

## RESOLUTION NO. 13-13829

### A RESOLUTION ADOPTING REGULATORY ACCOUNTING FOR INVESTMENT FAIR VALUE CHANGES

#### **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 shall fix, establish, maintain and collect rates and charges to provide revenues sufficient to cover costs and maintain certain debt service coverage ratios. 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 District qualifies for the application of Government Accounting Standard Board Statement No. 62 (GASB 62), which outlines the concept of Regulatory Accounting for entities or operations that are rate regulated. Accordingly, certain expenses and revenues, normally reflected in the Change in Net Position as incurred, may be recognized when included in rates and recovered from, or refunded to, customers.

Application of GASB 62 requires Commission approval for each type of expense or revenue deferred. Examples of items the Commission has previously approved the application of Regulatory Accounting for include: Resolution No. 10-13561-derivative fair value changes, Resolution No. 10-13572-significant contributions, Resolution No. 10-13573-conservation expenditures, Resolution No. 11-13648-swap termination payments and Resolution No. 13-13795-debt issuance costs. These deferrals are fully disclosed in the audited financial statements. Expenses or revenues that may be deferred under GASB 62 also include investment fair value changes required under Governmental Accounting Standards Board Statement No. 31 (GASB 31).

In accordance with GASB 31, “Accounting and Financial Reporting for Certain Investments and External Investment Pools,” the District records changes in the fair value of certain investments to the Statement of Revenues, Expenses and Changes in Fund Net Position as a component of Investment Income. Changes in fair value of investments occur as market interest rates fluctuate from the time of purchase, thus impacting the market value of the investments. However, it is the District’s practice to hold investments to maturity and the ultimate value of an investment at maturity is not impacted by changes in fair value. Valuation gains or losses on investments that are held to maturity net to zero over time and result in no net impact to the District’s financial position, cash flows or rates. However, the requirements of accounting for investment fair value changes under GASB 31 can result in significant volatility to Changes in Net Position in any individual reporting period.

Historically, the change in fair value of investments has not been material. However, with cash reserves forecasted to increase and remain strong in the future, the adjustments for

the change in fair value of investments are expected to increase as well. In addition, after a period of interest rates remaining relatively stable and at historic lows, there is potential that the volatility of interest rates will increase as rates are impacted by changing market conditions and economic policies.

Without adopting Regulatory Accounting, investment fair value changes are recorded in the financial statements each period, however, the changes are not recognized in the ratemaking process since investments are typically held to maturity when the changes net to zero. Consequently, without adopting Regulatory Accounting, there is a mismatch between how the expense or revenue is recognized in the financial statements and how the expense or revenue is currently reflected in rates.

### **ANALYSIS AND STAFF RECOMMENDATION**

In addition to continuing the required accounting under GASB 31, the District may also adopt GASB 62 to eliminate the impact of changes in the fair value of investments on the District's Statement of Revenues, Expenses and Changes in Fund Net Position. GASB 62 allows an entity with cost-based rates to defer expenses or revenues as Regulatory Assets or Liabilities, respectively, and recognize them when recovered from customers. Since the Commission establishes cost-based rates, the District may adopt GASB 62 and defer the investment fair value changes required under GASB 31 as Regulatory Assets or Liabilities and recognize them when recovered effectively through rates.

Recording investment changes in fair value in accordance with GASB 31 without also adopting Regulatory Accounting could result in significant volatility in the District's financial results in the future. The District's analysis of the current investment portfolio indicates that if the requirements of GASB 31 alone are applied to the financial statements at December 31, 2013, the District would incur additional net losses of approximately \$2 million, although that net loss would be reversed in future periods, but not before other fluctuations in the District's earnings were recorded.

Going forward, recording investment fair value changes in accordance with GASB 31 without also adopting GASB 62 could result in the District's financial statements being materially different from the normal practice used by the Commission in setting rates. The District's rates reflect actual investment earnings based upon terms known at the time of investment purchases. The use of fluctuating fair value changes rather than actual interest rates is not appropriate for setting rates, particularly when the fluctuating fair value changes have no long term impact on the District's earnings or cash flow since the District typically holds investments to maturity. Any gain or loss recognized under GASB 31 would be reversed with no net unrealized gain or loss upon maturity of the investment.

Staff has presented the background, requirements and considerations for adopting Regulatory Accounting in general and for other matters at prior Commission meetings. Staff presented the background, requirements and considerations for adopting Regulatory Accounting for investment fair value changes at the November 4, 2013 meeting. District staff

recommends that it is in the best interest of the District to also adopt Regulatory Accounting for investment fair value changes. This will be accomplished by recording Regulatory Assets or Liabilities simultaneously with recording the investment fair value changes required by GASB 31 so as to result in no net impact on the District's Statement of Revenues, Expenses and Changes in Fund Net Position. This will reduce volatility in the financial statements caused by market fluctuations 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 is hereby adopted for investment fair value changes.

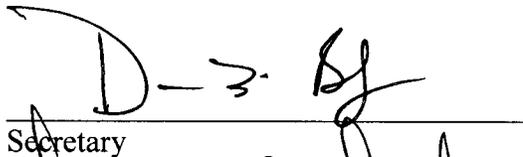
Section 2. This resolution is intended to clarify and support the appropriate accounting treatment of investment fair value changes made by the District.

Dated the 2nd day of December 2013.

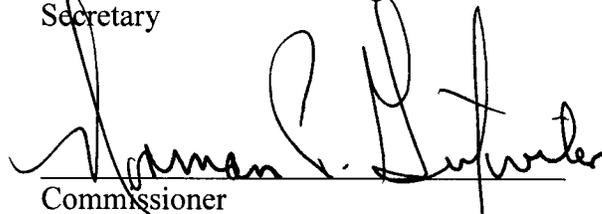
  
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President

ATTEST:

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Vice President

  
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