FEDERAL ENERGY REGULATORY COMMISSION

Fiscal Year 2002 Annual Financial Report

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

As authorized by the Reports Consolidation Act of 2000, this report presents the Federal Energy Regulatory Commission's (FERC's, the Commission's) audited annual financial statements and its success in meeting its fiscal year 2002 performance goals.

This document contains information about the FERC's principal financial statements for fiscal year 2002 (FY2002), including a balance sheet; statements of: net cost; changes in financial position; budgetary resources; financing; and custodial activity; and notes to the financial statements. Additionally, it presents an overview of the FERC, its mission and organizational structure, and performance information. It serves as a guide to key FERC initiatives and activities taking place during FY2002, and planned for future years that demonstrate the breadth of the Commission's work.

Overview of the FERC

The FERC is an independent regulatory agency within the Department of Energy that:

- Regulates the transmission and sale of natural gas for resale in interstate commerce;
- Regulates the transmission of oil by pipeline in interstate commerce;
- Regulates the transmission and wholesale sales of electricity in interstate commerce by public utilities;
- Licenses and inspects private, municipal and state hydroelectric projects;
- Conducts environmental analyses related to the siting of natural gas pipelines, and the licensing of hydroelectric projects;
- Administers accounting and financial reporting regulations and conduct of jurisdictional companies;
- Approves site choices as well as abandonment of interstate pipeline facilities;
- Promotes understanding of energy market operations and technologies;

- Assures pro-competitive market structures and operations; and
- Remedies individual market participant behavior as needed to ensure just and reasonable market outcomes.

The Department of Energy Organization Act created the FERC on October 1, 1977, and abolished its predecessor, the Federal Power Commission (FPC). The Commission is composed of five members who are appointed by the President, with the advice and consent of the Senate. Commissioners serve five-year terms and have an equal vote on regulatory matters. No more than three members may belong to the same political party. The President designates one member to serve as Chairman and administrative head of the Commission. The Commission generally meets twice a month to transact business. Meetings are open to the public under the provisions of the Government in the Sunshine Act.

The Commission collects the full cost of its operations from annual charges and fees authorized by the Federal Power Act (FPA), Omnibus Budget Reconciliation Act of 1986 and other laws. Congress annually adopts a budget appropriation authorizing the Commission to use funds from the Treasury to meet operating expenses. The Commission returns to the Treasury all revenue from annual charges and fees; therefore, there is no direct taxpayer funding.

Mission

The Federal Energy Regulatory Commission regulates and oversees energy industries in the economic and environmental interest of the American public.

Organizational Structure

Approximately 1,184 full time equivalents carried out the Commission's mission in FY2002 utilizing a budget of $184.2 million.

Below is a list of offices within the agency as well as a short description of the role they play in the Commission's operations. In FY2002, FERC established two new offices, the Office of Market Oversight and Investigation and the Office of Administrative Litigation. An organizational chart for the FERC, as of November 10, 2002, is included at the end of this section.

Office of Energy Projects (OEP) – Fosters economic and environmental benefits for the nation through the approval and oversight of hydroelectric and natural gas pipeline energy projects that are in the public interest. Included in OEP are FERC's five regional offices located in Atlanta, Georgia; Chicago, Illinois; New York, New York; Portland, Oregon and San Francisco, California.

Office of Markets, Tariffs and Rates (OMTR) – Deals with matters involving markets, tariffs and rates relating to electric, natural gas and oil pipeline facilities and services.

Office of Market Oversight and Investigation (OMOI) – Oversees and assesses the operations of the nation's gas, oil pipeline and electricity markets.

Office of Administrative Law Judges (OALJ) – Resolves contested cases as directed by the Commission effectively, efficiently and expeditiously, either through impartial hearing and decision or through negotiated settlement, ensuring that the rights of all parties are preserved.

Office of the General Counsel (OGC) – Provides legal services to the Commission. OGC represents the Commission before the courts and Congress and is responsible for the legal phases of the Commission's activities. Included in OGC is Dispute Resolution Service (DRS). DRS assists participants achieve resolution of disputes through consensual decision making.

Office of Administrative Litigation (OAL) – Represents the public interest in administrative proceedings at the Commission. OAL provides testimony, exhibits and studies on electric rate, transmission, open access and restructuring cases and in natural gas rate-design cases.

Office of External Affairs (OEA) – Responsible for all external communications with the public and media for the Commission.

Office of the Secretary (OSEC) – Serves as the official focal point through which all filings are made for proceedings before the Commission.

Office of the Executive Director (OED) – Provides administrative support services to the Commission including human resources, procurement, organizational management, financial, logistics, information technology and other.

Federal Energy Regulatory Commission

Commissioners

Pat Wood III, Chairman

Linda Key Breathitt · William L. Massey · Nora M. Brownell

Office of Administrative Law Judges

Office of External Affairs

- Press Services
- Congressional, Intergovernmental & Public Affairs

Office of Administrative Litigation

- Technical Division
- Legal Division

Office of the Secretary

Office of the General Counsel

- Dispute Resolution Service
- Markets, Tariffs & Rates
- Energy Projects
- Solicitor
- General & Administrative Law

Office of Energy Projects

- Management & Operations
- Pipeline Certificates
- Environmental & Engineering Review
- Hydropower Administration & Compliance
- Dam Safety & Inspections
- Regional Offices

Office of the Executive Director

- Chief Accountant
- Logistics Management
- Procurement
- Financial Services
- Financial Policy
- Budget
- Management, Admin & Payroll Support
- Regulatory Audits
- Regulatory Accounting Policy
- Deputy Executive Director
- Human Resources Mgmt.
- Organizational Mgmt.
- Deputy Chief Information Officer

Office of Market Oversight & Investigation

- Market Oversight & Assessment
- Information Development
- Energy Market Oversight
- Financial Market Assessment
- Integrated Market Assessment
- Investigations & Enforcement
- Operational Investigations
- Technical Investigations
- Enforcement

Office of Markets, Tariffs & Rates

- Administration & Data Support
- Tariffs & Market Development - East
- Tariffs & Market Development – South
- Tariffs & Market Development – Central
- Tariffs & Market Development - West
- Policy Analysis & Rulemaking

Strategic Plan and Business Plan

The United States has the world's most durable market economy, every sector of which depends vitally on energy. FERC's primary duty is to make natural gas and electric power markets work well and thereby support a strong, stable national economy.

During the past two years, American energy markets have suffered a series of shocks from sustained high electric and natural gas prices in the West due to the collapse of Enron. These shocks have had long-term as well as short-term effects. In the short term, customers have sometimes paid very high prices for power. In the longer term, the financial instability of the industry and uncertainty about how markets will operate in the future has discouraged the infrastructure investment that is necessary to ensure the long-term health of the industries. FERC has responded to both the immediate market disruptions and the need for stable, fair long-term market structures.

California was among the first states to open its electric industry to competition, opening a restructured market in 1998. Until June 2000, California's electric markets appeared to work well. However, California's flawed market rules failed to send generators signals to build new capacity, even while the state experienced rapid economic growth. The lack of new capacity made the California market vulnerable. In 2000, a series of other conditions exposed that vulnerability: a severe drought curtailed hydropower; demand-side response was virtually non-existent, partly because of fixed retail rates; and a hot summer followed a cold winter. The balance between supply and demand tightened, and electric prices rose dramatically.

FERC responded to the crisis in Western energy markets by mitigating unjustifiably high electric prices and ensuring that power sellers did not withhold supplies to drive prices up. These measures provided customers with relief from extreme spot market prices. FERC also removed a series of regulatory obstacles to expedite providing increased energy supplies to the West. Since June 2001, throughout the West, electric prices have dropped to normal levels and below, and remained there. Several factors led to this result: reduced demand, relatively mild weather, increased supplies and FERC's price mitigation. Nonetheless, it is abundantly clear that market crises can erupt quickly, especially in electricity. If not prevented or treated quickly, they can do enormous damage.

The Commission responded to allegations of market manipulation by Enron by undertaking a large-scale investigation, not only of Enron but also of all other market participants in the West. That investigation clearly showed ways in which Enron and others could manipulate the markets. FERC is continuing investigations of specific company practices. Equally important, FERC has instituted measures to prevent such behavior in the future. Similarly, FERC showed how unregulated companies could take loans from regulated subsidiaries in hopes that rate-payers might cover the losses in case of default. The Commission is currently examining ways to prevent customers from suffering from such behavior.

In the aftermath of the electricity crisis in the Western United States, the Commission comprehensively revised and approved a new Strategic Plan on September 26, 2001. FERC developed a comprehensive Business Plan that aligns all of the activities it undertakes with the new Strategic Plan.

Given the experience of Western energy markets, it is now clear that the Commission's primary emphasis must be to facilitate a full transition to competitive wholesale energy markets as soon as possible, and to address crucial issues that arise during the transition. FERC's most important responses are:

- **A New Sense of Focus and Direction.** This is embodied by the Commission's new Strategic Plan, which forms the structure for both its budget and its efforts in the future.

- **An Increased Emphasis on Market Oversight and Investigation.** This is embodied in the third of the Commission's four goals, discussed below.

The new Strategic Plan lays out the Commission's goals in four areas:

1. Energy Infrastructure. Goal: Promote a Secure, High-quality, Environmentally Responsible Infrastructure Through Consistent Policies. This goal will encourage investment in the infrastructure needed to sustain energy markets by removing roadblocks, providing cost recovery clarity and welcoming innovative thinking about rates and use of new technology. By focusing on infrastructure, this goal covers many of the Commission's important traditional responsibilities, for example, pipeline certificates, hydropower licenses and preliminary permits, compliance activities, environmental and other licensing conditions, dam safety inspections and most rate determinations.

2. Competitive Markets. Goal: Foster Nationwide Competitive Energy Markets as a Substitute for Traditional Regulation. This goal focuses on FERC's need to complete the transition to competitive energy markets as quickly and comprehensively as possible. This will require the growth of many new institutions, particularly clearly defined and independent regional transmission organizations (RTOs), to make electric markets work. The Commission also needs to establish standardized market designs that will apply in every wholesale electric market, and encourage continued efforts by industry groups to standardize reliability and business practice standards, promote the use of demand-side participation in energy markets, and establish regional transmission planning. Along with some traditional work in the area of rate determinations, this goal furthers work on initiatives begun in the last couple of years such as RTOs and new policies for natural gas.

3. Market Oversight. Goal: Protect Customers and Market Participants Through Vigilant and Fair Oversight of the Transitioning Energy Markets. This goal will ensure that competitive energy markets benefit the Nation over the long run. FERC has established a new office to coordinate all market oversight and investigative activity. FERC needs a much stronger ability to recognize and respond to problems in the markets. At the systemic level, FERC needs to recognize problems when or before they develop and craft solutions quickly. The Commission must also be able to police individual behavior in markets much more effectively than in the past. Work toward this goal also includes more traditional work, such as some aspects of litigation, dispute resolution, complaints, mergers and auditing.

4. Resource Management. Goal: Strategically Manage Agency Resources. The Commission will be unable to meet programmatic challenges without management support. This includes enhancing the talents and skills of the staff through recruitment and training, building effective, customer-friendly information technology (IT) services, supporting the Commission with logistics and financial services and strengthening strategic management processes. This goal also covers the Commission's communication, outreach and collaboration efforts.

FERC adopted its first annual Business Plan in September 2001, detailing the Commission's activities and resource allocations to meet the Strategic Plan's goals and objectives. The Business Plan enables management to tie budget resources to Commission activities. To build in accountability, the Business Plan also identifies responsible offices, due dates and priorities. Developing the Business Plan is an iterative process. In its early stages, it is helping to identify which activities move the Commission toward particular goals and objectives. Future iterations will better refine priorities, identify gaps in implementation, organize resource allocation, and ensure the results the Commission wants to see by allowing FERC to more accurately compare estimated to actual resource use by strategic goals.

Looking Ahead – Making Markets Work

Since June 2001, electric prices across the West have dropped to normal levels and below and remained there with relatively minor exceptions. Several factors led to this result: reduced demand, relatively mild weather, increased supplies and the Commission's price mitigation. Nonetheless, it is clear that market crises can erupt quickly, especially in electricity, and the Commission is acting to provide a much more stable long-term platform for electricity markets. Two initiatives are especially important:

- Standard Market Design (SMD), and
- Market Oversight and Investigation.

SMD. On July 31, 2002, the Commission proposed for public comment a new rule which will facilitate the adopting of standard designs for electric power markets using the best practices from around the country and the world. SMD, which will permit regional flexibility, is a comprehensive proposal for shaping electric markets throughout the country and, when adopted, will:

- Eliminate residual undue discrimination by creating uniform rules for transmission service across the interstate grid with regional flexibility as appropriate;
- Ensure transmission grid and short-term markets will be operated by a fair, independent organization (e.g., RTO);
- Establish procedures to monitor market operations and mitigate market power and manipulation;
- Preserve and expand role of states in regional planning, resource adequacy, and pricing for new resources and facilities;
- Supplement long-term bilateral contracts with real-time energy markets that reveal the true costs of transmission congestion and value over location and time;
- Manage congestion on the electric grid by price instead of service denial, creating economic signals for new investments in infrastructure and technology;
- Set procedures for minimum long-term regional resource adequacy using generation, transmission and demand-side resources, with details set by regional state committees;
- Permit customers under existing contracts to keep the same level and quality of transmission service if they choose to;
- Allow flexible transmission pricing, including participant funding (cost causers are cost payers) for new transmission facilities;
- Rationalize and improve power plant transmitting siting with better signals, participant funding, and regional resource planning; and
- Create stability and certainty for customers and investors.

This proposal will save customers money because effective wholesale markets will:

- Achieve more efficient use of the current electric system;
- Increase the number of new, efficient, clean generators built, which drive down electricity prices;
- Treat everyone fairly;
- Protect existing contracts and service quality for native load;

- Prevent California-type melt-downs through market oversight and market power mitigation;
- Reduce price volatility; and
- Assign risk to the market, not customers.

The Commission's proposal will also improve reliability and security of the nation's infrastructure because effective wholesale power markets will:

- Use stable and balanced market rules to encourage investment in new generation, transmission and demand reduction;
- Make smart use of the existing transmission grid by using latest technologies;
- Encourage investment in new technologies that offer greater efficiencies and better environmental solutions;
- Adopt cyber-security standards that reduce grid vulnerability to terrorism;
- Increase and identify new resources available due to long-term planning and adequacy requirements, reducing short-term scarcity and outages; and
- Locate resources smarter and closer to customers, making the grid more reliable and secure.

When SMD is implemented, electric markets will have a strong long-term basis for providing customers with the very real – and very large – benefits that come from competition. For these reasons, the Commission is committed to properly formulating the rule in order to support reliable competitive markets in all regions across the country. Tailoring the market design so that the markets are established in a way that work most effectively in each region of the country is paramount. The intent of the standard market design proposal is to build on RTOs introduced in Order No. 2000, where the Commission recognized the need for regional variation in certain aspects of market design. In the Southeast and the West, for example, the Commission has recently reaffirmed this need for reliance on the formation of RTOs and regional differences that come naturally from that process.

Market Oversight and Investigation. One of the clearest lessons of the electric market crisis is that FERC needs to do a much better job of policing natural gas and electric markets and at addressing problems before they become severe. In the spring of 2002, the Commission established a new Office of Market Oversight and Investigation. This Office's job is to make sure that energy markets work. It will, for example:

- By working with regional market monitors, serve as the "cop on the beat" to identify individual players who abuse their market position;
- Provide objective benchmarks to assess market conditions and infrastructure needs; and
- Identify and remedy problems in the way markets are structured or operating.

OMOI will give FERC the ability to identify market conditions and address market problems quickly and effectively. This is a necessary part of restoring public confidence in energy markets. FERC has developed a new Commission meeting process to update Commissioners frequently on market developments, the first essential change in how the Commission does business in many years.

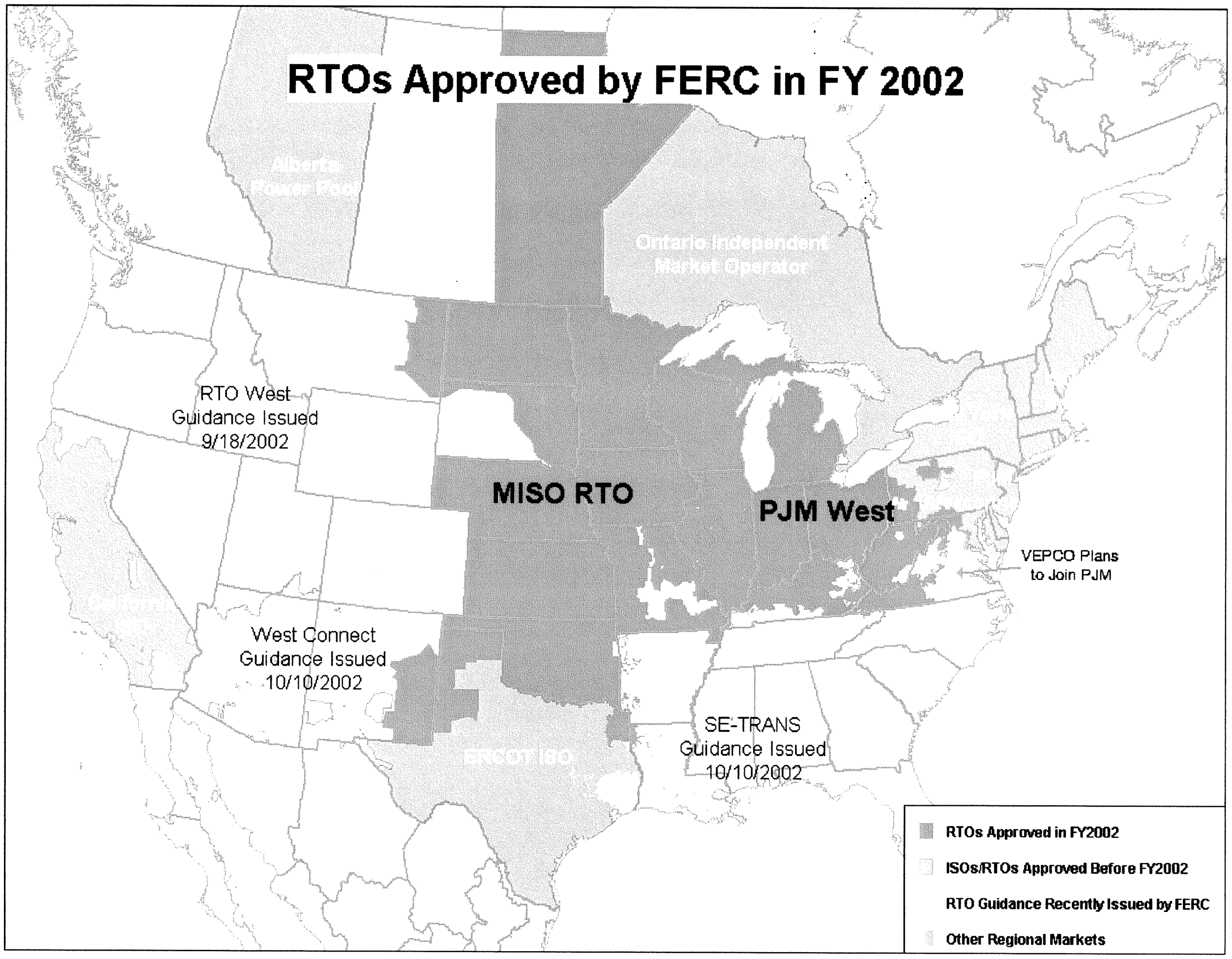
Program Performance

To ensure the FERC is making strides in fulfilling its mission, the Commission developed its Strategic Plan and Business Plan as discussed above, as well as performance measures, in accordance with the Government Performance and Results Act of 1993 (GPRA). Performance measures included in this overview were drawn from the FERC's Annual Performance Plan as submitted to Congress with the FERC's FY2002 Budget Request as well as the FY2001 Annual Performance Report (March 2002), which assesses FY2001 performance efforts and highlights the goals for FY2002 and FY2003. At this point it is essential to note that the FY2002 performance measures were developed prior to the electricity crisis in the Western United States and the collapse of Enron. They were also developed prior to creation of the Commission's new Strategic Plan. Hence, FERC believes several of the measures (in particular those associated with Competitive Markets and Market Oversight) are ineffective. The Commission is working to develop better performance measures to capture the effectiveness and efficiencies of its programs based on the Commission's new strategic direction. A complete list of the Commission's FY2002 performance measures and results is included at the end of this Management's Discussion and Analysis (MD&A) as other accompanying information.

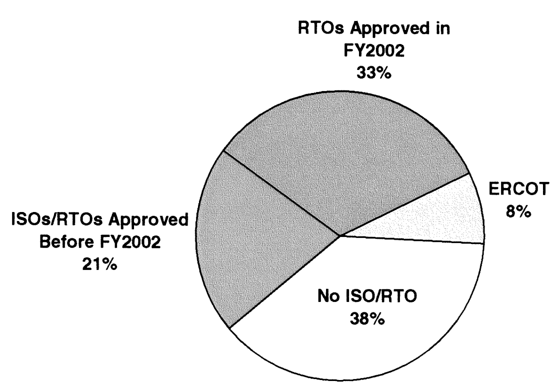
As mentioned previously, the Commission's most significant activities in FY2002 were the development of a Standard Market Design and the creation of the Commission's OMOI. The Commission has selected the following three measures for inclusion in this MD&A relating to the formation of regional transmission organizations as key to the success of SMD and the effective operation of OMOI.

The Commission began advancing competitive markets through establishment of RTOs and development of a SMD. As previously stated, when a SMD is implemented, electric markets will have a strong long-term basis for providing customers with the very real and significant benefits that come from competition. After the country is required to adopt some form of SMD, new performance measurements will be developed to track its success.

FY2002		
Performance Measurement	Performance Target	Result
Amount of load covered by regional institutions	20% increase over FY2001	Performance target achieved. See map "RTOs Approved by FERC in FY2002." The map shows a number of RTOs that received approval or preliminary guidance during FY2002. A statistical breakdown is provided in the graph "Percentage of Customer Demand Covered by RTOs Approved by FERC in FY2002." (See map and graph on page 12)
Number of public utilities separating ownership or operation of transmission facilities from generation	Increase over FY2001	Performance target achieved. See the map on page 11 titled "RTOs Approved by FERC in FY2002." For public utilities, separation of ownership or operation of transmission facilities from generation is a condition of approval to participate in an RTO. A statistical breakdown is provided in the graph "Percentage of Customer Demand Covered by RTOs Approved by FERC in FY2002." (See map and graph on page 12) Note: Separating energy transmission ownership or operation from energy production and sale is a circumstance of joining an ISO or RTO and serves to help prevent manipulation of the transportation system. While the Commission promotes and encourages forming RTOs, it has not directed companies to join; therefore, this performance measurement does not attain its intended purpose of measuring the Commission's success or failure in achieving such separation and effectively constrain some kinds of market power. After implementation, measurements that capture relevant aspects of standard market design should be more effective in tracking the Commission's success at developing energy markets (e.g., increase in the percentage of the country covered by independent transmission providers).
Number of market monitoring institutions and systems	Increase over FY2001	Performance target achieved. See the map "RTOs Approved by FERC in FY2002." Market monitoring activities are conducted by market monitoring units (MMUs) within approved RTOs and independent system operators (ISOs). A statistical breakdown is provided in the graph "Percentage of Customer Demand Covered by RTOs Approved by FERC in FY2002." (See map and graph on page 12)



Percentage of Customer Demand Covered by RTOs Approved by FERC in FY 2002



Source: FERC Form 714 net energy for load data for 2001.

Standard Market Design addresses all three of our strategic program goals. It will promote the development of the energy infrastructure the nation needs by:

- Providing a resource adequacy requirement for all regions of the country. While the specifics of the requirement may differ from one region to another, the bottom line is that no region will be able to ignore future needs. A shortage of operating capacity is one of the factors that led to the price run-up in California. One key to this provision of SMD is that demand and supply alternatives will compete equally. That will promote efficient investment in whatever resources will best meet the needs of the region.

- Encouraging market entry (in conjunction with the related interconnection initiative). SMD and the interconnection initiative will ensure that all resources will be treated equally in gaining access to the transmission grid.

- Introducing locational pricing for electric power and congestion revenue rights (CRRs) for those who have rights to firm transmission service. This will identify the value of power at different places around the grid. It makes clear where new resources would be most valuable, thereby promoting investment where it will do the most good for customers. CRRs provide a financial mechanism by which customers can obtain protection from congestion costs.

- Requiring a regional planning process. This will involve all states in the region in balancing appropriate investment across the entire region with cost recovery by the customers that benefit from the investment. Planning across the region rather than across only a single utility's system will yield optimal solutions for the region and will facilitate the siting of facilities that may be located in one state but may benefit customers in a neighboring state.

SMD will develop healthy power markets in several ways. For instance, it will:

- Require that independent transmission providers (ITPs) operate day-ahead and real-time power markets. These will be visible markets that participants can trust, because the operator is independent of all those with a position in the market. They will be markets that can work because they are based on proven designs that are already being used in the Northeast. They will be markets that ease entry into the electric business because they will be as standard as practical around the country and will allow demand to compete equally with supply.

- At the same time, be sufficiently flexible to accommodate differences among regions. For example, it will have provisions to address the specific issues raised by energy-limited resources (such as hydroelectric power), and intermittent power sources (such as wind and some other renewables).

- Respect state prerogatives in relation to bundled retail load. It works with state systems that include retail access and those that do not. It respects the rights of States to use cost-of-service rate-making to price power for retail customers. It anticipates the use of participant funding for new transmission, thereby protecting retail customers from paying for lines needed to serve other loads. And it lets entities that serve retail customers receive the CRRs needed to ensure that retail customers need not pay for congestion that may arise from increased market activity.

Finally, SMD will protect customers and market participants from market abuses. For instance, it will:

- Require the transmission operator to be fully independent of market participants.

- Impose market mitigation to prevent the exercise of market power. This mitigation begins with the resource adequacy requirement that is designed to prevent shortages from arising. It includes an absolute bid cap that will ensure offers to sell cannot exceed a certain level (perhaps $1,000 per megawatt hour as is currently done in Northeast markets). It also includes provisions directed specifically at load pockets that prevent any generator which is located in the load pocket from bidding an amount greater than its costs plus a reasonable return during periods of transmission congestion. Finally, it includes optional mitigation measures that could apply during periods of sustained market stress.

- Create market monitoring units (MMUs) in each region. The MMUs will be responsible for overseeing market performance, identifying problems and responding as needed. The MMUs will work closely with the Commission's new OMOI to ensure that there is fair and vigilant oversight in the markets to prevent market abuses.

While at this time, SMD is only a proposed rule in many parts of the country, RTOs and independent system operators (ISOs) are already implementing the key features of SMD. In the Northeast, most SMD features are already in place – and the region is continuing to move toward a single market design across all three ISOs. For example, New England will implement locational marginal pricing (LMP) in 2003. California, Texas (ERCOT) and the Midwest also are already implementing most SMD features. Even in regions that do not yet have functioning independent system operators or RTOs, RTO proposals have incorporated much of SMD. This is particularly true of the Northwest (RTO West) and parts of the Southeast (SeTrans).

In summary, over the past year, the Commission has led a major effort to improve market designs in all parts of the country. While several aspects of the Commission's proposal have been controversial, through ISOs and RTO proposals, most regions have implemented or have committed to implement key elements of SMD. These elements include independent operation of the transmission grid, regional transmission planning, common energy and ancillary service markets and a single transmission tariff for the region, market monitoring and market power mitigation, locational pricing and congestion management. The progress already achieved has significantly improved and broadened the geographic scope of such markets and already provides a defense against major market failures. FERC anticipates that SMD and RTOs will continue to develop over 2003, resulting in better markets and better guarantees against failure.

Market Oversight and Assessment

The events of 2000 and 2001 showed that the Commission must develop and impove its capability to oversee and investigate energy markets. The General Accounting Office (GAO) listed three key challenges facing the Commission:[1]

- The Commission's organizational structure limited the effectiveness of its oversight program because there was not sufficient focus on the problem;

- The Commission had not defined and implemented an effective approach to overseeing competitive energy markets; and

- The Commission faced significant challenges in addressing its human capital needs.

In FY2002, FERC moved aggressively to meet these challenges.

FERC has given market oversight the organizational structure it needs. OMOI became a formal, functioning Office within the Commission, in 2002. OMOI reports directly to the Chairman for administrative purposes. FERC has also designed a new agenda process so that OMOI reports directly to all of the Commissioners on market oversight and enforcement matters. As a result, market oversight and enforcement now has equal weight with more traditional forms of regulation in the Commission's deliberations.

1 GAO, *Energy Markets: Concerted Actions Needed by FERC to Confront Challenges That Impede Effective Oversight,* issued June 2002, but largely describing conditions as they were before formation of the Office of Market Oversight and Investigation.

FERC has transferred all of the oversight and investigation responsibilities to OMOI. All the core functions that OMOI will perform are now within the Office. The Commission has hired the executive team for the Office, the Office Director, the Deputy Director for Market Oversight and Assessment and the Deputy Director for Investigation and Enforcement.

FERC has made substantial progress in defining and implementing an effective approach to market oversight.

FERC has developed its first working blueprint for what market oversight and assessment must do. FERC revised Goal 3 of the Commission's Strategic Plan to reflect more precisely how it intends to oversee markets. Based on the revised Strategic Plan, FERC developed a Business Plan that describes the activities OMOI is undertaking, the products those activities will generate and the resources the Commission plans to spend on each activity. Together the revised Strategic Plan and the Business Plan are the best blueprint the Commission has ever had for how it will oversee markets. While the Business Plan will evolve, it is specific enough to guide the Commission's work now and provide a platform for changes in the future.

FERC is already implementing its new approach to market oversight. At the heart of OMOI's efforts to analyze and assess energy markets, is a series of periodic reports to the Commission, which include:

- A periodic Surveillance Report to Commissioners. This report, modeled on the practice of the Commodities Futures Trading Commission, describes important market developments directly to Commissioners once every two or three weeks. The reports are part of a closed Commission meeting to encourage full and open discussion of market developments. By the end of the fiscal year, the Surveillance Report had become a routine part of the Commission's agenda cycle.

- A semi-annual Seasonal Outlook. FERC produced its first Seasonal Outlook for the summer of 2002. In the future, FERC will produce one outlook in the fall (covering the winter heating season) and one in the spring (for the summer cooling season).

- An annual State of the Markets paper. This paper contains a review of overall market performance for both gas and electricity and highlights longer term issues identified by OMOI.

OMOI will also conduct investigations and enforcement actions closely focused on possible market manipulations and abuses, including random investigations of activities that could lend themselves to problematic behavior.

Finally, OMOI has begun an aggressive program of partnering with entities that must be part of an effective overall oversight program – other Federal regulatory agencies and MMUs at RTOs.

We are addressing our key human capital needs.

OMOI is obtaining the resources it needs. OMOI currently has about 90 employees on board at the end of FY2002 and is recruiting for additional positions. We have budgeted for the Office to have 110 full-time equivalents (FTEs) in FY2003. We have also budgeted $500,000 in contract dollars to obtain other resources that possess the expertise that we will need. We have hired more than 30 experts from outside the Commission. These include the Office Director and Deputy Office Directors. We have also greatly increased our expertise in financial markets, hiring a whole division of financial experts. Finally, OMOI is actively hiring for the senior level positions authorized by the Office of Personnel Management to recruit employees with extensive market-oriented expertise who can lead market oversight.

The Commission as a whole is taking action. We have undertaken a number of human capital initiatives. By offering early outs and buyouts, we are freeing up resources that can be redirected to program offices to augment market oversight capabilities. OMTR and OMOI are examining how to meet their needs for additional employees with market-oriented skills. OMTR is working with the Human Resources staff to post positions outside the Commission for high-level subject matter experts.

The Human Resources staff has begun a Workforce Planning effort involving representatives of major program and support offices. Office representatives are examining workload priorities, existing workforce capabilities and skills, future skills and staffing needs and strategies for closing identified gaps. This effort is tied to the Commission's strategic plan and will produce a blueprint for action on critical human capital issues.

The bottom line on market oversight and investigation is that we have moved rapidly to establish a credible program that is already producing valuable results.

Financial Performance

As of September 30, 2002, the financial condition of the FERC was sound with sufficient funds to meet program needs and adequate control of these funds in place to ensure FERC obligations do not exceed budget authority. The FERC prepared its financial statements in accordance with the accounting standards codified in the Statements of Federal Financial Accounting Standards (SFFAS) and with Office of Management and Budget (OMB) Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, as amended by OMB Bulletin No. 01-09.

Sources of Funds. The FERC receives an appropriation from Congress that is available until expended. The FERC's FY2002 new budget authority was $184 million. This represents an increase in new budget authority of $9 million over FY2001. Additional funds available to obligate in FY2002 were $10 million from prior-year appropriations. The sum of all funds available to obligate in FY2002 was $194 million.

Controls, Systems, and Legal Compliance

FERC's internal control program includes internal reviews conducted by each office. The Financial Managers Financial Integrity Act (FMFIA) requires that agencies identify material internal control problems and report them to management. External auditors, such as the Department of Energy's Office of Inspector General and the General Accounting Office, conduct audits annually. This year's reviews indicate a reasonable assurance that the Commission's management controls were working effectively, that applicable laws were being followed, and that FERC's resources were safeguarded against waste, loss or unauthorized use.

Limitations of the Financial Statements

The financial statements have been prepared to report the financial position and results of operations of the FERC, pursuant to the requirements of 31 U.S.C. 3515(b). While the statements have been prepared from the books and records of the FERC in accordance with generally accepted accounting principles for federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources to do so.

Other Accompanying Information: Performance Measurement Results

Performance Measurements for Energy Infrastructure (Goal 1)

FY2002		
Performance Measurement	**Performance Target**	**Result**
Percentage of cases completed in specified time	Specified time frames for FY2002 to be determined in FY2001 85% of cases completed within specified time frames: ➢ cases that involve no precedential issues and are unprotected, 159 days; ➢ cases that involve no precedential issues and are protested, 304 days; and ➢ cases of first impression or containing larger policy implications, 365 days ➢ cases requiring a major environmental assessment or environmental impact statement, 480 days	Number of days to complete 85% of the cases: ➢ 119 days for Category 1 ➢ 188 days for Category 2 ➢ 293 days for Category 3 ➢ 475 days for Category 4
Inspect each major onshore construction project at least once every four weeks during construction and at least once after construction completion	100% of qualifying projects inspected per established schedule	All six major onshore projects were inspected at least once every four weeks
Increase the percentage of licenses issued for applications using alternative licensing process (ALP)	2% increase over FY2001	9.4% increase over FY2001
Evaluate and improve effectiveness of required environmental enhancement and mitigation measures	Conduct 5 site visits to evaluate effectiveness	Conducted 5 site visits and evaluated the effectiveness of the targeted environmental mitigation measures
	Hold 2 regional meetings with stakeholders	Held 3 outreach meetings, i.e., shoreline management workshop in August 2002, American Fisheries Society meeting in August 2002, and water quality workshop in September 2002
	Initiate annual reports to evaluate the effectiveness of this effort	Issued 2 reports titled "Mitigation Effectiveness Studies at the FERC; An Overview"; and "Mitigation Effectiveness Studies at the FERC: Draft Water Quality Report."
Percentage of filings addressing the development of increased capacity	25% of all relicense cases using ALP or other collaborative process	26% of licenses issued resulted in an increase in capacity; 27% of licenses issued based upon collaborative process (ALP) resulted in an increase in capacity
Percentage of high- and significant-hazard potential dams meeting all current structural safety standards	Percentage remains uniformly high	94% of high- and significant-hazard potential dams met all current structural safety standards
Percentage of high- and significant-hazard potential dams inspected annually	100% of qualifying dams inspected annually	100% of high- and significant-hazard potential dams inspected in FY2002

FY2002		
Performance Measurement	**Performance Target**	**Result**
Percentage of high- and significant-hazard potential dams in compliance with emergency action plan requirements	100% of qualifying dams in compliance	100% of high- and significant hazard potential dams in compliance with emergency action plan requirements
Update and add new chapters to the Engineering Guidelines, as appropriate	Complete revisions to Chapter 3 Gravity Dams	Chapter 3 – Gravity Dams and Chapter 8 – Hydrology were completed
Complete development of the dam performance monitoring program	Performance monitoring program established	Performance monitoring program was established and a pilot program was implemented

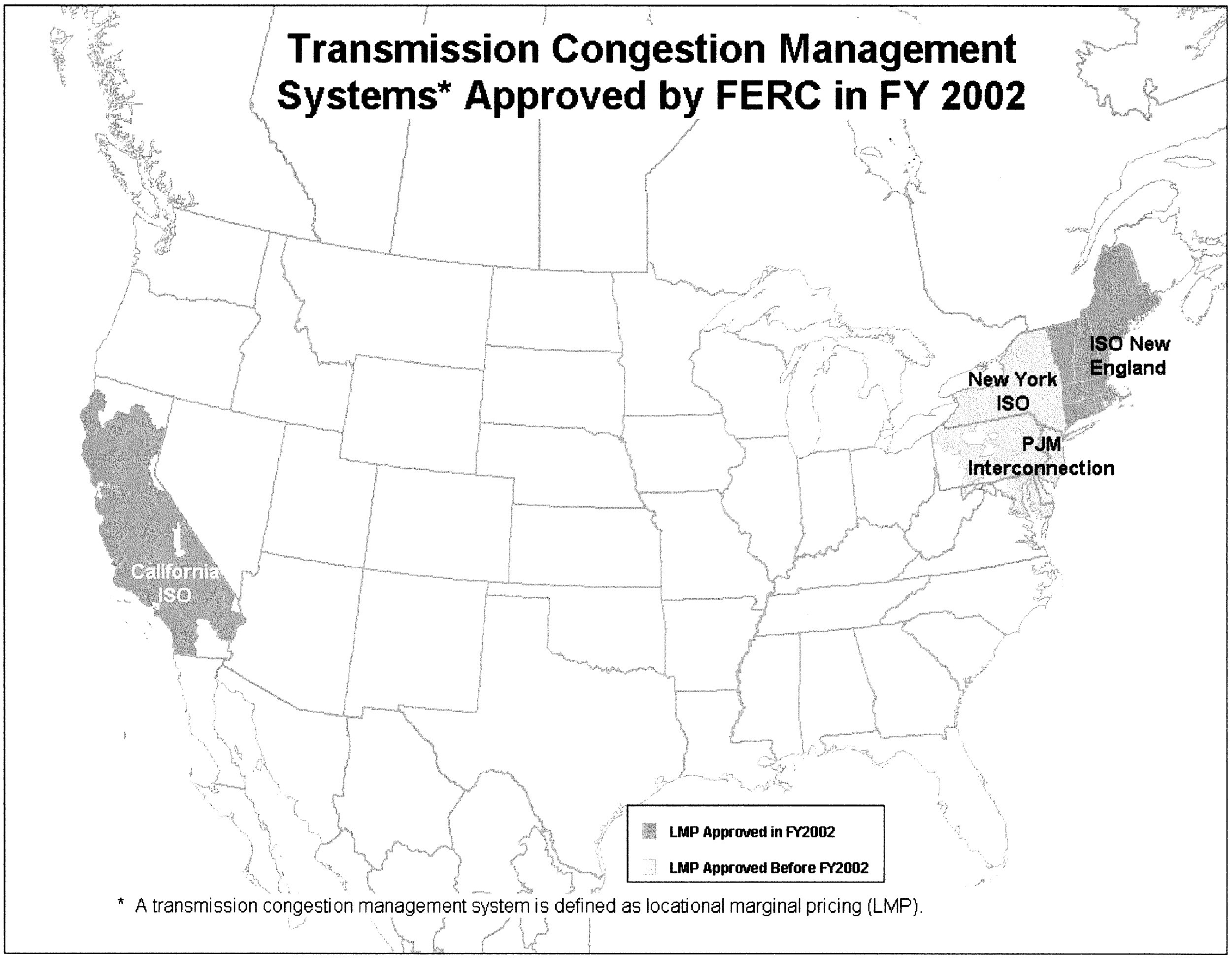
Performance Measurements for Competitive Markets (Goal 2)

FY2002		
Performance Measurement	**Performance Target**	**Result**
➢ Number and size of capacity holders by market ➢ Number and size of natural gas and electric secondary market participants ➢ Number and size of pipeline suppliers by region and major customer ➢ Number and size of electric power marketers	➢ Reasonable range of suppliers should lead to competitive pricing ➢ Participation indicates confidence in market rules and oversight	Several significant energy marketers have announced either plans to exit the energy trading business, or consideration of exit. Generally sited reasons include financial underperformance and credit concerns. The resulting contraction can have negative effects on liquidity in energy markets. Companies that have announced complete or partial exits from energy trading in recent months include large players like: • American Electric Power • Aquila • Dynegy • El Paso Companies considering exit include • Allegheny • CMS Some players have announced interest in entering as well, including the Bank of America.
Increase in types of tariffed services offered (e.g., parking and lending in natural gas)	Innovation indicates markets are working and market participants are creating their own solutions	In its Annual Performance Report for Fiscal Year 2001, the Commission acknowledged the ineffectiveness of this performance measurement to evaluate the agency's success at developing energy markets. New measurements will be in effect for FY2003 with attributes the Commission perceives to be necessary for markets to function
Increased services in the market (develop a time line for different services, e.g., new futures exchanges, new types of products (e.g., weather derivatives) and independent exchanges	New service offerings show adaptation to price volatility and help to stabilize markets through hedging of risks	With the end of Enron Online and Dynegy Direct, wholesale energy services largely shifted toward stronger, higher-quality services, including the New York Mercantile Exchange (NYMEX) and the Intercontinental Exchange (ICE). Enron Online and Dynegy Direct were not exchanges, but extensions of Enron's and Dynegy's marketing efforts. Consequently, they were susceptible to the credit weaknesses of their owners. Exchanges like NYMEX and ICE have better approaches to managing credit risk, and consequently are better for the industry. For example, NYMEX extended its credit clearing ability to certain over-the-counter natural gas and electricity trades. On October 22, 2002, NYMEX announced that it had cleared more than $1.1 billion of these deals since inception of the service on May 31,

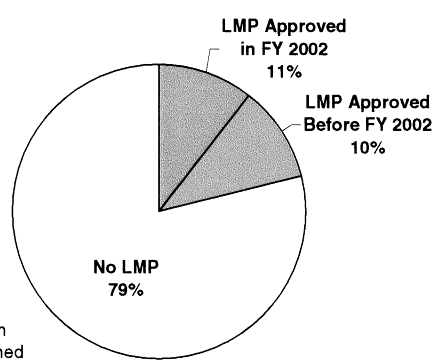
FY2002		
Performance Measurement	**Performance Target**	**Result**
		2002. In addition, on June 17, 2002, NYMEX and the Chicago Mercantile Exchange (CME) introduced their e-miNY natural gas contracts that handle smaller volumes than standard NYMEX natural gas contracts, extending the reach of exchange-traded futures contracts to smaller energy companies. E-miNY contracts are traded on CME's GLOBEX electronic trading platform. ICE began over-the counter clearing as well, in March 2002. On November 7, 2002, ICE announced that total cleared notional value of natural gas contracts in the United States had surpassed $10 billion. Success of these higher-quality products is a positive sign for energy markets.
Volume of financial risk-hedging transactions, e. g. futures contracts	Viable financial markets provide critical support for physical markets	Futures contracts for natural gas have shown promise in 2002, strengthening to what appears to be record levels. To date, however, there has been no attempt to revive electric futures markets in the U.S.
Response of prices to external conditions in natural gas and electricity (e.g., events, weather, plant outages)	Large price changes should normally be associated with some clear external event	Price differences that have been associated with external events in 2002 included: • The Leona fire in California in September 2002 caused a key transmission path to be taken out of service, and caused price differences between Northern and Southern California. • Hurricanes in the Gulf (Isidore and Lilli) caused temporary price increases in natural gas prices in September, but prices returned to normal levels after the storms. • Natural gas pipeline capacity into New York City is sometimes constrained, causing significant price increases. Price increases occurred at the end of July 2002 and early in August, with prices rising to a daily midpoint price $7.65. Although these price increases were related to capacity constraints on the pipeline system, they were nevertheless unusual for the season and are still being investigated to assess their cause. • Natural gas prices in Florida have spiked due to capacity problems that are exacerbated by lack of storage capacity. These price increases have occurred under

FY2002		
Performance Measurement	**Performance Target**	**Result**
		higher load conditions or when Operational Flow Orders have limited pipeline capacity.
Level of price volatility and changes in price volatility in electricity and gas	Changes in price patterns over time can reveal underlying market conditions	Futures price information indicates a slight lowering of price volatility for natural gas since June 2002, in comparison to 2001. From June to September, 30-day volatilities for the near-month contract have ranged from 40 to 70, compared with 80 to 100 during the last quarter of 2001. Without futures prices, similar calculations cannot be made for electricity; however, volatility has clearly dropped from pre 2002 levels.
Correlation of commodity prices across regions; narrowing of commodity price differences in the absence of transmission constraints	Correlations should be near 1.0, except when transmission constraints bind and prevent free flow of commodities	This performance measure is intended to gauge the extent to which arbitrage is causing prices to clear across regions – if arbitrage is effective, price difference should narrow. For 2002, this measure was studied by examining price difference identifying causes that were preventing arbitrage from being effective, or conducting further study to identify causes. These analyses of external conditions are described above under the performance measure for the responsiveness of prices to external conditions.
Increased use of market hub services in natural gas and electricity	➢ Increased usage of market infrastructure indicates market depth and liquidity ➢ Increased electronic commerce reduces transactions costs and allows broader market participation	Use has been affected negatively by contraction in the industry (see performance measure 1 of this section).
Growth of electronic services for the commodity and/or transportation		Higher quality options have replaced lower quality options and are showing some strength (see performance measure 3 of this section).
Increased economic transmission distance		Growth in RTOs and the associated development of regional markets in the Midwest (MISO) and through additions to Pennsylvania-New Jersey-Maryland (PJM) have begun to provide the basis for the needed market infrastructure. PJM has added additional utilities as part of PJM west and is beginning the process of adding AEP and other utilities. MISO has begun operation and is planning the development of markets along the lines of the Commission's Standard Market Design (SMD.) In addition, there are designs being discussed among MISO and PJM for the operation of a joint market. These developments will begin to reduce the transactions costs of participation in a broader power market.
Investment in generation and transmission	Investment should be adequate to meet market needs	There has been substantial growth of generation capacity in 2002. Nationwide, approximately 71,000 megawatts of electricity capacity is expected to be added in 2002, on top of around 42,000 megawatts added in 2001. The total capacity added in these two years (113,000 MW) is greater than

FY2002		
Performance Measurement	**Performance Target**	**Result**
		the total capacity added from 1990 to 1999 (87,000 MW.) At the same time, many future projects have been cancelled or tabled as a result of lower prices in forward markets and the financial problems of many companies. The current outlook is for adequate generation supplies in the near term, but an uncertain outlook in the longer term that will require continued assessment. Transmission investment increased in 2002 compared with previous years, roughly in proportion to the growth in generation. Thus, transmission capacity remains adequate for basic reliability and to accommodate the basic needs of interconnecting new generation capacity. However, there has been no evidence that transmission capacity has been expanded to address the needs of a changing market structure.
Number and type of reliability-related incidents (emergencies, involuntary load reductions, transmission load relief (TLRs))	Emergencies should be infrequent; routine market rules should be able to handle most situations	TLR events have not decreased in 2002. This is one of the issues that the Commission is addressing in the Standard Market Design rulemaking.
Amount of load covered by regional institutions	20% increase over FY2001	Performance target achieved. See map “RTOs Approved by FERC in FY2002.” The map shows a number of RTOs that received approval or preliminary guidance during FY2002. A statistical breakdown is provided in the graph “Percentage of Customer Demand Covered by RTOs Approved by FERC in FY2002.” (See map and graph on page 12)
Amount of load with congestion management systems	20% increase over FY2001	Performance target (12) achieved. See map “Transmission Congestion Management Systems Approved by FERC in FY2002.” A statistical breakdown is provided in the graph “Transmission Congestion Management Systems Approved by FERC in FY2002.” (See map and graph on page 25)
Number of wholesale service options available	Increase	Prior to FY2002, the Commission believed tracking the number of wholesale service options available would provide a measure for increased pricing efficiency. This indicator became invalid once the Commission began advancing competitive markets through development of a standard market design. When a standard market design (SMD) is implemented, electric markets will have a strong long-term basis for providing customers with the very real and significant benefits that come from competition. After the country is required to adopt some form of SMD, new measurements will be developed to track its success (e.g., lowering costs through standardized features, etc.).



Transmission Congestion Management Systems* Approved by FERC in FY 2002



* A transmission congestion management system is defined as Locational Marginal Pricing (LMP).

Source: FERC Form 714 net energy for load data for 2001.

Performance Measurements for Market Oversight (Goal 3)

FY2002		
Performance Measurement	**Performance Target**	**Result**
Number of market monitoring institutions and systems	Increase over FY2001	Performance target achieved. See the map "RTOs Approved by FERC in FY2002." Market monitoring activities are conducted by market monitoring units (MMUs) within approved RTOs and independent system operators (ISOs). A statistical breakdown is provided in the graph "Percentage of Customer Demand Covered by RTOs Approved by FERC in FY2002." (See map and graph on page 12)
Number of public utilities separating ownership or operation of transmission facilities from generation	Increase over FY2001	Performance target achieved. See the map "RTOs Approved by FERC in FY2002." For public utilities, separation of ownership or operation of transmission facilities from generation is a condition of approval to participate in an RTO. A statistical breakdown is provided in the graph "Percentage of Customer Demand Covered by RTOs Approved by FERC in FY2002." (See map and graph on page 12) Separating energy transmission ownership or operation from energy production and sale is a circumstance of joining an ISO or RTO and serves to help prevent manipulation of the transportation system. While the Commission promotes and encourages forming RTOs, it has not directed companies to join; therefore, this performance measurement does not attain its intended purpose of measuring the Commission's success or failure in achieving such separation and effectively constrain some kinds of market power. After implementation, measurements that capture relevant aspects of standard market design should be more effective in tracking the Commission's success at developing energy markets (e.g., increase in the percentage of the country covered by independent transmission providers)
Number of requests and referrals for Alternate Dispute Resolution (ADR) services	25% increase over FY2001	Dispute Resolution Service (DRS): There were 52 requests in FY2001, and 51 requests in FY2002. This represents a slight decrease. However, this amount also reflects an increase in the DRS non-case projects and development of stakeholder programs. The 51 request or active cases includes simple inquiries about ADR, cases in which persons eventually indicated that they were not interested in using ADR, cases referred to Enforcement Hotline, and ongoing cases.
Percentage of customers satisfied with ADR processes	85%	**OALJ/OAL:** Participants report near 100% satisfaction with ADR procedures. Satisfaction is indicated by calls from participants and by the increase in ADR procedures.

FY2002		
Performance Measurement	**Performance Target**	**Result**
		DRS: 90% (21 out of 23 completed cases). Note: This includes 10 cases that were begun prior to FY2002 but completed in FY2002. It does not include simple inquiries about ADR (6), cases in which persons eventually said they were not interested in using ADR (7), cases referred to Enforcement Hotline (1), or cases that were ongoing into FY2003 (14).
Percentage of processes that achieve consensual agreements ➢ ADR processes ➢ Cases set for litigation resolved, at least in part, through consensual agreement	➢ 25% increase over FY2001 ➢ 5% increase over FY2001	**OALJ/OAL**: Settlements were achieved in 69 out of 79 cases through ADR procedures. **During FY-2002:** 69 out of 79 cases (86.3%) were completed through ADR. **In FY-2001:** 62 out of 77 cases were completed through ADR (80.5%) **DRS**: 20 of 23 cases (87%) that were completed in FY2002 achieved settlement. Note: This includes 10 cases that were begun prior to FY2002 but completed in FY2002. It does not include simple inquiries about ADR (6), cases in which persons eventually said they were not interested in using ADR (7), cases referred to Enforcement Hotline (1), or cases that were ongoing into FY2003 (14).
Percentage of cases in time frames ➢ ADR processes completed ➢ litigated cases reaching initial decision	➢ 20% of ADR cases within 60 days ➢ 30% of ADR cases within 100 days ➢ 75% of ADR cases within 150 days ➢ 100% of ADR cases within 200 days ➢ 95% of simple litigated cases within 206 days (29.5 weeks) ➢ 95% of complex litigated cases within 329 days (47 weeks) ➢ 95% of exceptionally complex cases, 441 (63 weeks) ➢ 95% of regular complaints, 60 days ➢ 95% of fast track complaints, 8 days	**ADR Cases – OALJ/OAL**: 69 cases were completed by settlement: 4 out of 69 cases were settled within 60 days (5.8%). 11 out of 69 cases sere settled within 100 days (15.9%). 18 out of 69 cases were settled within 150 days (26%). 11 out of 69 cases were settled within 200 days (16%). 25 out of 69 cases were settled after 200 days (36%). **ADR Cases - DRS :** Of 23 completed cases: 5 were completed within 60 days (21% total). 7 more were completed within 100 days (52% total). 1 more was completed within 150 days (57% total). 2 more were completed within 200 days (60% total). The remaining 8 were completed in over 200 days. **Litigated Cases – OALJ/OAL:** **Track I Cases** – Standard processing Time = 29.5 weeks – None during FY-2002. **Track II Cases** – Standard Processing time = 47 weeks – FY-2002 average Processing Time 32.5 weeks **Track III Cases** – Standard Processing Time = 63 weeks – FY-2002 Average 39.42 weeks **Complaint Cases** – FY-2002 Complaints All took > 60 days to resolve.

Performance Measurements for Resource Management (Goal 4)

FY2002		
Performance Measurement	**Performance Target**	**Result**
Number of documents and filings available and received electronically	10% increase over FY2001	➢ The percent of qualified documents received electronically increased from 11.6% to 34.38% ➢ Number of filings received in FY2001 was 1,968; in FY2002 we reach 8,903.
Reliability of IT infrastructure services	➢ 98% network availability ➢ 33% annual PC replacement ➢ 98% Internet site availability	➢ 98.5% network availability ➢ 33% annual PC replacement ➢ 99.5% Internet site availability
Percentage of agenda items issued within 5 working days of a Commission meeting	100%	100%
Percentage of electric notices issued within 5 working days of receipt of filing	95%	95%
Unqualified opinion on annual financial statements	Unqualified opinion	Commission received an unqualified opinion on its FY2001 financial statements
Monitor manage-to-budget concept	Track biweekly; review quarterly	Performed bi-weekly updates to manage- to-budget spreadsheets used by managers to track spending, and reviewed status quarterly
Effective and efficient financial and administrative support	➢ Collect annual charges within 45 days of billing ➢ 98% of invoices paid by electronic funds transfer ➢ 1% increase in contract awards and purchase orders to small, minority, and women-owned businesses ➢ All contracts advertised online ➢ All contracts performance-based	➢ Collected 98% of the annual charges it assessed in FY2002 within 45 days of billing ➢ Processed 100% of payments electronically ➢ 92% increase ➢ All contracts were advertised online ➢ All contracts were performance-based
Increase diversity of staff in high grades	Increase diversity in GS-14, GS-15, and SES positions by 10% over current baseline	Increased the number of minorities in GS-14, GS-15 and SES positions by five (or 6 percent).
Number of new hires from recruitment program	Meet the Commission's need for new talent through targeted recruitment, with 50% at entry levels	Exceeded 50% target level by 2%. Of the 103 permanent hires in FY2002, 54 were entry level recruits. Met the Commission's need for new talent through targeted recruitment.
Staff participation in learning and development programs	➢ Expand leadership development program ➢ Implement development plans for 20% of staff ➢ Initiate employee rotational development program	➢ Completed 360-degree feedbacks with senior staff ➢ Developmental plans for all new Federal Career Intern Program (FCIP) interns ➢ Draft proposal for a pilot rotational development program in OED
Periodic manager-staff discussions about performance accomplishments and improvements	Expand to 3 major offices the program for quarterly discussions on performance objectives	Made available to major offices the program for quarterly discussions on performance objectives. Completed the program in two offices.
Percentage of awards presented for helping accomplish specific Commission goals	More than 50% of awards for quality service based on accomplishments supporting strategic objectives	The target level was met. Based on the responses regarding FY2002 incentive awards more than 50% of awards were given for quality service based on accomplishments supporting strategic objectives.

Independent Auditors' Report

The Federal Energy Regulatory Commission and the
Inspector General, United States Department of Energy:

We have audited the accompanying balance sheets of the Federal Energy Regulatory Commission (the Commission) as of September 30, 2002 and 2001, the related statements of net costs and changes in custodial activities for the years then ended and the related statements of changes in net position, budgetary resources, and financing for the year ended September 30, 2002 (herein after referred to as the financial statements). The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our audits, we also considered the Commission's internal control over financial reporting and tested the Commission's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

SUMMARY

As stated in our opinion on the financial statements, we concluded that the Commission's financial statements as of and for the years ended September 30, 2002 and 2001, as presented in the Commission's fiscal year 2002 Annual Financial Report, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 13 to the financial statements, the balance sheet as of September 30, 2001 has been restated.

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses under standards issued by the American Institute of Certified Public Accountants. However, we noted no matters involving the internal control and its operation that we considered to be material weaknesses.

The results of our tests of compliance with laws and regulations disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*, issued by the Comptroller General of the United States, or Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The following sections discuss our opinion on the Commission's financial statements, our consideration of the Commission's internal control over financial reporting, our tests of the Commission's compliance with certain provisions of applicable laws and regulations, and management's and our responsibilities.

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying balance sheets of the Commission as of September 30, 2002 and 2001, the related statements of net costs and changes in custodial activities for the years then ended and the related statements of changes in net position, budgetary resources, and financing for the year ended September 30, 2002.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of September 30, 2002 and 2001, its net costs and changes in custodial activities for the years then ended and its changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations, for the year ended September 30, 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 13 to the financial statements, the balance sheet as of September 30, 2001 has been restated.

The information in the Management's Discussion and Analysis section and note 15 to the financial statements is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements.* We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses under standards issued by the American Institute of Certified Public Accountants. Material weaknesses are conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving the internal control and its operation that we considered to be material weaknesses as defined above.

We did, however, note other matters involving internal control over financial reporting and its operation that we will report to the management of the Commission in a separate letter.

COMPLIANCE WITH LAWS AND REGULATIONS

The results of our tests of compliance with certain provisions of laws and regulations described in the Responsibilities section of this report, exclusive of Federal Financial Management Improvement Act (FFMIA), disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 01-02.

The results of our tests of FFMIA disclosed no instances in which the Commission's financial management systems did not substantially comply with the three requirements discussed in the Responsibilities section of this report.

RESPONSIBILITIES

Management's Responsibilities

Management is responsible for:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;

- Establishing and maintaining internal controls over financial reporting, and preparation of the Management's Discussion and Analysis (including the performance measures), required supplementary information, and required supplementary stewardship information; and

- Complying with laws and regulations, including FFMIA.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies. Because of inherent limitations in internal control, misstatements, due to error or fraud may nevertheless occur and not be detected.

Auditors' Responsibilities

Our responsibility is to express an opinion on the fiscal year 2002 and 2001 financial statements of the Commission based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance about whether 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;

- Assessing the accounting principles used and significant estimates made by management; and

- Evaluating the overall financial statement presentation.

We believe that our audits provide a reasonable basis for our opinion.

In planning and performing our fiscal year 2002 audit, we considered the Commission's internal control over financial reporting by obtaining an understanding of the Commission's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin No. 01-02, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether the Commission's fiscal year 2002 financial statements are free of material misstatement, we performed tests of the Commission's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to the Commission. Providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No 01-02 and FFMIA, we are required to report whether the Commission's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

DISTRIBUTION

This report is intended for the information and use of the Commission's management, the Department of Energy's Office of the Inspector General, OMB and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 3, 2003

FEDERAL ENERGY REGULATORY COMMISSION

Balance Sheets

September 30, 2002 and 2001

Assets		2002	2001 Restated
Intragovernmental assets –			
fund balances with Treasury (note 4)	$	93,920,722	59,651,838
Accounts receivable, net (note 5)		14,521,092	11,021,175
Due from regulated entities (note 6)		—	12,741,064
Property and equipment, net (note 7)		14,204,345	14,781,885
Total assets	$	122,646,159	98,195,962
Liabilities and Net Position			
Intragovernmental liabilities:			
Accounts payable (note 16)	$	1,268,285	937,394
Accrued payroll benefits (note 16)		1,174,905	1,063,767
Resources transferable to Treasury (note 6)		36,199,310	23,741,051
Miscellaneous receipts transferable to Treasury		16,661	3,437,001
Workers' compensation payable (notes 9 and 16)		422,836	446,147
Total intragovernmental liabilities		39,081,997	29,625,360
Accounts payable		10,385,505	11,971,755
Due to regulated entities (note 6)		111,973	—
Accrued payroll and benefits		8,405,251	5,591,704
Collections due to states (note 3)		2,942,157	2,514,779
Revenue collected under protest (note 13)		29,062,800	11,821,372
Accrued leave (note 9)		9,537,901	9,331,838
Total liabilities		99,527,584	70,856,808
Commitments and contingencies (notes 8 and 13)			
Net position:			
Unexpended appropriations (note 10)		11,652,047	15,112,335
Cumulative results of operations		11,466,528	12,226,819
Total net position		23,118,575	27,339,154
Total liabilities and net position	$	122,646,159	98,195,962

The accompanying notes are an integral part of these statements.

FEDERAL ENERGY REGULATORY COMMISSION

Statements of Net Cost

Years ended September 30, 2002 and 2001

	2002			2001		
	Energy markets	Energy projects	Total	Energy markets	Energy projects	Total
Costs:						
Regulation:						
Intragovernmental	$ 30,525,781	20,350,520	50,876,301	28,940,660	19,740,013	48,680,673
Public	84,970,669	56,647,112	141,617,781	84,376,424	57,551,960	141,928,384
Total	115,496,450	76,997,632	192,494,082	113,317,084	77,291,973	190,609,057
Less earned revenue – with the public	115,295,050	76,863,366	192,158,416	112,552,059	76,770,159	189,322,218
Net program cost	201,400	134,266	335,666	765,025	521,814	1,286,839
Other programs:						
Intragovernmental	1,308	872	2,180	46,529	31,735	78,264
Public	8,720	5,813	14,533	—	—	—
Less earned revenue – intragovernmental	24,425	16,283	40,708	42,697	29,123	71,820
Net program costs	(14,397)	(9,598)	(23,995)	3,832	2,612	6,444
Total net cost of operations	$ 187,003	124,668	311,671	768,857	524,426	1,293,283

The accompanying notes are an integral part of these statements.

FEDERAL ENERGY REGULATORY COMMISSION

Statement of Changes in Net Position

Year ended September 30, 2002

		Cumulative results of operations	Unexpended appropriations
Beginning balances	$	5,003,900	15,112,335
Prior period adjustment (note 14)		7,222,919	—
Beginning balances, as adjusted		12,226,819	15,112,335
Budgetary financing sources (uses):			
Appropriations received		—	184,155,000
Appropriations used		187,615,288	(187,615,288)
Transfers-out to Treasury without reimbursement		(196,621,214)	—
Other financing sources:			
Imputed financing		8,557,306	—
Total financing uses		(448,620)	(3,460,288)
Net cost of operations		(311,671)	—
Ending balances	$	11,466,528	11,652,047

The accompanying notes are an integral part of these statements.

FEDERAL ENERGY REGULATORY COMMISSION

Statement of Budgetary Resources

Year ended September 30, 2002

Budgetary resources:		
Budget authority	$	5,482,057
Unobligated balance		8,488,718
Spending authority from offsetting collections earned		184,324,676
Total budgetary resources	$	198,295,451
Status of budgetary resources:		
Obligations incurred	$	196,490,146
Unobligated balances available and apportioned		1,762,681
Unobligated balances – not available		42,624
Total status of budgetary resources	$	198,295,451
Relationship of obligations to outlays:		
Obligated balance, net – beginning of period	$	26,145,765
Obligations incurred		196,490,146
Spending authority from offsetting collections		(184,324,676)
Obligated balance, net – end of period (note 12)		(34,046,107)
Total outlays	$	4,265,128
Outlays:		
Disbursements	$	188,459,730
Collections		(184,194,602)
Net outlays	$	4,265,128

The accompanying notes are an integral part of these statements.

FEDERAL ENERGY REGULATORY COMMISSION

Statement of Financing

Year ended September 30, 2002

Resources used to finance activities:	
Budgetary resources obligated:	
Obligations incurred	$ 196,490,146
Less: spending authority from offsetting collections	(184,324,676)
Obligations, net of offsetting collections	12,165,470
Other resources:	
Imputed financing from costs absorbed by others	8,557,306
Transfers-out, net of appropriations received	(12,399,620)
Net other resources used to finance activities	(3,842,314)
Total resources used to finance activities	8,323,156
Resources used to finance items not part of the net cost of operations:	
Change in budgetary resources obligated for goods/services/benefits ordered but not yet provided	(3,393,749)
Resources that finance the acquisition of assets	2,760,932
Payments to states	5,507,239
Other resources and adjustments	(155,324)
Total resources used to finance items not part of the net cost of operations	4,719,098
Total resources used to finance the net cost of operations	3,604,058
Components of the Net Cost of Operations that will not require or generate resources in the current period:	
Components requiring or generating resources in future periods – increase in exchange revenue receivable from the public	(3,129,385)
Components not requiring or generating resources:	
Depreciation and amortization	3,338,473
Reduction in allowance for doubtful accounts receivable	(4,406,731)
Other	905,256
Total components of net cost of operations that will not require or generate resources	(163,002)
Total net cost of operations that do not require or generate resources in current period	(3,292,387)
Net cost of operations	$ 311,671

The accompanying notes are an integral part of these statements.

FEDERAL ENERGY REGULATORY COMMISSION

Statements of Custodial Activity

Years ended September 30, 2002 and 2001

		2002	2001
Sources of collections:			
Cash collections – annual charges	$	15,958,829	25,258,662
Accrual adjustment		40,697	485,190
Total custodial revenue		15,999,526	25,743,852
Disposition of revenue:			
Transferred to others:			
United States Army – Corps of Engineers		(6,365,704)	(6,387,014)
Department of Interior		(6,086,508)	(5,271,878)
United States Treasury		(201,458)	(101,245)
Other agency costs		(2,807,648)	(13,415,990)
Increase in amounts to be transferred		(538,208)	(567,725)
Net custodial activity	$	—	—

The accompanying notes are an integral part of these statements.

(1) Description of Reporting Entity

The Federal Energy Regulatory Commission (the 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 and oil 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, the Natural Gas Policy Act of 1978, and the Public Utility Regulatory Policies Act of 1978.

The Commission's activities are separated into the following two segments.

The Energy Markets Program

The Commission's overall objective in regulating oil, gas, and electric energy markets is delivery of reliable, competitively priced services. It has fostered the emergence of competitive markets and is addressing key market issues by formulating new regulatory approaches. The Commission monitors markets to ensure that market-based regulatory strategies remain effective, and it continues regulating along traditional lines where competition is not adequate. The Commission retains responsibility for ensuring just and reasonable rates for oil pipeline transmission and for transmission and sales for resale of natural gas and electric power.

The Energy Projects Program

The Commission licenses nonfederal hydropower projects and issues certificates for the construction of interstate natural gas pipelines. These projects have economic, environmental, and cultural implications, all of which must be considered in the licensing or certificating process. In addition, the Commission determines the safety of hydropower projects and the operational safety and reliability of liquefied natural gas storage facilities. At the core of the Commission's efforts is the need to determine that energy projects are sustainable environmentally and economically.

Cost Recovery

As described below, the Commission recovers 100% of its annual appropriation from the U.S. Treasury (the Treasury) through annual charges and filing fees authorized by the Omnibus Budget Reconciliation Act of 1986 and other laws.

(Continued)

Annual Charges

The Commission recovers most of its administrative program costs through allocated annual charges to the entities it regulates, regardless of the number or type of services rendered to any particular entity during the 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 Code of Federal Regulations (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 1,000 (minor projects).

Gas, Electric, and Oil

Authority – Section 3401 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. The fees are 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. Fee structure and procedures are codified in 18 C.F.R. Part 381.

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; and
- 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."

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The accompanying financial statements have been prepared to report the financial position of the Commission and its net costs, changes in net position, budgetary resources, reconciliation of net costs to budgetary obligations, and custodial activity in accordance with accounting principles generally accepted in the United States of America applicable to federal government entities.

These financial statements have also been prepared in accordance with the form and content for financial statements specified by Office of Management and Budget (OMB) in Bulletin 01-09, *Form and Content of Agency Financial Statements.* As permitted by that Bulletin, the Commission has presented comparative fiscal year 2001 information for only the Balance Sheet, the Statement of Net Cost, and Statement of Custodial Activities.

The financial statements include all activity related to the Commission's portion of appropriation (89X0212), including the budget authority allotted by DOE to other DOE agencies. In addition, the Commission receives small allotments from six DOE appropriations: (8990224), (8980224), (89X0224), (89X0240), (89X0243), and (89X5105). All of the Commission's appropriations relate to budget functional classification code 276, Energy Information Policy and Regulation.

Entity assets disclosed in notes 3 and 5 include those assets that the Commission has the authority to use in its operations.

Nonentity assets disclosed in notes 3 and 5 include those assets that result from the Commission's custodial billing activities for other federal agencies, including the Army Corps of Engineers and the Bureau of Reclamation.

(b) Budgets and Budgetary Accounting

Congress annually adopts a budget appropriation that provides the Commission with authority to use funds from the Treasury to meet its operating and capital expenditure requirements. The appropriated funds are not restricted to use in a specific fiscal year. All revenue from annual charges and filing fees is remitted to the Treasury when received.

(c) Basis of Accounting

The Commission's financial statements are prepared using 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 monitor its budget authority at the various stages of execution, including allotment, obligation, and eventual outlay.

(d) Revenue and Financing Sources

As described above, the Commission receives funds for its operating and capital expenditures through an appropriation allotment from DOE. For financial statement purposes, the appropriation allotment is recognized as a financing source when operating expenses (primarily salaries and benefits), other than depreciation, are incurred and when capital assets are purchased.

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. At year-end, the Commission records a due from or to regulated entities to reflect the difference between the charges and the actual program costs for the year. The Commission adjusts the subsequent year's charge for such amount. Revenue is recognized for filing fees when received.

The Commission recognizes an imputed financing source for the estimated annual pension and life and health insurance costs in excess of contributions made by the Commission during the year. These costs will ultimately be funded by the Office of Personnel Management.

Reimbursable work agreement revenue, included in other programs' earned revenue, is recognized when the related services are rendered.

Transfers-out represent receipts collected and remitted to the Treasury during the year and net accounts receivable that, once collected, will be returned to the Treasury, less any amounts due to regulated entities for the excess of estimated and billed costs over actual costs incurred.

(e) Fund Balances with Treasury

The Commission does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the Treasury. The balance of funds with the 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.

(f) Allowance for Doubtful Accounts

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

(g) Property and Equipment

Property and equipment is stated at cost less accumulated depreciation. The Commission capitalizes property (other than furniture) and equipment purchases with a cost greater than $25,000 and a total useful life exceeding two years. The Commission capitalizes furniture purchases with a cost greater than $50,000, and commercially purchased or developed software with a cost greater than $25,000. Depreciation is calculated based on an estimated useful life of 20 years for leasehold improvements, 10 years for furniture, 2 to 5 years for commercially purchased or developed software, and 5 years for all remaining assets. Expenditures for repairs and maintenance are charged to program costs as incurred.

(h) 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 disclosed in note 9 as liabilities not covered by budgetary resources.

(i) Revenue Collected Under Protest

Revenue collected under protest is deferred and recorded as a liability until the protest is resolved.

(j) Collections Due to States

The Commission disburses 50% 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 initially deposited into the Treasury's miscellaneous receipts fund.

(k) 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.

(l) Workers' Compensation Payable

The Federal Employees Compensation Act (FECA) provides income and medical cost protection to cover federal civilian employees injured on the job, employees who have incurred a work-related occupational disease and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits for the Commission's employees under FECA are administered by the Department of Labor (DOL) and are ultimately paid by the Commission. The workers' compensation payable represents unpaid billings to DOL. An actuarial estimate of unbilled claims is recorded by DOE at the departmental level and was not separately calculated for the Commission.

(m) *Net Position Accounts*

Net position account balances consist of the following components:

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

Cumulative results of operations – Represents the Commission's net results of operations since inception, including (1) the amount in the Special Receipts Fund Balance with Treasury, (2) the cost of property and equipment acquired that has been financed by appropriations, less accumulated depreciation, and (3) 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.

(n) *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.

(o) *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

(3) Non-Entity Assets

Non-entity assets at September 30, 2002 and 2001 consisted of:

		2002	2001
Fund balances with Treasury:			
Appropriated fund balance with Treasury	$	88,025	88,930
Collections due to states		2,942,157	2,514,779
Miscellaneous receipts held in suspense		1,661	14,061
Accounts receivable, net		732	2,673
Total non-entity assets		3,032,575	2,620,443
Total entity assets		119,613,584	95,575,519
Total assets	$	122,646,159	98,195,962

(Continued)

(4) Fund Balances with Treasury

Fund balances with Treasury at September 30, 2002 and 2001 consisted of:

		2002	2001
Fund balances:			
Appropriated funds	$	47,770,932	34,655,787
Revenue collected under protest		29,062,800	11,821,372
Special receipts fund		7,222,919	7,222,919
Other		9,864,071	5,951,760
Total	$	93,920,722	59,651,838
Unobligated budgetary resources:			
Available	$	1,762,681	8,488,718
Unavailable		42,624	2,509,653
Obligated balance not yet disbursed		92,115,417	48,653,467
Total	$	93,920,722	59,651,838

(5) Accounts Receivable

Entity and nonentity governmental accounts receivable at September 30, 2002 and 2001 consisted of:

		2002		
Entity		**Annual charges (note 6)**	**Other**	**Total**
Uncollected billings	$	19,427,676	42,870	19,470,546
Allowance for doubtful accounts		(5,436,034)	(10,614)	(5,446,648)
Total entity accounts receivable, net		13,991,642	32,256	14,023,898
Nonentity				
Uncollected billings		2,355,649	732	2,356,381
Allowance for doubtful accounts		(1,859,187)	—	(1,859,187)
Total nonentity accounts receivable, net		496,462	732	497,194
Total accounts receivable, net	$	14,488,104	32,988	14,521,092

		2001		
Entity		**Annual charges (note 6)**	**Other**	**Total**
Uncollected billings	$	20,386,987	19,502	20,406,489
Allowance for doubtful accounts		(9,842,765)	(987)	(9,843,752)
Total entity accounts receivable, net		10,544,222	18,515	10,562,737
Nonentity				
Uncollected billings		1,960,608	2,673	1,963,281
Allowance for doubtful accounts		(1,504,843)	—	(1,504,843)
Total nonentity accounts receivable, net		455,765	2,673	458,438
Total accounts receivable, net	$	10,999,987	21,188	11,021,175

(6) Resources Transferable to Treasury

Resources transferable to Treasury at September 30, 2002 and 2001 consist of:

		2002	2001
Accounts receivable, net related of annual charges (note 5)	$	14,488,104	10,999,987
Fund balance with Treasury		21,823,179	—
Total net accounts receivable		36,311,283	10,999,987
Due from (to) regulated entities		(111,973)	12,741,064
Total resources transferable to Treasury	$	36,199,310	23,741,051

The fund balance with Treasury amount as of September 30, 2002 above relates to certain revenue initially collected under protest which was settled in the Commission's favor in late September 2002. The resources were transferred to the Treasury in October 2002.

(Continued)

(7) Property and Equipment, Net

Property and equipment, and related accumulated depreciation at September 30, 2002 and 2001 consisted of:

		2002		
		Acquisition amount	Accumulated depreciation	Net
Equipment	$	4,979,504	3,077,125	1,902,379
Furniture		9,070,773	6,211,587	2,859,186
Leasehold improvements		9,491,415	3,282,687	6,208,728
Software		11,246,911	8,012,859	3,234,052
Total	$	34,788,603	20,584,258	14,204,345

		2001		
		Acquisition amount	Accumulated depreciation	Net
Equipment	$	3,402,217	3,207,413	194,804
Furniture		9,070,773	5,304,510	3,766,263
Leasehold improvements		9,491,415	2,808,115	6,683,300
Software		10,527,308	6,389,790	4,137,518
Total	$	32,491,713	17,709,828	14,781,885

(8) 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) Liabilities Not Covered by Budgetary Resources

Liabilities not covered by budgetary resources at September 30, 2002 and 2001 consisted of:

		2002	2001
Intragovernmental — workers' compensation payable	$	422,836	446,147
Accrued leave		9,537,901	9,331,838
Total	$	9,960,737	9,777,985

(Continued)

(10) Unexpended Appropriations

Unexpended appropriations at September 30, 2002 and 2001 consist of:

		2002	2001
Unobligated – available	$	1,762,681	8,488,718
Undelivered orders		9,889,366	6,623,617
Total unexpended appropriations	$	11,652,047	15,112,335

(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% 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% of employees' pay and matches any employee contribution up to an additional 4% of pay. For most employees hired since December 31, 1983, the Commission also contributes the employer's matching share for Social Security.

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 paid by the Commission for both plans for fiscal years 2002 and 2001 was approximately $10.9 million and $10.3 million, respectively. During fiscal year 2002 and 2001, an additional $8.6 million and $7.5 million, respectively, of pension and life and health insurance expense was recognized by the Commission for amounts that will ultimately be funded through the Office of Personnel Management. This amount is also recorded as an imputed financing source.

(12) Statement of Budgetary Resources

The obligated balance, net – end of period at September 30, 2002 is comprised of the following components:

Accounts receivable	$	(732)
Unfilled customer order from Federal sources		(18,630)
Undelivered orders		9,889,366
Accounts payable		24,176,103
Total obligated balance, net – end of period	$	34,046,107

(Continued)

(13) Contingencies

Certain licensees have filed appeals with the Commission challenging the basis for other agencies' costs included in the annual charges billed by the Commission. These appeals total $29.1 million and $11.8 million as of September 30, 2002 and 2001, respectively, and are included in revenue collected under protest. If these licensees were to prevail in their argument that there is no substantial evidence to support the other agencies' costs at issue, then the Commission might be obligated to grant relief not only for the appellants, but also to all other similarly situated licensees, of which there are over 600. Related losses cannot be estimated at this time.

(14) Prior Period Adjustment

During the year ended September 30, 2002, the Commission corrected its balance sheet for the omission of certain fund balances identified by the Treasury as unavailable receipts. This adjustment totaled $7,222,919 and increased fund balances with Treasury and cumulative results of operations as of September 30, 2001.

The Commission currently bills regulated companies as a custodian for certain federal agencies, including the Army Corps of Engineers and the Bureau of Reclamation. The receivables are maintained by the Commission, and the collections are processed directly to each federal agency on a monthly basis. In addition to the annual charges billed yearly, penalty and administrative costs are assessed on past-due bills and remitted to the Treasury when received. For fiscal years 2002 and 2001, these custodial transactions totaled approximately $16.0 million and $25.7 million, respectively.

(15) Custodial Activity

The Commission currently bills regulated companies as a custodian for certain federal agencies, including the Army Corps of Engineers and the Bureau of Reclamation. The receivables are maintained by the Commission, and the collections are processed directly to each federal agency on a monthly basis. In addition to the annual charges billed yearly, penalty and administrative costs are assessed on past-due bills and remitted to the Treasury when received. For fiscal years 2002 and 2001, these custodial transactions totaled approximately $16.0 million and $25.7 million, respectively.

(16) Required Supplementary Information – Intragovernmental Balances (Unaudited)

Intragovernmental accounts payable at September 30, 2002 and 2001 consists of:

		2002	**2001**
Government Printing Office	$	641,763	647,725
General Services Administration		416,518	135,007
Veterans Administration		63,933	60,000
Office of Personnel Management		18,215	50,000
Department of Health and Human Services		27,308	32,000
Others		100,548	12,662
	$	1,268,285	937,394

Intragovernmental accrued payroll benefits at September 30, 2002 and 2001 consists of:

		2002	2001
Office of Personnel Management	$	868,426	748,363
Social Security Administration		306,479	211,206
Federal Retirement Thrift Investment Board		—	104,198
	$	1,174,905	1,063,767

Intragovernmental workers' compensation payable at September 20, 2002 and 2001 totals $422,836 and $446,147, respectively, and is due to the Department of Labor.