
Sempra Energy believes offering the fair value option for certain nonfinancial instruments would result in significant tangible improvement in financial reporting. This would be apparent in aligning the reported results of a commodity business with the economic management of that business. For example, a commodity-trading business is typically managed by valuing financial instruments, physical inventories, and other contracts within that business at fair value. These portfolios may include instruments that meet the definition of a derivative under FASB Statement No. 133, as amended, which typically are reflected at fair value in the financial statements. However, components in these portfolios that do not meet the definition of a derivative are managed on a fair value basis but reported at historical cost or, in the case of inventory, the lower of cost or market.
In response to the questions posed by the Exposure Draft (recapped in the opening paragraph above), we note that availability of a fair value option for certain nonfinancial instruments could result in the following benefits in the commodity example case above:

A) Financial reporting would be improved. Reported results would more validly reflect business performance; the current mixed-attribute model introduces significant earnings volatility. We note that some entities, including Sempra Energy, have chosen to address this issue by including “non-GAAP” financial measures in public disclosures, which are offered as a direct and ongoing adjustment to net income and other GAAP reporting. We believe that if the difference between these “non-GAAP” measures and GAAP results is material, this practice is 1) necessary to improve the reader’s understanding of results, and 2) superior to reporting GAAP results only. However, we also believe perpetuating this disclosure undermines the integrity of the financial reporting process, and is inconsistent with the need for financial statements to be relevant, reliable and comparable, as discussed throughout Concepts Statement No. 2.

B) Problems with reported earnings caused by the mixed-attribute model would be mitigated. Currently, the accounting alternatives to address the mixed-attribute model include hedge accounting and scope exceptions (e.g. normal purchases and normal sales), both articulated in FASB Statement No. 133, as amended. The use of these alternatives may be either difficult or impossible to apply in certain situations. For example, a contract for the purchase of commodity storage capacity (generally a non-derivative due to its physical nature) may be readily valued. However, constructing an effective accounting hedge for that same contract, if possible, may impact the ability to optimize, or subsequently alter, the economics of the total position as market circumstances evolve. Separately, the use of the normal purchases and normal sales scope exception may be inconsistent with a commodity-trading business.

C) Accounting methods would be simplified, with workloads and costs reduced. As discussed above, a commodity business may be monitored, controlled and managed on a fair value basis. To publish results on a GAAP basis, a separate process is employed to revalue those assets or liabilities that are not reported on a fair value basis. The efforts required increase resources needed to complete the accounting close, analytical reviews, and reporting processes, impacting the ability to report timely financial results.

D) Fair value information is not only readily available for the nonfinancial instruments in question, but also is used daily for calculating margin, managing the business and monitoring risk. We believe price discovery for certain nonfinancial instruments, including commodity inventories, storage contracts and transportation contracts, is readily available using market data and, in some cases, proven options theory. We note that
current accounting for similar financial instruments is typically done on a fair value basis. In any case, calculating fair value for certain nonfinancial instruments would be consistent with the Fair Value Measurement initiative.

Separately from the responses above, we observe that the Exposure Draft currently defines no qualifying criteria for the use of the fair value option, other than its scope. We believe a Fair Value Option for certain nonfinancial instruments could be similar. We note that in the commodity-trading business context, a fair value option would likely be utilized continuously. However, an owner/operator of assets that is also entering similar instruments may choose not to elect the option, because this type of business may not be managed or reported on a fair value basis. We note that for this latter type of business, the cost of implementing fair value reporting would likely exceed the associated benefits. Similarly, establishing criteria that would require or preclude fair value accounting creates a responsibility for all entities involved to apply those criteria. We agree that dictating the application of the fair value option is not necessary, and could have unintended consequences.

In summary, we support the inclusion of certain nonfinancial instruments within the scope of a fair value option. We appreciate the opportunity to comment on this topic, and encourage its expeditious review.

Respectfully,

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