FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

March 23, 2007

In Reply Refer To:
Transcontinental Gas Pipe Line Corporation
Docket Nos. AC06-153-000
CP88-391-033
RP93-162-018

Transcontinental Gas Pipe Line Corporation
P.O. Box 1396
Houston, TX 77251

Attention: Scott C. Turkington, Director-Rates and Regulatory

Reference: Revised Annual Cash-Out Reports and Accounting Statements

Dear Mr. Turkington:

1. On September 7, 2006, in Docket No. AC06-153-000, Transcontinental Gas Pipe Line Corporation (Transco) filed for approval to restate its 2004 FERC Form No. 2 (Form 2) and to use Account 439, Adjustments to Retained Earnings, to record a prior period adjustment to correct an error related to the calculation of its weighted average cost of gas (WACOG) (September 7, 2006 filing). On December 21, 2006, in Docket Nos. CP88-391-033 and RP93-162-018, Transco filed revised annual cash-out reports and proposed surcharges and refunds for each of the annual periods ending July 31 for the years 2001-2005 to reflect the accounting correction (December 21, 2006 filing). Transco requests that the Commission accept and approve the revised cash-out report and authorize Transco to make the appropriate refunds and surcharges to each shipper, as necessary. The Commission will conditionally accept Transco's restated 2004 Form 2 and accept its adjustment to retained earnings and revised cash-out reports. We will also approve Transco's proposed surcharges and refunds.

2. On April 11, 2006, Transco filed a notice of intent to restate its 2004 Form 2 financial statements for the years 2004 and 2003, and to use Account 439 to correct its accounting for gas inventory for the period June 2000 to November 2005 (April 11, 2006 filing). Public notice of the April 11, 2006 filing was issued by the Commission on June 9, 2006. The Commission received four motions to intervene and no protests.

3. In the September 7, 2006 filing, Transco requested approval of the proposed restatement and use of Account 439 and provided additional details. On October 18, 2006, Transco filed a follow-up letter providing proposed journal entries supporting the use of Account 439 (October 18, 2006 filing). The Commission issued a Data Request on December 21, 2006; and Transco provided a response on February 2, 2007. Public notice of the September 7, 2006 and October 18, 2006 filings was issued on December 21, 2006. Two motions to intervene and one motion to intervene out-of-time were filed. No protests or comments were filed.

4. Transco states that from the inception of its cash-out program until June 2002, it calculated its weighted average cost of gas (WACOG) each month as the weighted average cost of the system inventory components that realized a net decrease in volume for the month plus the cost of purchasing excess cash-out gas supplies for the cash-out program, if applicable. Transco states that until June 2000, the monthly WACOG calculation did not yield any anomalous results. However, for the month of June 2000, Transco states that the calculation resulted in a WACOG of negative $24.02 per decatherm (Dth) compared to $2.20 per Dth in May 2000.[1]

5. Transco asserts that due to the anomalous WACOG in June 2000, it revised its WACOG calculation to isolate the cash-out inventory from the rest of its system inventory creating a separate inventory cost pool for gas purchased and sold under the cash-out program. Transco states the revised calculation provided a better matching of cash-out revenues and cash-out costs, prevented price anomalies in the WACOG calculation by isolating the cash-out inventory pool from the rest of the system inventory pools, and eliminated the impact of the cost of cash-out purchases from shippers in the calculation of the monthly WACOG. Transco explains that, when it adopted the change in inventory methodology under the revised WACOG, it believed the methodology was in compliance with Generally Accepted Accounting Principles (GAAP).[2]

6. Transco states that its independent auditors reviewed its accounting for gas inventory during a 2005 audit and determined that a separate inventory pool for the cash-

[1] *See* September 7, 2006 filing at 2.

[2] *Id*.

out program was not in compliance with GAAP. Transco states that, generally, GAAP requires inventory that is identical and interchangeable but purchased at different times and at different prices to be maintained in one inventory pool. Consequently, Transco asserts that it again merged the cash-out inventory pool with the rest of the system inventory pool and recalculated the WACOG each month from June 2000 to November 2005 using the WACOG calculation in place prior to June 2000. Transco states that it continued using the pre-June 2000 WACOG calculation for all periods after November 2005.[3]

7. Transco explains that the recalculation of the WACOG for June 2000 through November 2005 affected previously reported amounts of fuel gains, storage losses, and deferred cash-out gains and losses.[4] Transco requests approval to record the $7.1 million adjustment applicable to periods prior to 2003 in Account 439 as an adjustment to its 2003 beginning balance of retained earnings and restate its 2004 Form 2. Transco argues that the impact of the adjustment is not material to any of the previously issued financial statements. However, Transco asserts that the cumulative adjustment required to correct the error in inventory methodology was significant to the Statement of Income for 2005. Transco states that it has also determined that the quarterly financial information included in its FERC Form No. 3-Q submissions for the first, second, and third quarters of 2005 were not materially misstated and can be relied upon.[5]

8. With respect to its cash-out reports, Transco states that it started its cash-out program in 1991 in order to resolve shippers' monthly transportation imbalances in cash by either purchasing gas from or selling gas to individual shippers to settle their monthly imbalances.[6] Transco's tariff requires it to file annual cash-out reports that state the volumes involved in cash-out transactions and amounts paid to or by firm and

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[3] *See* id. at 3.

[4] Id.

[5] *See* October 18, 2006 filing.

[6] According to Transco, its cash-out program was initially approved in Docket No. CP88-391-000. *Transcontinental Gas Pipe Line Corp.*, 55 FERC ¶ 61,446 (1991). Transco states that Section 37 of its General Terms and Conditions (GT&C) of its tariff contains the currently effective provisions governing the operation of its cash-out program, including the pricing terms applicable to cash-out purchases and sales. September 7, 2006 filing at 1. Transco states that its use of the inventory method of accounting for gains and losses in its cash-out program was reviewed by the Commission and deemed appropriate, citing *Transcontinental Gas Pipe Line Corp.*, 75 FERC ¶ 61,028 (1996); *Transcontinental Gas Pipe Line Corp.*, 83 FERC 61,347 (1998). Id. at 2.

interruptible transportation customers and Operational Balancing Agreement (OBA) parties. Transco states that at the end of each annual period, revenues received and costs incurred are compared, and, pursuant to Section 15 of its GT&C, if revenues exceed costs (gain), Transco refunds the excess to its customers. Conversely, Transco states that if costs exceed revenues (loss), the net under-recovery is carried forward to the next annual period.[7] In the December 21, 2006 filing, Transco states that the impacts associated with the changes to its inventory accounting methodology that were implemented beginning in June 2000, were reversed on Transco's books in November 2005 retroactive to June 2000, thus essentially reinstating the methodology in effect prior to June 2000. As a result, Transco states that the cash-out reports filed and approved for each of the annual periods ending July 31, 2001, 2002, 2003, 2004 and 2005 are no longer accurate.[8] Consequently, Transco contends that the amount of refunds during those periods is different, *i.e.*, cumulative over-recoveries are now cumulative under-recoveries, and have been recalculated.[9]

9. In its December 21, 2006 filing, Transco states that the revised cash-out reports reflect a corrected cumulative under-recovery of $0.6 million for the period ended July 31, 2001 and a cumulative over-recovery of $12.9 million for the period ended July 31, 2005. Transco proposes to surcharge the appropriate shippers to recoup the $2.3 million that was over-refunded to such shippers in 2001 and refund to the appropriate shippers an additional $10 million that was under-refunded to such shippers in 2005. Transco requests that the Commission accept the revised cash-out reports and allow it to make appropriate refunds and surcharges to its shippers. Public notice of the December 21, 2006 filing was issued on December 28, 2006. No protests or adverse comments were filed.[10]

10. Based on the information provided by Transco as described above, Transco's request to restate its 2004 Form 2 and use of Account 439 to record a $7.1 million prior period adjustment to its 2003 beginning balance of retained earnings are conditionally

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[7] September 7, 2006 filing at 1.

[8] *See* December 21, 2006 filing at 1-2. Transco states that the cash-out report for the annual period August 1, 2005 through July 31, 2006 reflects the reinstated inventory accounting methodology and was accepted by the Commission. *Transcontinental Gas Pipe Line Corp.*, 117 FERC ¶61,136 (2006). Therefore, Transco contends that no revisions to that report are necessary. *See* December 21, 2006 filing at 2, note 2.

[9] *See id*. at 2.

[10] *See id*.

approved as described below. We will require Transco to correct the restated 2004 Form 2 it filed on May 25, 2006 to report the $7.1 million prior period adjustment on line 3 of the Statement of Retained Earnings on pages 118-119, rather than reflecting it as a reduction of the 2003 beginning balance of retained earnings. Accordingly, Transco must revise and refile its 2004 Form 2 to correctly report the prior period adjustment within 30 days of the date of this order.

11. As to Transco's revised cash-out reports and proposed surcharges and refunds, we find that, for the reasons set forth in Transco's filings summarized above, the proposed corrections to its cash-out reports and associated refunds and surcharges are reasonable. Accordingly, the revised cashout reports are accepted for filing and the proposed refunds and surcharges are approved.

By direction of the Commission.

Philis J. Posey,
Acting Secretary.