be capitalized and reported in the balance sheet accounts established for capital leases. However, a jurisdictional entity may choose to implement the ASU's guidance to report operating leases with a lease term in excess of 12 months as right of use assets, with corresponding lease obligations, in the balance sheet accounts established for capital leases. Entities that choose to do so must: (1) record the capitalized operating leases using the existing FERC balance sheet accounts for capital leases (Accounts 101.1, 227, and 243); (2) maintain unique subaccounts and auxiliary ledgers to separately identify and track the capitalized operating lease amounts included in the capital lease balance sheet accounts; (3) provide footnote disclosures in Notes to the Financial Statements of the FERC Form Nos. 1, 1-F, 2, 2-A, and 60 of any amounts included in the capital lease balance sheet accounts that relate to operating leases; (4) have in place

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[1] This accounting guidance does not amend the Commission's accounting regulations for lease accounting. Rather, it provides guidance on lease accounting within the existing regulated accounting framework. *See* 18 C.F.R. Part 101 and Part 201 (2018), General Instructions Nos. 19 and 20; and Definitions Nos. 15 and 16 (Part 101) and Nos. 18 and 19 (Part 201); *see also* 18 C.F.R. Part 367 (2018), General Instructions Nos. 18 and 19; and Definitions Nos. 25 and 26.

[2] *See* 18 C.F.R. Part 101, Part 201, and Part 367 (2018). Part 101 also provides Account 120.6 (Nuclear Fuel Under Capital Leases).

strong internal controls to ensure that there is no impact to the existing ratemaking treatment or practices for leases.

2. **Question:** How should jurisdictional entities account for capital leases on the balance sheet for Commission accounting and reporting purposes?

Response: Jurisdictional entities must continue to follow the Commission's current accounting regulations for capital leases.

3. **Question:** Under ASU No. 2016-02, some land easements may now be considered leases in the GAAP financial statements, whereas the Commission's accounting regulations require the cost of land and land rights, including land easements, to be reported in utility or gas plant accounts. How should jurisdictional entities account for land easements on the balance sheet for Commission accounting and reporting purposes?

Response: Jurisdictional entities must continue to record land easements to the appropriate utility or gas plant accounts. The Commission's accounting for easements remains unchanged.[3]

ACCOUNTING FOR LEASES ON THE INCOME STATEMENT AS A LESSEE

Under ASU No. 2016-02, capitalized lease assets are depreciated to expense accounts, and interest expense on the lease obligation is recognized and reported on the income statement. However, under the Commission's accounting regulations, depreciation of capital lease assets, and accrued interest expense on lease obligations, are not recognized. Rather, the Commission's regulations provide that the amounts recorded for the capital lease asset and the related obligation are reduced by equal and offsetting amounts over the lease term.[4] The Commission's accounting regulations only provide for the actual amounts paid under a lease arrangement to be recorded on the income statement in the appropriate rent expense account.

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[3] *See* 18 C.F.R. Part 101 and Part 201 (2018), Plant Instruction No. 7, and Part 367 (2018), Plant Instruction No. 55.

[4] *See* 18 C.F.R. Part 101 and Part 201 (2018), General Instruction No. 20, and Part 367 (2018), General Instruction No. 19.

4. **Question:** Will jurisdictional entities be allowed to utilize the accounting provisions of ASU 2016-02 for recording expenses associated with lease arrangements for Commission accounting and reporting purposes?

Response: No. Jurisdictional entities must continue to follow the Commission's accounting regulations for recording expenses related to lease arrangements. There should be no change to the expense account used to record the expense or to the amount of expense recorded as a result of this accounting guidance.

ACCOUNTING FOR LEASES AS A LESSOR

5. **Question:** Will there be any changes to the Commission's accounting for leases from a lessor perspective?

Response: No. Jurisdictional entities will continue to follow the Commission's accounting regulations for recording lease arrangements for lessors.

DISCLOSURES AND FUTURE FILINGS TO THE COMMISSION

6. **Question:** What are the required disclosures or filings to the Commission related to changes made to a jurisdictional entity's accounting practice in response to ASU No. 2016-02?

Response: In addition to the footnote disclosures required in the response to Question No. 1 above, jurisdictional entities should disclose any changes in accounting practice in response to ASU No. 2016-2 in their respective FERC Forms filed to the Commission quarterly and annually, within the Notes to the Financial Statements. The disclosure should also provide a statement indicating how such amounts are included in Commission jurisdiction cost-of-service rates.

To the extent a jurisdictional entity has a specific lease transaction that it proposes to treat differently from the guidance provided herein, the entity should request the Commission's approval prior to the implementation of its proposed accounting. Additionally, to the extent that there will be any rate impacts resulting from proposed changes in the jurisdictional entity's lease accounting, the entity should request the Commission's approval prior to the implementation of its proposed accounting.

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 (2018). The Director has designated this authority to the Acting 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 (2018).

Sincerely,

Steven Hunt

Steven D. Hunt
Acting Chief Accountant and Director
Division of Audits and Accounting
Office of Enforcement