

RESOLUTION NO. 10 - 13573

A RESOLUTION ADOPTING REGULATORY ACCOUNTING FOR
CONSERVATION PROGRAM EXPENDITURES

FACTUAL BACKGROUND AND REASONS FOR ACTION

The Board of Commissioners (“Commission”) establishes rates for the District that are designed to recover the costs of providing services. The Commission has covenanted in bond resolutions that the District will charge retail rates sufficient to cover costs and maintain certain debt service coverage ratios. On June 21, 2010, the Commission also approved financial policies under Resolution No. 10-13555 which require the District to maintain certain debt service coverage ratios, liquidity targets, debt ratios and rates of return to maintain the long-term financial health of the District. If projections reflect that future results will vary from established targets, recommended corrective action, including potential retail rate actions, will be presented for Commission consideration and action.

As a result, the PUD qualifies for the application of FASB Accounting Standards Codification (ASC) 980, Regulated Operations, (formerly known as SFAS 71 “Accounting for the Effects of Certain Types of Regulation”), which requires that the effects of the rate-making process be recorded in the financial statements. Accordingly, certain expenses and credits, normally reflected in the Change in Net Assets as incurred, may be recognized when included in rates and recovered from, or refunded to, customers. Expenses that may be deferred under ASC 980 include conservation program expenditures.

In November 2006, Washington voters approved the Energy Independence Act, also known as Initiative 937 (I-937). The Act, codified as RCW Chapter 19.285, imposes targets for energy conservation and use of eligible renewable resources on the state’s electric utilities that serve more than 25,000 customers. The District serves more than 25,000 electric customers and is subject to the Act’s requirements.

Conservation is defined in the statute as any reduction in electric power consumption resulting from an increase in the efficiency of energy use, production or distribution. Beginning January 1, 2010, qualifying utilities must begin acquiring all conservation that is cost-effective, reliable and feasible. Each impacted utility must establish a biennial acquisition target and meet that target during the subsequent two-year period.

On November 16, 2009, the Commission adopted a 10-year conservation potential plan and two-year conservation target under Resolution No. 09-13504 in compliance with the Energy Independence Act. The plans include a significant increase in Conservation program expenditures. Current accounting practice recognizes these expenditures as incurred, however, the benefit of these expenditures occurs over multiple years in the future. Consequently, without adopting Regulatory Accounting, there is a mismatch between when

the expense is currently recognized and when the benefit is received and reflected in rates. As a result, the increase in conservation expenditures required by I-937 may cause significant volatility in the District's financial results.

ANALYSIS AND STAFF RECOMMENDATION

While the District has supported various conservation measures and incentives in the past, the District's updated conservation plans include a significant increase in program expenditures in the coming years to support compliance with I-937. Examples of conservation programs which secure energy savings from our customers include, but are not limited to: compact fluorescent lamps, low income weatherization, industrial lighting retrofits, ResourceSmart, weatherization insulation, windows and doors and EnergyStar.

With these conservation investments, the District is considered to be buying an energy resource from our customers. In other words, saving a kilowatt is equivalent to adding a kilowatt of new generation. Energy conservation is viewed as one of the most cost-effective and environmentally-friendly energy resources available. Increasing the District's supply of energy by "purchasing back" the electricity through conservation measures and incentives also keeps retail rates low by making more District energy available to sell on the wholesale power market.

ASC 980 allows an entity with cost-based rates to capitalize costs as Regulatory Assets and recognize those costs when recovered from customers. Since the Commission establishes cost-based rates, the District may adopt ASC 980 and defer the conservation program expenditures as Regulatory Assets and recognize them when recovered through rates.

Implementation of I-937 conservation measures without also adopting ASC 980 could result in significant volatility in the District's financial results and result in the District's financial statements being inconsistent with the normal practice used by the Commission in setting rates. The District's cost-based rates consider energy savings through conservation efforts, as well as the impact to wholesale revenues. Since the District is considered to be "buying back" energy over future years, it also makes sense to defer the upfront conservation program expenditures and recognize them when recovered through rates, i.e. over the energy savings period.

Staff has presented the background, requirements and considerations for adopting ASC 980 at the June 29, 2010, Audit Committee Meeting and July 12, 2010, Commission meeting. District staff recommends that it is in the best interest of the District to adopt Regulatory Accounting (ASC 980) for conservation program expenditures incurred after December 31, 2010. This will be accomplished by recording Regulatory Assets simultaneously with expensing the program costs so as to result in no impact on the District's Statement of Revenues, Expenses and Changes in Net Assets. The Regulatory Asset will be amortized, and included in rates, over the benefit period or as determined by Accounting. This will reduce volatility in the financial statements caused by increased conservation program expenditures and better support the financial policies and rate setting process.

The General Manager and Chief Financial Officer have reviewed this recommendation and concur.

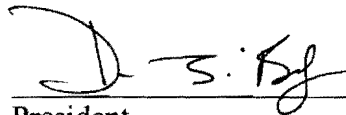
ACTION

IT IS RESOLVED BY THE COMMISSION OF PUBLIC UTILITY DISTRICT NO. 1 OF CHELAN COUNTY, WASHINGTON, as follows:

Section 1. Regulatory Accounting (ASC 980) is hereby adopted for conservation program expenditures incurred after December 31, 2010.

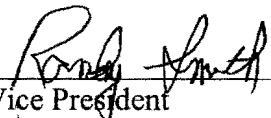
Section 2. This resolution is intended to clarify and support the appropriate accounting treatment of conservation expenditures by the District.

Dated the 18th day of October 2010.



President

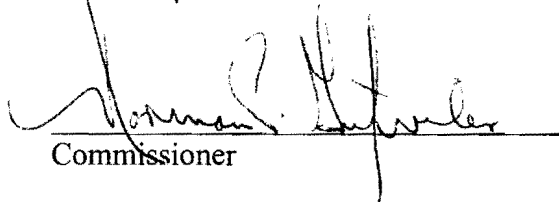
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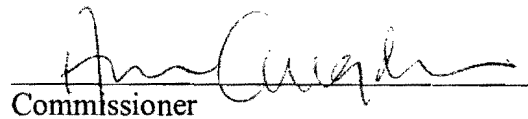
Vice President



Secretary



Commissioner



Commissioner

SEAL

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