

**BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**Docket Nos. UE-111048 and UG-111049  
Puget Sound Energy, Inc.'s  
2011 General Rate Case**

**WUTC STAFF DATA REQUEST NO. 216**

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**RE: FERC accounting for income taxes. Refer to the Rebuttal Testimony of Matthew Marcellia at page 62.**

- 1) Please explain fully PSE's understanding of FERC and Uniform System of Accounts accounting for uncertain income tax positions. Identify and provide a copy of any documents relied upon in your response.
- 2) Please explain fully PSE's understanding of FERC and Uniform System of Accounts accounting for tax impacts of repairs deductions. Identify and provide a copy of any documents relied upon in your response.
- 3) Please explain in detail exactly how PSE has followed the FERC and Uniform System of Accounts accounting that applies to the tax impacts of repairs deductions.
- 4) Does PSE have any revenue requirements that are regulated by FERC? If not, explain fully why not. If so, please identify and describe PSE's FERC-regulated revenue requirements.

**Response:**

Puget Sound Energy, Inc. ("PSE") objects to WUTC Staff Data Request No. 216 as overly broad and unduly burdensome in that it asks PSE to fully explain its understanding of FERC accounting. Without waiving such objection, and subject thereto, PSE responds as follows:

1. Attached as Attachment A to PSE's Response to WUTC Staff Data Request No. 216, please find a FERC memorandum that contains PSE's understanding of FERC and Uniform System of Accounts for uncertain tax positions.
2. PSE is not aware of any special FERC guidance related to repairs.

3. PSE recorded the repairs method change consistent with the FERC and Uniform System of Accounts guidance. PSE has no uncertain tax position related to the repairs method change. As a result, there is no variance between PSE's FERC reporting and PSE's financial reporting.
4. Yes, PSE has two groups of customers that are regulated by FERC. Attached as Attachment B to PSE Response to WUTC Staff Data Request 216, please find the FERC Schedule 5 tariff. Attached as Attachment C to PSE Response to WUTC Staff Data Request 216, please find the Open Access Transmission Tariff (OATT).

**ATTACHMENT A to PSE's Response to  
WUTC Staff Data Request No. 216**

FEDERAL ENERGY REGULATORY COMMISSION  
Office of Enforcement  
Washington, D.C. 20426

In Reply Refer To:  
OE  
Docket No. AI07-2-000  
May 25, 2007

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

Subject: Accounting and Financial Reporting for Uncertainty in Income Taxes

The Financial Accounting Standards Board (FASB) has issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109, *Accounting for Income Taxes* (FIN 48 or the Interpretation). FIN 48, as amended by FASB Staff Position No. FIN 48-1,<sup>1</sup> clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement No. 109. The Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or to be taken in a tax return. The Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

Under FIN 48, an entity must evaluate all tax positions using a two-step process. The first step is recognition: The entity determines whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, the entity should presume that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The second step is measurement: A tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The

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<sup>1</sup> On May 2, 2007 FASB issued FASB Staff Position No. 48-1, *Definition of settlement* in FASB Interpretation No. 48, an amendment to FIN 48. FIN 48-1 clarifies how an entity should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits.

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tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement.

The FASB states it issued FIN 48 because the absence of more definitive guidance in this area resulted in diversity in how entities recognize, derecognize, and measure potential tax benefits associated with tax positions. The FASB's stated objective in issuing the Interpretation is to increase comparability in financial reporting of income taxes.

Commission jurisdictional entities recognize income taxes in accordance with FASB Statement No. 109 for Commission accounting and reporting purposes. As previously noted, FIN 48 is an interpretation of FASB Statement No. 109. Although increasing the comparability in reporting of income taxes is generally desirable, it is also essential that the Commission and others have available to them financial information about jurisdictional entities' costs and revenues that is useful for the development and monitoring of rates charged for services provided. Certain aspects of FIN 48, if not implemented in accordance with the guidance contained herein, could reduce the usefulness of income tax data for ratemaking purposes and or otherwise be inconsistent with existing Commission accounting requirements. Therefore, Commission jurisdictional entities should implement FIN 48 for Commission accounting and reporting purposes, but in doing so should comply with the guidance set forth below.

The guidance is being provided to all jurisdictional entities to ensure proper and consistent implementation of FIN 48 for Commission financial reporting purposes beginning with the 2007 FERC Form Nos. 1, 1-F, 2, 2-A, 6, and 60 due to be filed in 2008. Earlier implementation is encouraged.

This guidance is for Commission financial accounting and reporting purposes only and is without prejudice to the ratemaking practice or treatment that should be afforded the items addressed herein. Neither FIN 48 nor the guidance contained in this letter for implementing the Interpretation for Commission financial accounting and reporting purposes relieves entities from the requirements of Section 154.305, Tax normalization [for interstate pipelines], or Section 35.24, Tax normalization for public utilities, of the Commission's regulations.

## 1. ACCOUNTING FOR AND REPORTING TAX POSITIONS

**Background:** FIN 48 applies to all tax positions accounted for in accordance with FASB Statement No. 109. The term *tax position* as used in FIN 48 refers to a position in a previously filed tax return or a position expected to be taken in a future tax return that is

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reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods. As a result of applying the recognition and measurement provisions of this Interpretation, the amount of benefit recognized on the balance sheet may differ from the amount taken or expected to be taken in a tax return for the current year. These differences represent unrecognized tax benefits, which are the differences between a tax position taken or expected to be taken in a tax return and the benefit recognized and measured pursuant to the Interpretation. A liability is created (or the amount of a net operating loss carryforward or amount refundable is reduced) for an unrecognized tax benefit because it represents an entity's potential future obligation to the taxing authority for a tax position that was not recognized pursuant to the Interpretation. The Interpretation requires the liability to be reported as current to the extent the entity anticipates payment of cash within one year, or the operating cycle, if longer, and does not permit the liability for unrecognized tax benefits to be combined with deferred tax liabilities or assets.

**Question 1:** How should jurisdictional entities account for unrecognized tax benefits related to temporary differences<sup>2</sup> for Commission accounting and reporting purposes (Forms 1, 1-F, 2, 2-A, 3-Q, 6, 6-Q and 60)?

**Response:** Under existing Commission requirements, entities measure and recognize current and deferred tax liabilities (and assets) based on the positions taken or expected to be taken in a filed tax return and recognize uncertainties regarding those positions by recording a separate liability for the potential future payment of taxes when the criteria for recognition of a liability contained in FASB Statement No. 5, *Accounting for Contingencies*, are met, generally as part of the accrual for current payment of income tax. Where uncertainties exist with respect to tax positions involving temporary differences, the amounts recorded in the accounts established for accumulated deferred income taxes are based on the positions taken in the tax returns filed or expected to be filed. Recognition of a separate liability for any uncertainty related to temporary differences is therefore not necessary because the entity has already recorded a deferred tax liability for the item or would be entitled to record a deferred tax asset for the item if a separate liability for the uncertainty was recognized.

This practice results in the accumulated deferred income tax accounts reflecting an accurate measurement of the cash available to the entity as a result of temporary differences. This is an important measurement objective of the Commission's Uniform

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<sup>2</sup> Temporary difference as used here means a difference between the tax basis of an asset or liability as reflected or expected to be reflected in a tax return and its reported amount in the financial statements.

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Systems of Account<sup>3</sup> because accumulated deferred income tax balances, which are significant in amount for most Commission jurisdictional entities, reduce the base on which cost-based, rate-regulated entities are permitted to earn a return. FIN 48, which does not permit a liability for uncertain tax positions related to temporary differences to be classified as a deferred tax liability, frustrates this important measurement objective. Therefore, entities should continue to recognize deferred income taxes for Commission accounting and reporting purposes based on the difference between positions taken in tax returns filed or expected to be filed and amounts reported in the financial statements. Also, consistent with the direction provided in Docket No. AI93-5<sup>4</sup> regarding the implementation of FASB Statement No. 109, public utilities and licensees, natural gas companies and centralized service companies should not remove from accumulated deferred income taxes and reclassify as a current liability the amount of deferred income taxes payable within 12 months of the balance sheet date.

## 2. ACCOUNTING FOR AND REPORTING PENALTIES AND INTEREST

**Background:** When the tax law requires interest to be paid on an underpayment of income taxes, paragraph 15 of FIN 48 requires an entity to begin recognizing interest expense in the first period the interest would begin accruing according to the provision of the relevant tax laws. Also, if a tax position does not meet the minimum statutory threshold to avoid payment of penalties, paragraph 16 of FIN 48 requires an entity to recognize an expense for the amount of the statutory penalty in the period in which the enterprise claims or expects to claim the position in the tax return. Paragraph 19 of the Interpretation allows interest recognized in accordance with paragraph 15 to be classified

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<sup>3</sup> See 18 C.F.R. Part 101, *Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act* (2006); 18 C.F.R. Part 201, *Uniform System of Accounts Prescribed for Natural Gas Companies Subject to the Provisions of the Natural Gas Act* (2006); 18 C.F.R. Part 352, *Uniform System of Accounts Prescribed for the Oil Pipeline Companies Subject to the Provisions of the Interstate Commerce Act* (2006); 18 C.F.R. § 366.22, *Accounts and records of service companies* (2006) and 18 C.F.R. Part 367, *Uniform System of Accounts for Centralized Service Companies Subject to the Provisions of the Public Utility Holding Company Act of 2005*, Order No. 684, issued October 19, 2006, *Financial Accounting, Reporting and Records Retention Requirements Under the Public Utility Holding Company Act of 2005*, FERC Stats. & Regs. ¶ 31,229 (2006).

<sup>4</sup> *Accounting for Income Taxes*, Letter Order to Public Utilities, Licensees and Natural Gas Companies, Docket No. AI93-5 (April 23, 1993) (unpublished letter order).

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in the financial statements as either income taxes or interest based on the accounting policy election of the entity. Similarly, penalties recognized in accordance with paragraph 16 of the Interpretation may be classified in the financial statements as either income taxes or another expense classification, based on the accounting policy election of the entity.

**Question:** What FERC accounts should jurisdictional entities use to record and report interest expense and penalties applicable to underpayment of income taxes?

**Response:** The Commission's Uniform Systems of Account Prescribed for Public Utilities and Licensees, Natural Gas Companies and Centralized Service Companies require interest and penalties on tax deficiencies to be charged to Account 431, Interest Expense and Account 426.3, Penalties, respectively.<sup>5</sup> Therefore, public utilities and licensees, natural gas companies and centralized service companies should comply with these requirements for Commission accounting and reporting purposes. Classification of interest and penalties on tax deficiencies as income taxes is not permitted. Although not explicitly addressed in the Uniform System of Accounts Prescribed for Oil Pipeline Companies Subject to the Provisions of the Interstate Commerce Act, oil pipeline companies should charge interest expense and penalties on tax deficiencies to Account 660, Miscellaneous Income Charges, to similarly exclude such amounts from classification as income taxes for Commission accounting and reporting purposes.

### 3. ADJUSTMENTS TO RETAINED EARNINGS

**Background:** Paragraph 23 of FIN 48 requires the cumulative effect of applying the provisions of the Interpretation to be reported as an adjustment to the opening balance of retained earnings.

**Question:** How should FERC jurisdictional entities recognize any required adjustment to the opening balance of retained earnings? Is a separate filing requesting Commission approval of that accounting required?

**Response:** Public utilities and licensees, natural gas companies, oil pipeline companies and centralized service companies should use the accounts shown below to record any adjustment to the opening balance of retained earnings required in connection with

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<sup>5</sup> See Account No. 236, Taxes Accrued and Account No. 426.3, Penalties. 18 C.F.R. Parts 101, 201 and 367.



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implementing FIN 48 for Commission accounting and reporting purposes. This guidance letter constitutes the required Commission approval for use of these accounts for this purpose and a separate filing with the Commission requesting such approval is not needed. Public utilities and licensees, natural gas companies and oil pipeline companies should report any amounts recorded in the accounts listed below on the lines designated for these accounts in the Statement of Retained Earnings contained in the FERC Form Nos. 1, 1-F, 2, 2-A, 3-Q, 6 and 6-Q.

Jurisdictional Entity	FERC Accounts
Public utilities and licensees (Major and Nonmajor)	Account 439, Adjustments to retained earnings
Natural gas companies	Account 439, Adjustments to retained earnings
Oil pipeline companies	Account 705, Prior period adjustments to beginning retained income account
Centralized service companies	
<input type="checkbox"/> Periods prior to January 1, 2008	Account 216, Unappropriated retained earnings
<input type="checkbox"/> January 1, 2008 and subsequent periods	Account 439, Adjustments to retained earnings

#### 4. COST-OF-SERVICE TARIFFS/FORMULA RATE

**Background:** Jurisdictional entities may have cost-of-service tariffs or formula rates under which amounts billed each month will change based on amounts recorded pursuant to a Commission prescribed Uniform System of Accounts. Under the tariff or formula rate, only amounts recorded in certain specified accounts affect the monthly billings.

**Question:** May jurisdictional entities include in their monthly billings any amounts recognized or reclassified in connection with the implementation of FIN 48 for FERC reporting purposes?

**Response:** No. Adoption of the accounting guidance contained in this letter is for Commission accounting and reporting purposes only, and may not affect the measurement or periods in which amounts are included in jurisdictional entities' billing determinations without prior regulatory approval. If an entity's billing determinations are

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affected by the adoption of the guidance contained in this letter, the entity shall make a filing with the proper rate regulatory authorities before implementing the accounting change for billing purposes.

The Commission delegated authority to act on this matter to the Chief Accountant under 18 C.F.R. § 375.303 (2006). This guidance letter constitutes final agency action. Your company may file a request for rehearing with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713 (2006).

Anna V. Cochrane  
Acting Chief Accountant