

Letter of Comment No: 22 File Reference: 1201-100

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September 7, 2004

Ms. Suzanne Bielstein
Director – Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856

Re: File Reference No. 1201-100

Dear Ms. Bielstein:

The National Rural Electric Cooperative Association (NRECA) is pleased to provide comment on the Proposed Statement of Financial Accounting Standards regarding Fair Value Measurements (Exposure Draft) published by the Board on June 23, 2004.

NRECA is the trade association representing 930 rural electric systems providing electricity to more than 36 million consumer owners in 47 states. Of the 930 rural electric systems, 64 are generation and transmission cooperatives (G&Ts) that are owned by and sell power at wholesale to some 750 of the 866 electric distribution cooperatives.

As borrowers of the Rural Utilities Service (RUS), an agency of the U.S. Department of Agriculture, most of the nation's G&Ts and distribution cooperatives are subject to oversight and accounting regulation of the RUS. Substantially all of the remaining G&Ts and distribution cooperatives, which are not RUS borrowers, are subject to the ratemaking and accounting jurisdiction of the Federal Energy Regulatory Commission (FERC). Furthermore, substantially all NRECA members meet the criteria to apply the provisions of FASB Statement No. 71 "Accounting for the Effects of Certain Types of Regulation."

To facilitate their regulatory oversight, both RUS and FERC promulgate a Uniform System of Accounts (USoA) to be used by their respective jurisdictional entities. The RUS USoA is substantially similar to the USoA promulgated by FERC. The FERC/RUS USoAs are essentially cost accounting systems designed to easily discern a jurisdictional entity's cost-of-service to be used to develop rates; the USoAs generally endeavor to interpret Generally Accepted Accounting Principles (GAAP) for their jurisdictional entities and not to deviate from them.

NRECA is responding to the Exposure Draft on behalf of its members.

Fair Value Hierarchy - Issue 5

NRECA asserts that the fair value hierarchy proposed in the Exposure Draft, which emphasizes first and foremost quoted market prices (Level 1 and Level 2) to establish carrying amounts to be reported, is oftentimes not relevant for entities that are rate-regulated on a cost-of-service basis - as electric cooperatives generally are. Rather, to determine fair value for entities that qualify for treatment under FASB Statement No. 71, primary and paramount emphasis should be placed on the rate treatment methodology that rate-regulators employ for the asset.

In general, rate-regulated enterprises are limited to recovery of the historical cost of an asset. Applying the proposed fair value hierarchy in the Exposure Draft emphasizing quoted market prices (say, for assets and liabilities acquired in a business combination) would misstate – usually overstate due to inflation – the revenue-producing power of a regulated asset. Furthermore, applying FASB Statement No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" does not alleviate the problem, since under this statement the carrying amount of an asset is written down only when its expected <u>undiscounted</u> cash flows are less than the carrying amount.

For a rate-regulated enterprise that is limited to rate recovery based on historical asset cost, the most appropriate carrying amount for a regulated asset is, therefore, its historical cost. This result would appear to be more or less consistent with the cost approach and/or income approach envisioned in Level 3 of the proposed fair value hierarchy.

Other Issues – Issue 13

NRECA recognizes that the USoA and GAAP are designed to meet the needs of two different sets of financial statement users. In recent years, GAAP, perhaps quite appropriately for non-rate-regulated public companies, has continuously moved to expand the use of fair value reporting to more and more categories of assets and liabilities. On the other hand, NRECA asserts that the most relevant and reliable financial statements for entities meeting the criteria to apply the provisions of FASB Statement No. 71 are those prepared in accordance with the historical-cost-based USoA, if the expected rate treatment of the asset is based on its historical cost. Electric cooperatives, substantially all of which — as mentioned above — are subject to the provisions of FASB Statement No. 71, generally believe that their general-purpose financial statement users (lenders, member-owners, and major vendors) would receive little, if any, benefit from fair value re-measurement that deviates from the USoA, and yet the cooperatives would incur significant cost to implement and maintain these accounts.

Thus, at best, the Board's moves to expand the use of market-based fair value measurements for all companies is likely to ultimately result in a requirement for rate-regulated utilities, including electric cooperatives, to maintain two sets of books – one set prepared in accordance with the USoA as prescribed by rate regulators and the other set in accordance with GAAP. This circumstance would, of course, add considerable cost

for a rate-regulated enterprise as compared to an entity that is not subject to rate regulation. At worst, fair value GAAP financial statements prepared by rate-regulated enterprises may be misleading and confusing to general-purpose financial statement users, since many general-purpose financial statement users will likely also have access to the reporting entity's alternate set of financial statements prepared in accordance with the USoA.

Any FASB fair value guidance should, therefore, consider the special operating environment of rate-regulated enterprises, just as FASB Statement No. 71 itself does. Indeed, NRECA respectfully urges the Board to coordinate with the accounting staffs of FERC and RUS to minimize to the extent possible the differences between GAAP and the USoAs.

NRECA appreciates the opportunity to respond to the Exposure Draft regarding Fair Value Measurement. If you have any questions about these comments please feel free to contact Gary Bartlett at voice (703) 907-5817 or e-mail gary.bartlett@nreca.coop or Steve Piecara at voice (703) 907-5802 or e-mail gary.bartlett@nreca.coop.

Sincerely yours,

Stephen J. Piecara

Steve Precura

Director - Tax, Finance & Accounting Policy