

RESOLUTION NO. 10-13572

A RESOLUTION ADOPTING REGULATORY ACCOUNTING
FOR SIGNIFICANT CONTRIBUTIONS IN AID OF
CONSTRUCTION

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. Credits that may be deferred under ASC 980 include Contributions in Aid of Construction transactions required under Governmental Accounting Standards Board (GASB) Statement No. 33.

In 1998, GASB issued Statement No. 33 (GASB 33), "Accounting and Financial Reporting for Nonexchange Transactions." This statement establishes accounting and financial reporting standards to guide decisions by governmental entities about when to report the results of nonexchange transactions involving cash and other financial and capital resources. In a nonexchange transaction, a government receives (or gives) value without directly giving (or receiving) equal value in return.

GASB 33 requires that the District recognize contributions in aid of construction (CIAC) as income in the period the resources are received and expense that amount over the expected life of the asset acquired. This results in a mismatch between the timing of the reported income and the related depreciation expense. This can cause considerable volatility in the financial results when a significant, non-routine contribution is received.

ANALYSIS AND STAFF RECOMMENDATION

A portion of the District's utility plant is funded by contributions from customers, property owners and developers. Examples of routine capital contributions include, but are not limited to: line extension fees, connection fees and system development charges. The total amount of these contributions does not vary significantly from year to year (typically \$3-4 million). Because the District has received these contributions for many years, the annual CIAC received typically offsets the annual depreciation expense on these routinely contributed assets.

In addition to these routine contributions, the District expects to receive some significant capital contributions within the next few years that exceed typical contribution levels. Some examples include, but are not limited to: the Rural Utilities Service Networks grant (\$25 million), Valhalla substation improvements funded by Alcoa (estimated at \$20 million), and hatchery improvements funded by another utility (\$2 million).

GASB 33 requires reporting these contributions as income in the year received and expensing over the life of the contributed asset. Consequently, these significant contributions will distort financial results and be inconsistent with rate setting practices if regulatory accounting is not adopted for these transactions.

In addition to applying GASB 33 requirements, the District may adopt ASC 980 to eliminate the significant impact of these contributions on the District's Statement of Revenues, Expenses and Changes in Net Assets. ASC 980 allows an entity with cost-based rates to capitalize costs or revenues as regulatory assets or liabilities and recognize when recovered from, or refunded to, customers. Since the Commission establishes cost-based rates, the District may adopt ASC 980 and defer the significant contributions as regulatory liabilities and recognize the income over the useful life of the contributed asset.

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 significant, non-routine capital contributions (over \$1 Million) that are required to be reflected in the Change in Net Assets by GASB 33.

This will be accomplished by recording regulatory liabilities simultaneously with booking the entries required by GASB 33 so as to result in no impact on the District's Statement of Revenues, Expenses and Changes in Net Assets. The recognition of income from these contributions will be deferred as a regulatory liability and (non-operating) income will be recognized over the life of the asset to approximately match the depreciation of the asset received. This action will result in the same net impact to the financial statements at the end of the asset's useful life,

support the District's financial policies and rate setting processes and represent a more accurate view of financial performance on an annual basis.

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

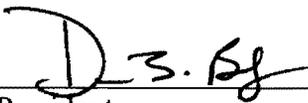
ACTION

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 individual capital contributions over \$1 Million.

Section 2. This resolution is intended to clarify and support the appropriate accounting treatment of significant contributions in aid of construction by the District.

Dated the 4th day of October 2010.



President

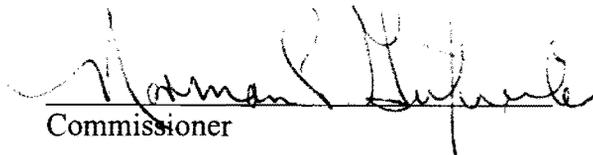
ATTEST:



Vice President



Secretary



Commissioner



Commissioner

SEAL