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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF AVISTA CORPORATION DBA AVISTA UTILITIES FOR A DEFERRED ACCOUNTING ORDER.	**CASE NO. AVU-G-00-8/ AVU-E-00-12** **COMMENTS OF THE COMMISSION STAFF**

COMES NOW the Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, John Hammond, Deputy Attorney General, and in response to the Notice of Application, Notice of Modified Procedure, and Order No. 28609 issued on January 12, 2001, submits the following comments.

On December 26, 2000, Avista Corporation dba Avista Utilities (Avista) filed its Application for a deferred accounting order. Avista states that it is an investor-owned utility engaged in the generation, transmission and distribution of electricity in Eastern Washington and Northern Idaho. Avista also provides natural gas distribution service in Eastern Washington, Northern Idaho, California and Oregon.

Avista requests that the Commission issue an order authorizing the establishment of a regulatory asset and/or regulatory liability associated with the implementation of Financial

Accounting Standards 133 & 138 (FAS-133/138), Accounting for Certain Derivative Instruments and Certain Hedging Activities for its electric and natural gas portfolios. The Financial Accounting Standards Board (FASB) issued FAS-133 in June 1998. It was later amended by FAS-138 in June 2000. All companies with a calendar year-end must adopt these rules no later than January 1, 2001.

This standard requires all derivatives and certain embedded derivatives to be reported on the balance sheet at fair value, i.e. mark-to-market. Changes in the fair value of derivatives are to be recorded through earnings. Avista contends that this standard will potentially expose its accounting earnings to significant volatility not experienced previously. Avista contends that this volatility is strictly related to timing differences between when a resource acquisition contract is entered and when it is settled. Avista states that accounting associated with FAS-133/138 therefore will generally not be part of its regulated pricing. It requests deferred accounting treatment be approved so that any entries it makes for balance sheet recognition can be offset by regulatory assets or liabilities and not recorded through the statement of income. Avista contends that this will allow it to continue to make prudent and timely resource acquisition decisions unencumbered by concerns about this new financial accounting standard.

Avista conducted an analysis of all instruments and contracts to determine which ones would be viewed as a derivative requiring mark-to-market accounting under FAS 133/138 and which ones were exempt, i.e. scoped out. Staff has reviewed the criteria used in the analysis, the resulting contract list and the amount of fluctuation that would have occurred in 2000. The net amount of fluctuation under FAS 133/138, to be reported quarterly, would have created liabilities on the balance sheet with a corresponding reduction to the 2000 earnings. For the regulated utility operations during 2000 this fluctuation could have been greater than $150,000,000 in a single reporting period. One individual contract could have had exposure of up to $70,000,000 in 2000. These liabilities and earnings impacts would ultimately be reversed if the contracts were actually fulfilled and the power delivered or received as is the case for normal utility operations.

The Derivatives Implementation Group (DIG) continues to further define and provide guidelines of its interpretation on specific types of instruments and contracts for FAS 133/138 implementation. The following items were discussed at the December, 2000 DIG meeting with discussions to continue at the February, 2001 DIG meeting (since a final decision was not made in December):

1) "Normal Purchases and Sales Exception in the Electric Industry for Capacity Contracts Including Contracts that May Have Some Characteristics of Purchases and Written Options" and
2) "Normal Purchases and Sales Exception for Electricity Contracts Subject to Bookouts".

The DIG decisions will impact the financial impact under FAS 133/138 due to normal purchases and sales to manage regulated customer loads and resources. The financial changes in reported income without a corresponding change in cash flow could potentially impact stock and bond ratings and ultimately the cost of capital. This risk currently should be minimal for Avista since it doesn't currently have coverage ratio requirements in its bond covenants but that may change in the future.

Staff is concerned that the quarterly financial income fluctuations from FAS 133/138 on Avista might create a situation where new accounting standards rather than prudent utility operations could drive management decisions. Staff believes, utility decisions should be made with the goal to provide the utility service to customers at the lowest possible price. Staff also believes an accounting order allowing Avista to defer as regulatory assets and liabilities, offsets to the accounting entries that will be required under FAS 133/138, will not force this goal to be excluded from the decision making process of utility management. The intent of the proposal is to continue the treatment of long-term sales and purchase contracts as they have been in the past with the expenses recognized at the embedded prices contained in the contract rather than restating the costs of these contracts on a quarterly basis at market prices. Staff believes this is consistent with the regulatory treatment currently authorized by this Commission.

Transactions where a contract is settled for cash at a gain or loss in advance of normal delivery of power would continue to be available for Commission review in the determination of rates. This proposal does not in any way relieve Avista of its obligation to demonstrate the prudence of its resource acquisition decisions including review of the original contract, Company actions, or lack of actions with respect to the contract or settlement of the contract prior to completion.

Staff recommends that the Commission issue an accounting order authorizing Avista to establish regulatory assets and/or regulatory liabilities to defer the impact associated with the implementation of Financial Accounting Standards 133 & 138 (FAS-133/138), Accounting for

Certain Derivative Instruments and Certain Hedging Activities for its electric and natural gas portfolios. Staff believes deferral is reasonable and is more consistent with existing regulatory policies.

Dated at Boise, Idaho, this   day of February 2001.

John Hammond
Deputy Attorney General

Technical Staff: Terri Carlock

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