N A R U C
National Association of Regulatory Utility Commissioners

April 20, 2009

The Honorable Mary L. Schapiro, Chair
Office of the Chair
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File S7-27-08 – NARUC Comments on SEC Release No. 33-8982 - *"Roadmap for the Potential Use of Financial Statements prepared in accordance with International Financial Standards by U.S. Issuers".*

Dear Chair Schapiro:

The National Association of Regulatory Utility Commissioners (NARUC) respectfully offers these comments in response to the Securities and Exchange Commission's (SEC) notice on the *Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers (Roadmap)*.[1] We appreciate the extension granting additional time to generate comments.[2] These comments provide an overview of concerns raised by the proposed SEC action on public utility[3] regulation in the United States.

NARUC has long been recognized by Congress and Courts[4] as an appropriate representative for those government officials in the fifty States, the District of Columbia, Puerto Rico, and the Virgin Islands, charged with the duty of regulating utilities and common carriers. NARUC's members are necessarily very interested in the outcome of this proceeding. Any transition from current reporting standards to international standards will impose significant costs on both utilities and regulatory agencies. These additional costs will likely be paid by U.S. utility consumers. NARUC is also concerned about the possible impact on the financial viability of regulated utilities because of potential earnings volatility and a lack of comparable data for regulatory purposes. The proposed changes may also create additional investor concerns that

1 "Proposed Rule," 73 Federal Register 70815 (November 21, 2008) available at: <http://edocket.access.gpo.gov/2008/E8-27559.htm>.

2 "Proposed Rule; extension of comment period," 74 Federal Register 6359 (February 9, 2009), available at: <http://edocket.access.gpo.gov/2009/E9-2607.htm>.

3 For purposes of these comment, the utility industry includes the energy (electric and gas), water, wastewater, telecommunications industry and similar entities.

4 *See* 47 U.S.C. § 410(c) (1971) (Congress designated NARUC to nominate members of Federal-State Joint Boards to consider issues of concern to both the FCC and State regulators.); *Cf.* 47 U.S.C. § 254 (1996). *Cf. NARUC, et al. v. ICC*, 41 F.3d 721 (D.C. Cir 1994) (where the Court explains "…Carriers . . . applied to…(NARUC), an interstate umbrella organization that, as envisioned by Congress, played a role in drafting the regulations. . .the ICC issued to create the "bingo card" system.)

limit utility infrastructure financing options. Such investments are desperately needed. Additional infrastructure is needed in all critical infrastructure industries. Federal (and many State) authorities have targeted new electric metering, generation and transmission facilities to promote green and more efficient energy operations, additional investments in broadband facilities and programs, and new funding to replace aging water infrastructure.

Background

Publicly issued financial statements are currently a critical element in setting retail public utility rates. The regulation of such utilities in the United States has evolved over the last one-hundred years. Each State currently has at least one statutorily designated entity to oversee the operations of public utilities within its jurisdiction. Utility prices are often established based on cost plus ratemaking. This methodology allows a utility to earn up to an authorized return on investment and/or return on equity, while also recovering its operating expenses, operating taxes, and investment cost. Other methods of establishing utility rates include price caps, price indices, or cost-plus pricing, methods that are all typically subject to adjustment based on certain performance measures. It is common practice for regulators to monitor investments, expenses, and earnings through utility financial statements. Moreover, the foundation or starting point for many of these rate setting methodologies is the utility's audited financial statements.

The SEC is proposing a roadmap for the potential transition from GAAP-compliant financial statements to statements prepared in accordance with International Financial Reporting Standards (IFRS). The SEC notice sets forth several milestones that, if achieved, could lead to the required use of IFRS by U.S. issuers in 2014 if the Commission believes it to be in the public interest and for the protection of investors.

The primary mission of the SEC is to protect investors, maintain fair, orderly, and efficient markets, and to facilitate capital formation. Most of the questions in the *Roadmap* seek input on the impact that changes would have to investors and issuers of financial statements subject to the SEC's oversight. However, the agency should also take a broader view and consider that SEC actions, or inactions, can have a dramatic impact on the overarching economic well-being of the country and individual consumers. When the United States faces economic turmoil, it is difficult for markets to be fair or efficient. Current economic conditions add to the concern that utility regulation will not be able to provide a proper transition to IFRS for regulated utilities. This can only increase the associated costs which are frequently passed on to consumers in the form of higher rates. Such increases are likely to further burden customers at a time when increasing numbers of customers are unable to pay even their base utility bills.

Financial Statements Are Critical to Public Utility Oversight

The first look at a public utility's investment, revenues, expenses, and current earnings come from the issued financial statements or the books of account used to develop those statements. Under traditional public utility economic regulation, the determination of prices generally begins with audited financial statements. Thanks to the wide-spread use of Statement of Financial Accounting Standard 71, publicly issued financial statements used by investors generally reflect the operations and costs as viewed by regulators. Regulatory analysts typically do not try to recreate the audited financial statements or independently verify their accuracy. They are generally accepted as a reasonable and accurate starting point. From there, adjustments are made to reflect the specifics of that sector's regulatory process. Regulatory audits tend to verify whether or not a cost or investment should be the responsibility of the ratepayer or shareholder. For example, charitable expenses are generally deemed to be the cost responsibility of shareholders and not ratepayers, and thus are excluded when determining the level of costs that should be included in rates charged retail customers. These adjustments tend to be a relatively small percentage of the underlying capital investment amounts that are incorporated into the ratemaking process without change. The audited financial statements, currently based on GAAP (including SFAS 71 *Accounting for the Effect of Certain Types of Regulation*) are vital information for utility regulators.

Regulators also use financial statements to monitor certain new investments or specific expenses. Regulators continue to approve additional rate mechanisms that allow for the recovery of one particular expense or investment. Some public utilities are permitted to change their rates periodically based on the change in these cost components. SFAS 71 is a critical component of these mechanisms.

Today, the way financial transactions are recognized in rates is well synchronized with the way they are reported on publicly issued financial statements. *However, given some substantial differences between the accounting for certain items under IFRS or GAAP, either the current level of synchronization between the accounting and regulation will be lost, or there will need to be significant changes in the regulatory process to match the newly mandated international accounting and reporting standards.*

Key Differences Will Impact Public Utilities

In response to the SEC's decision to consider mandating the use of IFRS instead of GAAP, public utilities, regulators, consumer advocates, and the accounting profession have worked together to identify some key differences between the two standards. NARUC continues educational efforts on the specifics of International Accounting to allow better analysis and comparison with U.S. GAAP. The work of NARUC's Staff Subcommittee on Accounting and Finance has been critical both to that ongoing initiative and the compilation of these comments.

A number of significant differences for the utility industry have been identified. These are not the only differences found, but they are representative of issues that are likely to remain a focus of utility regulators.

One major difference between U.S. GAAP and International Accounting is that under International Accounting utilities may not report regulatory assets and liabilities. U.S. GAAP, on the other hand, *requires* rate-regulated utilities to record regulatory assets and liabilities for items, such as fuel and gas cost adjustment mechanisms, if certain criteria are met. *Without that regulatory asset and liability provision, many accounting conventions followed by utilities, would not be permissible under U.S. GAAP.* This deficiency is significant. As International Accounting currently stands, there is no option to report regulatory assets or liabilities on financial statements. Absent a change by the International Accounting Standards (IAS) Board, significant changes to existing regulatory regimes and/or the maintenance of separate off-book records could be required to track the transactional effects of specific regulatory decisions.

Additional regulatory differences that will impact financial statements in format and in substantive content are discussed in the attached NARUC report. Topics include:

- Equity is not allowed to be capitalized under IFRS as part of the Accumulated Funds Used During Construction (AFUDC), which is applied to longer-term utility construction costs, as a regulatory asset.
- Last-in, first-out (LIFO) inventory accounting
- Componentization of plant, property, and equipment;
- Major overhauls and inspections
- Asset impairment testing;
- The categorization of leases;
- The computation of employee benefits and pension expense;
- The definition of derivatives;
- Categorization of expenses on the financial statements;
- Accounting for income taxes;
- The recording of the cost of environmental liabilities; and
- The determination of asset retirement obligations.

Some Regulatory Response Required by Any Changes in Accounting

Public utilities subject to the oversight of the SEC must comply with the new international standards if mandated. However, they are also required to comply with regulatory standards imposed by State (and federal) regulators. If regulatory oversight does not change and SEC mandated reporting rules do, public utilities will have to keep even more records, with more *on-the-side* accounting (viewed by many as additional sets of books). Far from simplifying accounting for public utilities, it is much more likely to make their accounting procedures much more complex. Additional costs accompany more recordkeeping. These costs are generally paid for by customers, not shareholders, placing additional upward pressure on already increasing utility rates across the nation.

Regulation continues to balance the interests of investors and customers. It assures the public interest is served and must be recognized as part of the accounting and reporting requirements for public utilities. Special provisions were added to GAAP via adoption of SFAS 71 to recognize the regulatory process. This not only helps regulators (and utilities) to be more efficient, it also assures the financial community can properly account for regulatory oversight. There are many reasons to retain these requirements, and no reason to change. Yet change is the heart of the SEC proposal.

The impact of regulation on company operations will be lost to users of the financial statements. The use of footnotes to reflect regulator activities is likely to promote more confusion, rather than less.

Nor is it clear that regulators will modify existing procedures to promote consistency with the international standards. In many cases, that will not occur. Regulators have an obligation to do more than protect investors and markets. They must consider the impact on customers, and that impact can be far reaching. For example, when deciding whether certain costs should be expensed or capitalized, regulators look at issues such as generational equity, i.e., the fairness of imposing that expense on customers throughout the life of the asset versus having only current customers who benefit from the cost pay more quickly. Differences could occur if regulators adopted the international standard of capitalizing major plant overhauls rather than expensing them over a four or five year time period.

Regulators also have an obligation to try to keep utilities financially healthy while making sure that public input processes are respected. Many regulatory deferrals are part of this balance. For example, the cost of natural gas is extremely volatile in wholesale markets. These costs often comprise as much as eighty percent of a natural gas utility's operating expenses. To compensate, most natural gas utilities in the U.S. have a provision as part of the ratemaking process that allows them to collect the difference between the actually incurred costs and the level of costs contained in rates in an account. This accumulated difference is then amortized into rates over the course of some designated period, generally ranging from one month to one year. If these deferrals and true-ups are eliminated from the regulatory process to be consistent with international accounting, either investors or customers could be seriously harmed. If wholesale gas prices drop, customers could lose out on those cost decreases pending regulatory notices, party interventions and discovery, and possible hearings. The opposite would occur if such wholesale prices rose dramatically and the financial health of the utility could be at risk.

If the SEC does require migration to IFRS, concerned regulators may simply continue with current practices and just require utilities to maintain two completely different sets of records. Financial statements consistent with international standards would no longer recognize a regulatory asset or regulatory liability, even though for ratemaking purposes such costs often are spread over more than one accounting period. If wholesale supply costs increased, these increased costs would be reflected in the income statement resulting in a lower income for the initial accounting period and a higher income in later periods. Meanwhile investors, and perhaps even boards of directors, may have no idea as to the level of costs not reflected in rates and at risk for collection in the future.

Neither eliminating current procedures nor requiring separate accounting (un-reflected in the text of SEC required financial statements) appears to be in the best interest of public utilities, investors, or customers.

<u>Should Regulated Public Utilities be Exempt from the Mandate to Use IFRS?</u>

In its Notice seeking comments on the proposed *Roadmap*, the Commission poses Question 6 "Is it appropriate to exclude investment companies and other regulated entities filing or furnishing reports with the Commission from the scope of this Roadmap? Should any Roadmap to move to IFRS include these entities within its scope? Should these considerations be part of the Roadmap? Are there other classes of issuers that should be excluded from present consideration and addressed separately?"

This could certainly be one solution to the potential problems described earlier. However, many public utilities are part of larger conglomerates which file consolidated financial statements. It is unclear how these would (or should) be treated. It is also not clear how having different accounting standards for different industries will impact the capital raising ability of the exempt industry. All public firms compete in the market for capital and, obviously, utilities do not compete only with other utilities for new equity or additional debt. In spite of the current state of the U.S. economy, many utilities will be required to make significant investments to build new transmission and new generation. Access to capital markets at a reasonable rate is a concern if utilities are exempt from the transition to IFRS or have separate regulatory records. Adequate access can impact the quality and cost of public utility service.

Question number 4 poses a related series of questions: “What are commenters’ views on the mandated use of IFRS by U.S. issuers beginning in 2014, on an either staged-transition or a non-staged transition basis? Should the date for mandated use be earlier or later? If the Commission requires the use of IFRS, should it do so on a staged or sequenced basis? If a staged or sequenced basis would be appropriate, what are commenters’ views on the types of U.S. issuers that should first be subject to a requirement to file IFRS financial statements and those that should come later in time? Should any sequenced transition be based on the existing definitions of large accelerated filer and accelerated filer? Should the time period between stages be longer than one year, such as two or three years?”

This question raises issues and concerns similar to question 6. Adequate access to markets at a reasonable cost remains critical.

The Proposed Staging of Any SEC IFRS Implementation Requires Modification

The SEC has proposed making its decision in 2011 on whether to mandate the transition from GAAP to IFRS. It suggests that, if it finds it is in the public interest to move to IFRS, it will mandate the first set of IFRS financial statements be filed in 2014. However, the *Roadmap* specifies that these 2014 financial statements must include three years of financial information. This means 2012 and 2013 data will have to be presented consistent with IFRS. The SEC seeks comments on whether this timing is acceptable and appropriate.

If IFRS is adopted, the SEC should allow U.S. issuers to provide only one year of comparative information in the year of adoption for a total of two years of IFRS financial statements. This is consistent with the requirements of IFRS 1 and the previous SEC accommodation regarding first-time adoption of IFRS by private foreign issuers.

Mandating the use of IFRS in a staged transition beginning in 2014 is an unreasonable timeframe for regulated utilities. Companies may reasonably need a 3–5 year implementation period from the SEC’s decision date. It is difficult to actually begin the transition preparation process until the actual decision is made to convert to IFRS. It will require not only a substantial amount of time and effort to be able to have systems in place to use IFRS on a going forward basis beginning 2014, but will also require time and effort to restate financial data that has already been issued. Restating and reconciling can be more time consuming than the original preparation of financial statements. And, all this is likely to occur when the economy is still in the process of recovering from current market difficulties, and when the public utilities industry as a whole is engaged in one of the most capital intensive infrastructure construction building eras in recent memory.

Moreover, regulatory bodies realistically need additional time to consider the impacts on current regulatory requirements. Regulatory process tends to be slow moving, in part because of the need to allow for a wide variety of input. Once the Commission makes its decision, there are a number of other actions that must be taken, or at least considered, by other regulatory bodies. Currently, many of NARUC's members have legislative travel bans/restrictions, mandated pay cuts and furlough days if not layoffs. These conditions have already hampered regulators' ability to analyze the impact of an IFRS transition, including efforts to determine how to carefully adjust existing oversight regimes to avoid unanticipated negative ratepayer/industry impact. This situation seems unlikely to improve in the near term.

NARUC appreciates the opportunity to provide these preliminary thoughts on the SEC proposal. The association would be pleased to discuss our views with SEC staff or Commissioners at your convenience. If you have any questions, please do not hesitate to contact the undersigned at 202.898.2207 or jramsay@naruc.org.

Sincerely,

James Bradford Ramsay
NARUC General Counsel

cc
The Honorable Luis A. Aguilar, Commissioner
The Honorable Kathleen L. Casey, Commissioner
The Honorable Troy A. Paredes, Commissioner
The Honorable Elisse B. Walter (watlere@sec.gov)
Elizabeth M. Murphy, Secretary, SEC
Craig Olinger, Deputy Chief Accountant, SEC Div. of Corporation Finance
Michael Coco, Special Counsel, SEC Office of Internat'l Corp. Finance, Div. of Corp. Finance
Liza McAndrew Moberg, Professional Accounting Fellow, SEC Office of the Chief Accountant
rule-comments@sec.gov

International Accounting:

Why Should U.S. Utility Regulators Care?

Report by:

The NARUC Staff Subcommittee on
Accounting and Finance

The NARUC Staff Subcommittee on
International Relations

This Report was the subject of a February 2009 NARUC Resolution that "commends the staff for their work on this white paper, and directs that it be available from NARUC's Washington office as an official NARUC document."

February, 2009

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Introduction and Background

This report is intended to provide an overview of the topic of International Accounting as it relates to the regulation of public utilities[5] in the United States of America. The issue of whether publicly traded companies in the United States, including public utilities, should move from the mandated use of U.S. generally accepted accounting principles (GAAP) to international financial reporting standards (IFRS) is currently under consideration by the Securities and Exchange Commission (SEC). This report is intended to assist regulators, public utilities, and policy makers in identifying and understanding the issues surrounding the current discussion of a possible move to International Accounting. Once these issues are identified, regulators and others should be better able to weigh into the debate on the matter, if it is deemed appropriate to do so.

This report is intended to be a high-level summary of the International Accounting issues, rather than a detailed treatise on the topic. The NARUC Staff Subcommittees on Accounting and Finance and International Relations who have authored this paper will continue to monitor and study the issues identified in this report and provide appropriate follow-up as is seen to be necessary and appropriate. In addition to any follow-up written reports, the two Subcommittees intend to actively engage the utility industry in further discussions regarding the topic of International Accounting. We anticipate that this may be an on-going topic of discussion for the next several years.

What is International Accounting?

International Accounting is the general term used in this report to describe the mandatory accounting pronouncements issued by the International Accounting Standards Board (IASB). The pronouncements consist of International Financial Reporting Standards, International Accounting Standards, and Interpretations of both the Reporting Standards and the Accounting Standards. Together, these standards and interpretations are intended to form

> a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the various capital markets of the world and other users of the information to make economic decisions.[6]

More specifically, the International Financial Reporting Standards are applied to the general purpose financial statements of all profit-oriented entities. They establish the

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[5] For purposes of this report, the utility industry includes the telecommunications industry as well as energy, water, wastewater, and any similar entities. We note this to avoid the legal debate as to whether telecommunications firms are legally defined in all jurisdictions as public utilities.

[6] IASC Foundation Education, *A Guide through International Financial Reporting Standards (IFRSs) 2008*, (International Accounting Standards Committee Foundation), p.8.

protocol regarding the "recognition, measurement, presentation, and disclosure requirements dealing with transactions and events that are important in general purpose financial statements."[7] In other words, they establish the rules for how financial transactions are recorded in the books of for-profit entities and the requirements for how those transactions are reported in publicly issued financial statements. These protocols are the equivalent of (although different in form) the rules and standards established by the Financial Accounting Standards Board (FASB) and the SEC in the United States.

The United States has adopted the standards generally referred to as GAAP. These are the general set of accounting and reporting rules that are established by FASB and the SEC. Other countries have adopted their own set of accounting and reporting standards specifically as applicable to entities subject to each individual country's jurisdiction or oversight. The international standards, however, are currently mandated or allowed to be used in more than 100 countries around the world, including all of Europe. Thus, they have a broad reach and are quickly becoming a common reporting standard worldwide.

The International Financial Reporting Standards are based on an overall generally defined *framework* which facilitates the consistent and logical formulation of IFRSs. The *framework* deals with[8]:

a. the objective of financial statements;
b. the qualitative characteristics that determine the usefulness of information in financial statements;
c. the definition, recognition and measurement of the elements from which financial statements are constructed; and
d. concepts of capital and capital maintenance.

In discussing the objective of financial statements based on International Accounting, the framework is concerned with general purpose financial statements and the fact that many users rely on such financial statements as their major source of financial information. Hence, it is important that the financial statements be prepared and presented from the standpoint of their needs. Financial statements should also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it.[9]

The four principal qualitative characteristics of International Accounting are: understandability, relevance, reliability, and comparability. However, other items that are considered within each of these major categories include materiality, faithful representation, substance over form, neutrality, prudence, completeness, timeliness, the balance between benefit and cost, the balance between qualitative characteristics, and true and fair presentations.

[7] Ibid.
[8] Ibid, p.18.
[9] Ibid, p.20.

The financial effects of transactions and other events are grouped into broad classes according to their economic characteristics. These are then presented on the financial statements. These broad classes are referred to in the International Accounting framework as *elements.* These broad elements consist of assets, liabilities, equity, income, and expenses.

The last major matter addressed by the International Accounting framework relates to the concepts of capital and capital maintenance. Capital may be viewed two ways. Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the entity.[10] Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of the entity based on, for example, units of output per day.[11] Which view of capital dominates in the financial reporting should be based on the primary needs of the users of the financial statements. For example, the financial view would prevail if the primary concern of the users is with the maintenance of nominal invested capital or the purchasing power of invested capital. Alternatively, the physical concept of capital would dominate if the users are more concerned with the operating (physical productive) capability of the entity. The accounting model used in preparing the financial statements will depend on which capital maintenance concept is selected.

Some have indicated that the International Financial Reporting Standards are intended to be a more principles-based set of standards rather than the rules-based approach of U.S. GAAP.[12] One clear explanation of the difference between principles-based and rules-based accounting is found in the following analogy:

> Consider, for example, the difference between telling your child to be home at a reasonable hour (principles based) and telling her to be home at 11 p.m. and then providing for the 15 contingencies that might justify a different time (rules based).[13]

There are, however, also some more substantive, conceptual differences between international and U.S. accounting. These will be described in a later section of this report.

What have the FASB and the SEC been Doing Regarding International Accounting?

Since at least 2002, the FASB and the IASB have had a public commitment to make their existing financial reporting standards as fully compatible as soon as practicable. Specifically, the two boards entered into a Memorandum of Understanding ("The Norwalk Agreement") in September 2002 that committed the necessary resources to:

[10] Ibid, p.37.
[11] Ibid.
[12] Lawrence M. Gill, "IFRS: Coming to America," *Journal of Accountancy* (June 2007), pp.70-73.
[13] Ibid.

a. Undertake a short-term project aimed at removing a variety of individual differences between U.S. GAAP and IFRS;
b. Remove other differences between IFRS and U.S. GAAP that remain at January 1, 2005, through coordination of their future work programs;
c. Continue progress on the joint projects that they are currently undertaking, and
d. Encourage their respective interpretive bodies to coordinate their activities.

In February 2006, the two boards reaffirmed their "shared objective of developing high quality, common accounting standards for use in the world's capital markets."[14] Both FASB and the IASB also reiterated their belief that

> a common set of high quality accounting standards will enhance the consistency, comparability and efficiency of financial statements, enabling global markets to move with less friction.[15]

While FASB and the IASB continue their work aimed at the creation of one single set of high-quality international accounting standards, they also acknowledge that they have not yet reached that goal. As noted on FASB's website:

> At present, a single set of high-quality international accounting standards that is accepted in all capital markets does not exist…

So, while progress has been made toward the goal of convergence of U.S. and international reporting standards, the work has been tedious and slow. Meanwhile more and more globalization has occurred, such that

> The increasing integration of the world's capital markets, which has resulted in two-thirds of U.S. investors owning securities issued by foreign companies that report their financial information using IFRS, has made the establishment of a single set of high quality accounting standards a matter of growing importance. A common accounting language around the world could give investors greater comparability and greater confidence in the transparency of financial reporting worldwide.[16]

With the above statement, the Securities and Exchange Commission summarized part of their reasoning for their vote to publish, for public comment, a *Roadmap* that could lead to the use of International Financial Reporting Standards by U.S. companies

[14] Financial Accounting Standards Board, *News Release: FASB and IASB Reaffirm Commitment to Enhance Consistency, Comparability and Efficiency in Global Capital Markets,* Released February 27, 2006.
[15] Ibid.
[16] U.S. Securities and Exchange Commission, *Press Release: SEC Proposes Roadmap Toward Global Accounting Standards to Help Investors Compare Financial Information More Easily,* released August 27, 2008.

beginning in 2014. Pursuant to this SEC *Roadmap*, a decision would be made in 2011 on whether "adoption of IFRS is in the public interest and would benefit investors."[17] The result could be a dramatic change in some of the accounting and reporting that would apply to U.S. companies – including public utilities – no later than 2014.

On November 14, 2008, the Securities and Exchange Commission issued its proposed *Roadmap*[18] for public comment. The *Roadmap* sets forth milestones which, if achieved, could lead to the eventual use of IFRS by all U.S. issuers.[19] As described in the proposed *Roadmap*, the following are the key milestones to be examined and monitored by the SEC as it decides whether or not to move U.S. companies away from GAAP and onto International Accounting.

a. **Improvements in Accounting Standards.** The SEC intends to monitor the activities of the Financial Accounting Standards Board and the International Accounting Standards Board and the progress of their convergence efforts. The SEC urges the two Boards to "continue working towards the completion of their joint work plan estimated to be completed in 2011"[20] as it will examine the quality and comprehensiveness of International Accounting in 2011 – the date at which the SEC currently plans to decide whether or not to mandate the use of International Financial Reporting Standards.

b. **Accountability and Funding of the International Accounting Standards Committee (IASC) Foundation.** The IASC Foundation is based in London and selects, oversees, and funds the International Accounting standard setting body. However, the operations of establishing international accounting standards historically have been financed largely through voluntary contributions from a wide range of market participants. In 2006, the IASC Foundation agreed that four elements should govern the establishment of a funding approach designed to enable the Foundation to remain a "private-sector organization with the necessary resources to conduct its work in a timely fashion."[21] These four principles are: broad-based financing with an expanded base of support; a compelling system that makes free riding difficult; open-ended funding commitments that are not contingent on any particular action that would inhibit independence; and country-specific funding where major economies of the world provide funding on a proportionate basis, using gross domestic product (GDP) as a factor of measurement. Prior to mandating the use of International Accounting for U.S. firms, the SEC intends to examine whether the IASC Foundation has achieved its goal of "securing a stable funding mechanism

[17] Ibid.
[18] Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers, (Release Nos. 33-8982; 34-58960; File No. S7-27-08), released November 14, 2008.
[19] Ibid, p.20.
[20] Ibid, p.23.
[21] Ibid, p.24.

that supports the independent functioning of the IASB."[22] The SEC also intends to examine changes that are currently underway to provide for more linkage and accountability between the IASC Foundation and securities regulators in the various countries in which International Accounting is used.

c. **Improvements in the Ability to Use Interactive Data for IFRS Reporting.** The SEC is actively engaged in a project to require the filing of financial data in an interactive format – a format that allows the data to be downloaded directly into spreadsheets and analyzed in a variety of ways. The SEC intends, as part of its *Roadmap* process, to examine the level to which the International Accounting data meets the interoperability criteria being established.

d. **Education and Training.** The SEC intends to examine the current status of the "overall education, training and readiness of investors, preparers, auditors and other parties involved in the preparation of financial statements"[23] prior to mandating the use of International Accounting. In listing this particular milestone to be examined, it is noted that most of the education and training for accountants in the U.S. is based on domestic accounting principles and that only in the last year or so, has there been much focus by the larger accounting firms regarding International Accounting training. Furthermore, it is noted that the purpose of moving to a single set of global accounting standards would be negated if the investors failed to understand the internationally based financial statements.

e. **Limited Early Use of IFRS Where This Would Enhance Comparability for U.S. Investors.** The SEC is proposing changes to its rules that would permit (not mandate) some of the largest U.S. companies in industries in which International Accounting is the most-used set of standards globally to report domestically using International Accounting rather than U.S. GAAP prior to the SEC's planned 2011 decision on the use of International Accounting. The changes are being proposed in order to allow investors to benefit from the "enhanced ability to compare investment opportunities"[24] between domestic and international companies. The SEC also anticipates that this permitted voluntary use of International Accounting may broaden awareness and attention to the international standards. It is noted that foreign firms are already allowed to file their financial reports with the SEC using International Accounting without reconciling those statements to U.S. GAAP if the financial statements were prepared to fully conform to international standards as developed by the International Accounting Standards Board.

[22] Ibid, p. 25.
[23] Ibid, p. 30.
[24] Ibid, p 32.

f. **Anticipated Timing of Future Rulemaking by the Commission.** The SEC is already asking its staff to identify portions of its rules that might need modification if the decision were to be made to mandate the use of International Accounting beginning in 2014. This early work is consistent with the concept that an early decision on any mandated change would allow firms some time to transition from the current accounting and reporting system, and thus, the SEC is looking to make its decision in 2011. One of the challenges associated with this transition relates to the idea that while the first year of reporting using International Accounting would be 2014, that financial report issued in 2014 would likely require comparable financial data also using internationally-based reporting for 2012 and 2013.[25] To assist on these and other matters related to any decision that might be made to mandate the use of International Accounting, the SEC has directed its staff to undertake a study "on the implications for investors and other market participants of the implementation of IFRS for U.S. issuers."[26]

g. **Implementation of the Mandatory Use of IFRS.** The SEC is considering whether it might be prudent to implement the mandatory use of International Accounting, should it so mandate, in stages rather than for all U.S. issuers in one step. However, as part of this consideration, there is concern about the resulting non-comparability of financial statements among companies or even within an industry (if the staging were to occur based on the size of the firm). Thus, the SEC is also considering whether it should expand the criteria of those firms who would be permitted to voluntarily file using global standards earlier than mandated to do so. As part of its *Roadmap,* the SEC intends to consider the circumstances in which the early use of International Accounting "would be most appropriate for investor protection and capital formation."[27]

h. **Other Considerations.** The SEC recognizes that other considerations may also be important to take into account in its decision-making process. These other considerations include:

- -- interaction between the decisions of the SEC relative to financial accounting standards and the content of financial information provided to other government regulators (such as utility regulators, the Internal Revenue Service, and others);

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[25] *SEC Roadmap*, page 34, "Because the initiative to require the use of IFRS by U.S. issuers relates to the set of accounting principles that is used for financial reporting and not the periods for which financial reporting is required, the Commission expects that it would require three years of audited financial statements in the first year of IFRS reporting."
[26] Ibid.
[27] Ibid, p,36.

- -- changes required to systems and procedures used to identify, collect, analyze and report financial information and the corresponding controls;
- -- impacts on audit firms and their ability to be properly prepared to conduct audits of statements based on international standards; and
- -- the likely reduction of interaction, relevance, and influence of U.S. capital market participants in the international accounting and reporting standards setting process, compared to the current levels.

The SEC is quite serious in its consideration to mandate a move from U.S. GAAP to International Accounting in the foreseeable future, in spite of the number of items that it has identified that require examination and monitoring as part of its decision-making process. It is seeking comments (with a current comment deadline of February 19, 2009) on a number of specific questions, all of which relate to its proposed *Roadmap*, as generally described above. If the SEC determines that it is in the public interest to mandate the use of International Accounting in the near future, there are a number of questions and issues that regulators will then have to face that relate to the change. Additionally, there would be a number of serious challenges related to the transition timing and activities. Several of these are identified in the remainder of the report that follows.

What Are Key Differences between U.S. GAAP and International Accounting?

The two Subcommittees authoring this report have only recently begun to gain familiarity with some of the specifics of International Accounting to the point where comparisons and contrasts can be made to U.S. GAAP. However, with the assistance of the utility industry and accounting professionals, a number of key, significant differences, particularly for the utility industry, have been identified.[28] These are not the only differences that have been identified but are representative of the matters that are likely to continue to be discussed among utility regulators as the decision of whether International Accounting will be mandated is awaited.

Regulatory Assets and Liabilities

One of the major differences between U.S. GAAP and International Accounting is that under International Accounting utilities may not report regulatory assets and liabilities. U.S. GAAP, on the other hand, requires rate-regulated utilities to record

[28] Two of the most relied upon references relative to identifying differences between U.S. GAAP and International Accounting as contained in this section of the report were documents issued by PriceWaterhouseCoopers, *IFRS and U.S. GAAP Similarities and Differences*, IFRS Readiness Series (September 2008) and Deloitte, *International Finance Reporting Standards: Considerations for Power & Utilities*, Power & Utilities IFRS Webcast Series.

regulatory assets and liabilities for items, such as fuel and gas cost adjustment mechanisms, if certain criteria are met. Consequently, without that regulatory asset and liability provision, many accounting conventions followed by utilities, would not be permissible under U.S. GAAP. This lack of ability to continue to report regulatory assets and regulatory liabilities is one of the larger frustrations that some of the Canadian utilities and regulators have expressed with Canada's move to international standards.[29]

Prompted by filings and requests of several Canadian entities, including the National Energy Board and the Canadian Association of Members of Public Utility Tribunals (CAMPUT), the International Financial Reporting Interpretations Committee (IFRIC) has recently heard some of the concerns about the issues of regulatory assets and liabilities. The IFRIC Staff concluded that regulatory assets and liabilities do not currently fulfill the recognition criteria set for assets and liabilities under international standards[30] although there is some divergence of opinion by various analysts. In response to this conclusion, the IFRIC Staff recommended that the issue be referred back to the International Accounting Standards Board to be added to their agenda to address the matter directly,[31] rather than trying to reinterpret existing standards to allow regulatory assets and liabilities that have not historically been allowed by global standards.

On December 18, 2008, the IASB decided to add to its agenda a project on rate-regulated activities. The issue to be addressed is whether regulated entities could or should recognize an asset or a liability as a result of rate regulation imposed by regulatory bodies or governments. While the scope of the project is yet to be fully developed, it is most likely to address assets and liabilities developed under cost-of-service type rate regulation and exclude price-cap type regulation.

Nonetheless, as International Accounting currently stands, there is no opportunity to report regulatory assets or regulatory liabilities on the financial statements. Absent a change by the International Accounting Standards (IAS) Board, regulatory assets arising from a contractual or legal basis may fit the definition of an Intangible Asset, IAS 38, or Provisions, Contingent Liabilities and Contingent Assets, IAS 37. Companies and regulators could be forced to reinterpret these accounts. Alternatively, maintenance of separate off-book records could be required to track the transactional effects of specific regulatory decisions.

<u>Equity Financing Costs</u>

[29] Media Release Communique, *Canadian Accounting Standards Board Confirms Changeover Date to IFRS,* February 13, 2008, "The Canadian Accounting Standards Board has confirmed that use of International Financial Reporting Standards (IFRS) will be required in 2011 for publicly accountable profit-oriented enterprises."

[30] IFRIC Meeting, Information for Observers, *Regulatory Assets and Liabilities – Background (Agenda Paper 6A),* November, 2008, pp. 11 and 12.

[31] IFRIC Meeting, Information for Observers, *Regulatory Assets and Liabilities – Staff Analysis and Recommendation (Agenda Paper 6)*, November, 2008, p.12.

International Accounting does not permit the capitalization of equity based financing costs. U.S. GAAP permits utilities to capitalize the equity as part of the Accumulated Funds Used During Construction (AFUDC) which is applied to longer-term utility construction costs, as a regulatory asset. Thus, unless there is a change to current international standards, the equity portion of carrying charges incurred during a period of construction would not be capitalized as part of the plant.

The fact that equity is not capitalized is specifically addressed in International Accounting Standard 23, *Borrowing Costs*. In describing the scope of this accounting standard, it is specifically stated, "This Standard does not deal with the actual or imputed cost of equity, including preferred capital not classified as a liability." Thus, the Standard explicitly allows for borrowing costs to be part of the cost of the asset, but specifically and intentionally does not do the same for equity costs.

Property, Plant & Equipment

International Accounting requires the different components of a fixed asset to be identified and depreciated separately. For instance a power plant now would have separate components with different useful lives and depreciation rates (turbine rotor, turbine blades, boiler, electronic equipment, and so on). The detail for older plants or acquired plants may be limited making componentization more difficult. The costs eligible for capitalization may also be different. One such difference is that group depreciation methods that are commonly used by power and utility companies may not be permitted. In addition, all gains and losses on retirements would be recognized in earnings, and not recorded in accumulated depreciation.

Asset Impairment Test

Assets may be impaired earlier under International Accounting as it uses a single-step method for impairment write-downs rather than the two-step method used in the United States. Thus, many have expressed the opinion that write-downs are more likely under International Accounting than under U.S. GAAP.

Specifically, the International Accounting test compares the carrying amount of an asset to the recoverable amount which is measured as the higher of the asset's fair value less costs to sell or the asset's value in use (i.e., discounted cash flows). This is compared to the current U.S. GAAP method of first determining whether the carrying amount is lower than the undiscounted cash flows to determine whether an asset is impaired. If it is, then the impairment loss is measured as the difference between the carrying amount and the fair value, with fair value generally defined as the price that would be received to sell an asset.

Last-in, First-out Inventory Accounting

The last-in, first-out (LIFO) inventory accounting method is not permitted under International Accounting while it is permitted under U.S. standards. LIFO is not permitted even if the taxing authority (such as the Internal Revenue Service) permits LIFO as one of its acceptable costing methods.

Major Inspection or Overhaul Costs

While major overhauls and inspections are generally expensed under U.S. GAAP, the same is not true under International Accounting. International Accounting Standard 16, paragraph 14 explains that these types of costs are capitalized:

> A condition of continuing to operate an item of property, plant and equipment (or example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognized in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied…"

The general criteria to be satisfied are that (a) it is probable that future economic benefits associated with the item will flow to the entity, and (b) the cost of the item can be measured reliability. Thus, for items such as the major inspection of a power plant, this cost would be capitalized under international standards, rather than being expensed as is the current usual treatment in the U.S.

Leases

International Accounting lease standards cover a wider range of assets to be classified as leases. There are Operating Leases and Financial Leases without the bright line distinctions found in U.S. GAAP. The differences will require a reevaluation from day one of the lease. Many Operating Leases, such as a lease for a power plant, may need to be reclassified as a Financing Lease and could increase the cost of the lease. Finance Leases, under International Accounting, would be treated as either an asset or a liability by the Lessee. This potential increase in capitalized leases could result in larger rate base requests by public utilities.

Employee Benefits and Pension Expense

There are a number of differences in some of the specific employee benefit computations and pension asset computations between current U.S. GAAP and current International Accounting. The areas of differences include, but are not limited to treatment of actuarial gains and losses, expected return on plan assets, asset size limitations, plan asset valuations, and discount rates.

For example, U.S. GAAP permits the use of a calculated asset value (to spread market movements over periods of up to five years) in the determination of expected returns on plan assets. International Accounting precludes the use of calculated value and requires that the actual fair value of plan assets at each measurement date be used.

Extraordinary Items

U.S. accounting standards generally permit the reporting of items as extraordinary in the income statement, although only in very limited circumstances. Under International Accounting, there is no separate reporting of extraordinary items. These unusual transactions are reported along with the more normal transactions rather than as a separate line item in the financial statements. This is very clear and explicit in the International Accounting statements: "An entity shall not present any items of income or expense as extraordinary items, in the statement of comprehensive income or the separate income statements (if presented) or in the notes."[32]

Derivative Instruments

The definition of a derivative differs between International Accounting and U.S. GAAP meaning that the contracts within the scope of a derivative will also differ. International Accounting does not have interpretive issues specific to energy transactions. Since International Accounting is on a fully retrospective basis, each contract will need to be evaluated.

Financial Statement Presentation

There are differences in the way that transactions are presented on the financial statement pursuant to International Accounting compared to the U.S. domestic financial statements. In other words, "Users of IFRS statements quickly become aware of the fact that, while IFRS requires that a balance sheet and an income statement contain certain minimum information, IFRS does not require a precise format for the display of that information."[33]

One specific example of the different presentations relates to the categorization of expenses. The SEC requires categorization of expenses by their function, except depreciation, which can be presented as a separate line item. Under international standards, entities may present their expenses either by function (e.g., distribution expense, administrative expense, etc.) or by the nature of the expense (e.g., raw materials, employee benefits, depreciation, etc.). Additional disclosure of expenses by nature is then required if the functional presentation option is used.

Income Taxes

[32] International Accounting Standard 1, *Presentation of Financial Statements*, paragraph 87.
[33] Lawrence M. Gill, IFRS: Coming to America, *Journal of Accountancy* (June 2007), p. 72.

There would be two major effects of a conversion to International Accounting on income taxes. The differences between IAS 12, Income Taxes (the international standard), and Statement of Financial Accounting Standard (SFAS) 109, Accounting for Income Taxes (the U.S. standard), would affect how companies account for income taxes on their income statements and balance sheets. In addition, the many other differences between U.S. GAAP and IFRS standards would likely result in additional book-tax differences that would need to be considered for estimated tax payments, tax return preparation and calculation of deferred tax provisions and assets / liabilities. Differences in accounting for income tax include:

- Recognition, measurement, and disclosure of liabilities associated with uncertain tax positions;
- The probable lack of availability of the currently permitted regulatory-created exceptions (available pursuant to SFAS 71) to U.S. accounting for income taxes for companies that use or have used the flow-through method of accounting for certain book-tax differences and the deferred recognition of the effect of changes in tax rates on deferred tax assets and/or liabilities; and
- The classification of deferred tax assets/liabilities since all are classified as non-current under International Accounting.

The pre-tax differences between International Accounting and U.S. GAAP would need to be assessed to determine whether the new methods of accounting are permissible for income tax purposes. If the International Accounting methods are permissible and desirable for tax purposes, companies would need to assess whether it is necessary to obtain advance consent from the National Office of the Internal Revenue Service for the change in tax method of accounting and determine how the cumulative effect of the change is taken into account for tax purposes. The new International Accounting methods may result in a mandatory change in tax accounting (e.g., resulting from LIFO no longer being permissible) or may affect the timing of the recognition of an item for tax purposes (e.g., certain revenue recognition methods). Additional recordkeeping requirements may result from new book-tax differences caused by the conversion to International Accounting accompanied by a question of how these additional records will be maintained internally to continue to comply with tax reporting requirements.

Revenue Recognition

While the principles underlying revenue recognition appear to be similar between U.S. GAAP and International Accounting, there is a significant distinction in the number of specific rules which can create differences in when revenue is recognized. Generally, the International Accounting guidance regarding revenue recognition is less extensive than U.S. GAAP and contains little industry-specific instruction. Meanwhile, U.S. GAAP has highly detailed standards that dictate industry-specific accounting.

Environmental Liabilities

International Accounting does not contain a separate accounting direction specific to Environmental Liabilities as does U.S. GAAP.[34] Instead, the standard for this topic is contained within the general guidance on *Provisions, Contingent Liabilities and Contingent Assets*[35] which appears to rely more on judgment than does the U.S. standard. Under the international standard, a liability is recognized when an entity has a legal or constructive obligation as a result of a past event, it is more likely than not that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

This is different in several ways from the U.S. standard. One difference is that the threshold for recording a liability under the international standard is lower and thus, it is more likely to be reflected on the financial statements. A second difference is in the estimation of the cost of the obligation. Under U.S. GAAP, the most likely outcome should be accrued when there is a range of possible outcomes, with the lowest amount used if one outcome is no more likely than another. Under International Accounting, the best estimate should be used, with the mid-point of the range accrued if no amount is more likely than another.

Asset Retirement Obligations

U.S. GAAP has a specific accounting standard that describes the *Accounting for Asset Retirement Obligations.*[36] This standard applies to legal obligations associated with the retirement of tangible long-lived assets. Pursuant to this standard, entities are required to recognize the fair value of a liability for an asset retirement obligation in the period in which it is incurred if a reasonable estimate of fair value can be made. When a present value technique is used to estimate the liability, the discount rate will be a risk-free interest rate adjusted for the effect of the entity's credit standing.

There is no specific accounting related to asset retirement obligations under International Accounting. Instead, the matter falls under the accounting set forth in IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. Under this standard, liabilities are measured based on the best estimate of the expenditure required to settle the obligation or to transfer the obligation to a third party, as of the balance sheet date. When a present value technique is used to estimate the liability, the discount rate is to be a pretax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Thus, the discount rate to be used may be different than that currently prescribed under U.S. GAAP. The list of items that fall under the definition of what is a liability may also be different.

How does Accounting Impact Regulation?

[34] The U.S. accounting direction relative to Environmental Remediation Liabilities is found in Statement of Position (SOP) 96-1. It requires accrual of a liability when both the following have occurred: it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.

[35] International Accounting Standard (IAS) 37.

[36] Statement of Financial Accounting Standard 143.

Clearly, if the SEC were to mandate the move to International Accounting, the financial statements issued by domestic firms, including utility companies, would be different in a number of key ways from those that are currently issued. These financial statements are the foundation, or starting point, of the numbers provided to and utilized by utility regulators. Many of the specific decisions of regulators, and mechanisms utilized in regulating rates, are specifically reflected in the accounting and resultant financial reports. For example, gas cost adjustment mechanisms are an extremely common regulatory tool. The use of this mechanism generally results in the recording of either a regulatory asset or a regulatory liability (depending on over or under collections of costs) that is specifically recorded pursuant to Financial Accounting Standard 71 – a formal part of U.S. GAAP. So, what would happen to these types of deferral and true-up mechanisms if the accounting no longer had a special standard that permitted assets or liabilities to be created as a result of the action of regulators? In other words, does accounting drive regulation or does regulation drive accounting? The answer to this question is not clear, but an historical anecdote might be useful to the discussion.

In 1990, the Financial Accounting Standards Board issued a new accounting pronouncement regarding the recording of obligations related to post retirement benefits other than pensions.[37] This new accounting pronouncement caused quite a stir in the utility and regulatory community, as it required costs, such as post retirement health care benefits, to now be recorded on the utilities' books on an accrual basis, rather than the previous pay-as-you-go basis. These costs were now to be recorded on the books in a manner similar to pension costs – the amount that was estimated to be owed in the future to retirees was to be recorded, not only the amount of that cost that was actually being expended or funded. After a certain amount of debate and a period of transition, most U.S. regulators agreed to make the ratemaking of these costs match their accounting and began recognizing the costs on an accrual basis. However, as was their prerogative as economic regulators, a few jurisdictions chose not to make the change, and instead, required the post retirement benefits to be recognized in ratemaking on a pay-as-you-go basis. The point of this is that there is no mandate that the financial statements issued pursuant to SEC regulations and the treatment of costs for ratemaking have to precisely match.

Utility regulators could continue to defer costs, capitalize equity, expense overhaul costs and otherwise use the same cost treatment as they do today, even if the SEC were to mandate a different set of accounting instructions for financial statement purposes. But, there is no doubt, things will be much more complicated if significant differences exist between the cost treatment for economic regulation and financial reporting purposes. Before long, regulators would no longer be able to rely on published financial statements as a starting point for ratemaking since, for example, there would be a different plant balance if the utility continued to capitalize equity for rates but not for reports to investors. If regulators continue to defer expenses and make them into assets, the expense figures will be different between published reports and those used in ratemaking. It is not clear what the administrative cost of keeping an extra set of books

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[37] Statement of Financial Accounting Standard 106, *Employers' Accounting for Postretirement Benefits Other than Pensions*, effective for fiscal years beginning after December 15, 1992.

would be, but it is clear that increasing the chasm between ratemaking and financial reporting will diminish the understandability of the numbers.

What Should U.S. Regulators Be Doing Now to Prepare?

The two Staff Subcommittees have taken it upon themselves to open a project to begin to understand the implications of moving to International Accounting. The early work has revealed that there are more implications than just the changes described above. There are potential changes to the Uniform System of Accounts to consider, if the decision is made to try to match some of the financial accounting and regulatory accounting. History shows that making less significant changes to the regulatory accounting system than this project may require, can take many years. Furthermore, utilities will likely need to change their internal processes, their internal accounting systems, and their software to accommodate the changes to International Accounting – changes that likely will involve substantial cost as well as time. Regulators, utility personnel, policy makers, and others will need to become better informed on the topic of International Accounting in order to better effectuate any mandated transition. Yet, it is difficult to begin to actually implement change without knowing the decision that the SEC will make on this matter. It would be senseless to begin to implement a transition to International Accounting before the SEC decision has been made. Yet, a decision that is made in 2011 for implementation in 2014 may not provide nearly enough time to prepare for all the changes that are necessary. In fact, a survey of members of the American Institute of Certified Public Accountants (AICPA) indicates that most think that a three to five year transition is necessary.[38]

Given the difficulties of not knowing whether to begin making changes, or how any transition to International Accounting might be implemented (for instance, the use of a phased-in approach or not), it appears that efforts at this time are best spent on education and information gathering. However, it is important that commissioners as well as staff members begin to understand that there is a real possibility that issues regarding the transition to International Accounting may soon be before them. The topic of International Accounting should be added to the list of topics for discussions among regulators, utilities, consumer advocates and others, in order to promote a common understanding of the issues that we could be facing jointly.

It is important that regulators become part of the discussion with policy makers on the topic of International Accounting. It would be a shame for the SEC to make any decision on this matter without a full understanding of the regulatory perspectives having been relayed to them. Discussions between NARUC and the SEC would allow for a better informed decision, regardless of what that decision is.

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[38] AICPA Press Release, *AICPA Calls for Three to Five Year Timeline for Reasonable Transition to IFRS,* issued June 17, 2008. "A majority of AICPA members polled in an April 24 to May 12 survey said they believed it would take three to five years to prepare for IFRS. Thirty-four percent said they would need three years and 31.4 percent said they would need four or five years. The online survey of 1,240 members had a margin of error of less than 3 percentage points."

Furthermore, the International Accounting Standards Board recently opened a project to examine whether or not to allow regulatory assets and regulatory liabilities. This could be an opportunity for U.S. regulators to weigh in with the goal of making any transition to International Accounting easier and more in line with current U.S. regulatory practice. No educational opportunity should be overlooked particularly when it comes to interacting with those who will ultimately be deciding the accounting and reporting rules.

Conclusion and Next Steps

There is a very real possibility that the SEC will mandate – in the very near future – a significant change to the accounting and reporting standards that will be applied to U.S. firms, including public utilities. Now is the time for utility regulators and the utility industry to begin to understand these potential changes and their ratemaking implications.

The Staff Subcommittees on Accounting and Finance and International Relations intend to continue monitoring this matter. We also currently intend to look for additional ways to provide opportunities for updates and opportunities to share information with regulators and others regarding the topic of International Accounting. In doing so, we welcome the input of others and hope that this report will begin an important dialogue.