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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF AVISTA CORPORATION FOR AN ACCOUNTING ORDER REGARDING TREATMENT OF CERTAIN ASSET RETIREMENT OBLIGATIONS RESULTING FROM IMPLEMENTATION OF SFAS 143

CASE NO. AVU-G-05-3
AVU-E-05-9

COMMENTS OF THE COMMISSION STAFF

The Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Cecelia A. Gassner, Deputy Attorney General, in response to the Notice of Application and Notice of Modified Procedure in Order No. 29937 issued on December 20, 2005, submits the following comments.

BACKGROUND

On November 30, 2005, Avista Corporation ("Avista" or "Company") filed an Application with the Idaho Public Utilities Commission ("Commission") seeking an accounting order authorizing the Company to treat certain asset retirement obligations ("AROs") for the current and future fiscal years in accordance with Statement of Financial Accounting Standards (SFAS) 143. Pursuant to *Idaho Code* § 61-524, the Commission is empowered to establish a system of accounts to be kept by public utilities subject to its jurisdiction.

Avista is required to implement SFAS 143 as clarified by Financial Accounting Standards Board (FASB) Interpretation (FIN) 47 in order to comply with generally accepted accounting principles. Specifically, if a legally enforceable asset retirement obligation is deemed to exist an entity must measure and record the liability for the ARO on its books. The liability must be recorded at fair market value in the period in which the liability is incurred. SFAS 143 also provides that if market prices are not available, estimates of fair value can be calculated by discounting the estimated cash flows associated with the ARO to their present value at the date the liability is recorded. Due to the lack of an active market for settling AROs, Avista intends to use the expected present value method to determine its ARO liabilities and offsetting assets.

Avista's Application asks for an accounting order authorizing the Company to (1) record, as a regulatory asset or a regulatory liability, the cumulative financial statement impact resulting from the Company's implementation of SFAS 143, and (2) record on an ongoing basis, as a regulatory asset or a regulatory liability, an amount equal to the difference between the annual SFAS 143 accretion and depreciation expense and annual depreciation expense based on Commission-approved depreciation rates. The Commission granted similar accounting treatment to Idaho Power Company in Case No. IPC-E-03-11, Order No. 29414, issued January 8, 2004. Avista also requested the Commission Order in this case include confirmation that asset removal costs, in the form of negative net salvage, are currently accrued through annual depreciation expense, which is recoverable in rates; that these costs are based on estimates of the final removal costs; and that such costs are trued-up for ratemaking purposes at the time the related assets are retired and the actual removal costs are determined.

The accounting changes proposed by Avista are supported by a series of workpapers identifying the proposed journal entries the Company believes are needed to comply with SFAS 143. The Company states that nothing in its Application is intended to request any approval regarding future ratemaking treatment. However, the Application states that consistent with past rate proceedings, the Company will continue to seek recovery of prudently incurred removal costs not previously recovered through depreciation expense in future rate case proceedings.

OVERVIEW

SFAS 143 as clarified by FIN 47 requires entities to separately account and report the liability for asset retirement obligations, capitalize the asset retirement costs, charge earnings for the depreciation of the asset and the accretion of the liability. Under SFAS 71, a public utility is permitted to record a regulatory asset or regulatory liability for differences between SFAS 143 and regulatory accounting for asset retirement obligations rather than recording such differences as a charge or credit to net income. The Company's proposed accounting treatment will use SFAS 143 for reporting on its financial statements but retain its current methodology for ratemaking purposes. Neither the SFAS 143 transition entries nor the annual accounting entries will change the level of costs included in rates.

DISCUSSION OF SFAS 143 AND AVISTA'S APPLICATION

The basis of Avista's Application is SFAS 143, as clarified by FIN 47, Accounting for Conditional Asset Retirement Obligations. In June 2001, FASB issued SFAS 143, Accounting for Asset Retirement Obligations, effective for fiscal years beginning after June 15, 2002. The clarifying interpretation, FIN 47, is effective for fiscal years ending after December 15, 2005 (December 31, 2005 for calendar-year enterprises).

The FASB issued SFAS 143 to address the inconsistencies in accounting practices for asset retirement obligations. FASB noted that obligations that meet the definition of a liability were not being recognized when incurred or the recognized liability was not consistently measured or presented. Avista is required to implement SFAS 143 as clarified by FIN 47 in order to comply with Generally Accepted Accounting Principles.

Historically, under the accounting method currently used by Avista and other utilities, the reasonable cost of removing a tangible long-lived asset at retirement is included in the calculation of depreciation rates and is recovered over the useful life of the asset. Because the cost of removal is included in depreciation expense, it is included in the Company's revenue requirement. In its Application, Avista is not requesting any changes to its currently approved depreciation rates or any change in the level of asset removal included in the Company's revenue requirement through depreciation expense.

<u>SFAS 143 Asset Retirement Obligations (AROs)</u>

As noted in Avista's Application, SFAS 143 requires entities to recognize and account for certain asset retirement obligations in a manner different from the way Avista has traditionally recognized and accounted for such costs. Specifically, if a legally enforceable asset retirement obligation (ARO) as defined by SFAS 143[1] is deemed to exist an entity must measure and separately account and report the liability for the ARO (ARO Liability) on its books. This recognizes the entire cost of removal up-front while in ratemaking the cost of removal is included in depreciation expense over the life of the asset. The liability must be recorded at fair market value in the period in which the liability is incurred. SFAS 143 also provides that if market prices are not available, estimates of fair value can be calculated by discounting (using a credit-adjusted, risk-free interest rate) the estimated cash flows associated with the ARO to their present value at the date the liability is recorded. Avista will use the expected present value method to determine its ARO Liabilities and corresponding ARO Assets (see next section re: ARO Assets). If a company has chosen to remove assets for reasons other than legal obligations, then the future costs of removing those assets do not have to be recognized under SFAS 143.

Avista has determined that it will need to record AROs under SFAS 143 as clarified by FIN 47 for Coyotes Springs 2, Colstrip, its office building and transformers. While Avista has included in its workpapers three AROs associated with Colstrip, only one was considered material and included within its proposed entries. Avista also inadvertently included two sets of workpapers for its office building ARO with differing rates to discount and present value the ARO. The rates intended for use with this Application is a credit adjusted risk free rate of 6.13% based upon a 20-year treasury rate adjusted for Avista's credit rating because AROs are long-term.

SFAS 143 ARO Assets, Depreciation and Accretion Expenses

Under SFAS 143, at the same time the ARO Liability is recorded, a corresponding and equivalent Asset is also recorded on the entity's books as part of the cost of the associated tangible asset. The ARO Asset is then depreciated over the life of the associated tangible asset. In addition, a period-to-period increase in the carrying amount of the liability (accretion expense) is added to the ARO Liability annually to account for the time value of money, so that at the time of retirement the recorded ARO Liability will be sufficient to meet the legal obligation. Any gain or loss when the actual liability is paid in the future should be recognized in the Company's accounting records. The Federal Energy Regulatory Commission, in Order No. 631 dated April 9, 2003 from Docket No.

[1] According to SFAS 143, "it applies to legal obligations associated with the retirement of a tangible long-lived asset that result from the acquisition, construction, or development and (or) the normal operation of a long-lived asset, except...for certain obligations of lessees. As used in this Statement, a legal obligation is an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel."

RM02-7-000 specified that jurisdictional entities would *...record the depreciation of the asset retirement costs in account 403.1, Depreciation expense for asset retirement costs, and the accretion of the liability for the asset retirement obligations in account 411.10, Accretion expense.* Avista's workpapers underlying its Application does not reflect entries to these accounts. Instead, the Company will use Account 182376 (a regulatory asset) to record the ARO accretion expense and the depreciation expense for the asset retirement costs. For ease of review and to separate depreciation expense for asset retirement costs from the accretion of the liability for the asset retirement obligations, Staff believes the Company should record these items in separate sub-accounts even if they do not use the accounts specified by FERC.

Cumulative Effect at Implementation Date

Upon initial implementation of SFAS 143 as clarified by FIN 47, entities must establish in their financial statements all of the amounts that would have been recorded had the new requirements always been in place. Avista records this cumulative impact as transition entries. The initial implementation of SFAS 143 as clarified by FIN 47 proposed by Avista will create a regulatory asset for the cumulative accretion of interest on the ARO liabilities and the cumulative depreciation of the ARO assets. While Avista's Application (page 4, lines 3-4) states that a third entry will adjust the accumulated removal costs included in accumulated depreciation to the current amount, no such entry is included in Avista's workpapers. According to Avista personnel, this is because no removal costs were included in its current depreciation rates for these obligations. Typically this type of adjustment would be necessary to remove those costs already contained in its financial statements for legally obligated removals. In 2003 the Company reclassified utility plant retirement costs previously recorded in accumulated depreciation to regulatory liabilities to conform with SFAS 143. These costs do not represent legal or contractual obligations.

Rate-Regulated Entities, Regulatory Assets and Regulatory Liabilities

SFAS 143 as clarified by FIN 47 applies to rate-regulated entities that meet the criteria for Application of FASB Statement No. 71, Accounting for the Effects of Certain Types of Regulation. SFAS 143 recognizes that differences may exist between its requirements and the treatment of AROs for regulatory purposes. SFAS 143 provides that a regulated entity subject to SFAS 71 recognize differences between the two approaches as a regulatory asset or a regulatory liability as opposed to a charge or credit to net income if the requirements of SFAS 71 are met. Avista is requesting such treatment. The regulatory asset or regulatory liability will be removed at the time the related tangible long-lived asset is removed.

SUMMARY

SFAS 143 as clarified by FIN 47 requires entities to separately account and report the liability for asset retirement obligations, capitalize the asset retirement costs, charge earnings for the depreciation of the asset and the accretion of the liability. Under SFAS 71, a public utility is permitted to record a regulatory asset or regulatory liability for differences between SFAS 143 and regulatory accounting for asset retirement obligations rather than recording such differences as a charge or credit to net income.

The Company's proposed accounting treatment will use SFAS 143 as clarified by FIN 47 for reporting on its financial statements but retain its current methodology for ratemaking purposes. As a result, there should be no rate change, now or in the future, associated with the application of the requested accounting treatment. Neither the SFAS 143 transition entries nor the annual accounting entries will change the level of costs included in rates.

STAFF RECOMMENDATIONS

While Staff's review has identified immaterial inconsistencies in Avista's Application (as noted on page 4), Staff recommends approval for Avista to record, as a regulatory asset or regulatory liability, the cumulative financial statement impact resulting from the implementation of SFAS 143, and to record the ongoing annual differences between the SFAS 143 depreciation and accretion expenses and the annual depreciation expenses that are currently authorized by the Commission in depreciation rates.

Staff recommends that the Company record in separate sub-accounts the depreciation expense for asset retirement costs and the accretion of the liability for the asset retirement obligations. Staff believes this will aid tracking these items in subsequent cases.

Staff also recommends that the Commission require in its accounting order that Avista file annually and as part of its rate case filings, all journal entries made under the requirements of SFAS 143, including documents supporting the determination of regulatory assets and liabilities and related dollar amounts. Due to the nature of these entries, Staff will be reviewing the underlying support for them during analyses of assets and depreciation. As a result, Staff recommends that the Company maintain financial records associated with these entries similar to the long-lived assets to which they relate.

Staff acknowledges that Avista has a reasonable opportunity to recover prudently incurred removal costs. Staff recommends that the reasonableness of differences between actual and estimated costs should be addressed when those events occur. Staff recommends that no further confirmation be included in the Commission's accounting order.

Because these new accounting entries will not change the level of the costs included in rates, Staff is making no recommendation regarding the treatment of SFAS 143 Regulatory Assets and Regulatory Liabilities in future rate cases. If the assets and liabilities have an affect on rates, then the ratemaking treatment should be determined at the time of a rate case.

Respectfully submitted this 11th day of January 2006.

Cecelia A. Gassner
Deputy Attorney General

Technical Staff: Patricia Harms

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 11TH DAY OF JANUARY 2006, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NO. AVU-E-05-9/ AVU-G-05-3, BY E-MAILING A COPY THEREOF AND BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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