MEMORANDUM

EUGENE WATER & ELECTRIC BOARD

Rely on us.

TO: Commissioners Mital, Simpson, Helgeson, Manning and Brown

FROM: Sue Fahey, Finance Manager; Susan Eicher, Accounting and Treasury Supervisor

DATE: July 13, 2015

SUBJECT: Update of Financial Policies

OBJECTIVE: Approval of Resolution No. 1518 Updating Financial Policies

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Issue

The financial policies that support Board Policy SD6 require periodic updates. The last revision was approved by the Board in June 2013.

Background

The Board has established a number of reserves and designated fund accounts and has approved financial policies with targets for several of the accounts. On an annual basis, after the financial audit, staff prepares a summary of the year end reserves and funds balances, compares the balances to the Board Financial Policy targets, and recommends transfers and/or changes to financial policies. The transfers approved by the Board at the June 2, 2015 meeting included changes to reserve targets. The financial policies have been updated to reflect these. Additionally, certain sections of the policies have been updated to reflect changes required by accounting standards, changes in methodologies and operational changes. A summary of the substantive changes is included below.

Discussion

Finance now provides performance metrics to the Board on a quarterly basis. Since the Board is receiving updated metrics throughout the year, the year-end metrics were removed from the policies. Additionally, with Board Policies readily available on line, those reference documents have been removed from the Financial Policies.

Section 1.2 - Rate Stability Policy

This section has been updated to reflect the change in methodology for calculating the power reserve. The power reserve was originally intended to protect the Electric Utility from volatility due to changes in generation and market prices. The economy and the power markets have changed significantly, as has our understanding of, and ability to, measure the risks to which we are exposed. The current methodology incorporates four categories of risk.

Generation Risk
Calculated by measuring the financial impact to revenues when water available for generation is at Firm levels (about 70% of median) versus budget levels (about 90% of median).

Power Price Risk
Calculated by measuring the financial impact to revenues if forward power prices decrease 30% from current year budget expectations.

Retail Load Risk
Calculated by measuring the financial impact to revenues if actual retail load is 4% less than budgeted load.

Credit Risk
An estimation of risk exposure in the event of a credit default of power trading counterparties.

When combined, the total amount calculated for each separate risk will make up the target balance for the Power Reserve. The target balance is recalculated annually. The Board may choose to supplement the target amount at their discretion.

Other edits have been made to enhance clarity.

Section 1.3 - Capital Reserve Policy

The Capital Reserve Policy has been renamed the Capital Improvement Funding and Reserve Policy. An earlier update to this policy established capital improvement types and associated funding sources by type. The updated name recognizes that the policy is no longer limited to setting the level of the Capital Reserve. As in section 1.2, certain other wording has been updated for clarity, and targets have been updated for the most recent Board approval. Since the target is based on annual depreciation amounts, management is recommending that the target floor be removed.

Section 1.4 - Retirement Benefits Funding Policy

The Retirement Benefits Policy wording has been updated for clarity.

Section 2.0 - Financial Management Policies

The policies in this section have been edited to align with the 2014 revision of Board Policy El-1 and for clarity.

Section 3.0 Risk Management Policies
With the creation of an Enterprise Risk Function, this section has been revised to focus on Financial Risk Management. Enterprise Risk Management will be covered in a separate policy. Additional edits have been made to enhance clarity.

Section 4.0 – Accounting Policies

The accounting policies section has been edited for clarity, and to conform with changes in accounting standards.

Section 5.0 Reference Documents

Appendices referencing other Board policies have been removed and the cash and reserve targets summary has been updated.

Recommendation and Requested Board Action

Management recommends approval of Resolution No. 1518 updating the financial policies that support the Board's financial targets, strategies and reporting.

Policy Number: SD6
Policy Type: Strategic Direction
Policy Title: Financial Policies
Effective Date: June 4, 2013, Revised July 21, 2015

The following financial policies shall govern staff's operation of the utilities:

1. Rate Sufficiency Policy - Rates and charges will be adequate to provide revenues sufficient to maintain a degree of financial soundness over and above requirements for compliance with existing bond covenants. (FP 1.1)

2. Rate Stability Policy - Certain funds will be held in reserve for the purpose of mitigating the customer rate impact of unanticipated events. (FP 1.2)

3. Capital Improvement Funding and Reserve Policy - ~~Net investment in~~ ~~u u~~Utility plant assets will be maintained, including such capital additions ~~and reserves~~ as may be necessary to support growth in loads and customer base~~.~~, and associated infrastructure. (FP 1.3)

4. Retirement Benefits Funding Policy - All long-term liabilities that must be either disclosed and/or accounted for in the financial statements will be funded according to a rational and consistent plan that targets full funding of the liabilities over a specified period of time. (FP 1.4)

5. Cost Management Policy - EWEB will take cost management actions that provide for authorized budgets and include actions to maintain expenditures within authorized budget levels. (FP 2.1)

6. Budget Policy - The authorized annual spending plan will be balanced such that resources meet or exceed requirements in each fiscal year. (FP 2.2)

7. Debt Policy - Funds to acquire major capital improvements will be provided in accordance with the estimated useful lives of such assets. (FP 2.3)

8. Billing and Collection Policy - Services will be billed in an accurate and timely manner and collected with fair and equitable consideration for all customers.
(FP 2.4)

9. ~~Enterprise~~ Financial Risk Management Policy – Financial risks associated with EWEB operations will be proactively managed in a cost-effective and efficient manner consistent with prudent utility practice. (FP 3.1)

10. Power Risk Management Policy – Purchases and sales of electric power and related financial instruments will be managed to maximize the benefits to customers from wholesale transactions while minimizing the risk that wholesale activities will adversely affect retail prices. (FP 3.2)

11. Investment Policy - EWEB's investment portfolio will be managed to achieve safety of capital, achieve market rates of return, and provide sufficient liquidity to meet disbursement schedules. (FP 3.3)

12. Financial Entity Policy - EWEB will account for separate financial entities and will clearly define relationships among those entities to facilitate management decision-making. (FP 4.1)

13. Capitalization Policy - Major utility expenditures for labor, materials and/or services that result in revenue or benefits in future reporting periods will be capitalized and allocated to match such future revenue or benefits through periodic amortization or depreciation, using methodologies acceptable under accounting standards. Additions, renewals, and betterments with a minimum cost of $5,000 are capitalized. Repairs and minor replacement are recorded as operating expenses. (FP 4.2)

Source: Board Approved 01/18/2000, Ratified 04/19/2005, Amended 07/19/2005, Amended 06/04/2013 (Resolution No. 1308 07/16/13); Amended 07/21/2015 (Resolution No. 15xx)

RESOLUTION NO. 1518
JULY 2015

EUGENE WATER & ELECTRIC BOARD
FINANCIAL POLICIES

WHEREAS, the Eugene Water & Electric Board is the body designated by the Eugene City Charter and City Code to administer the Electric and Water utilities of the City of Eugene;

WHEREAS, the Eugene Water & Electric Board has established financial policies to support the Board's financial targets, strategies and reporting.

WHEREAS, the Eugene Water & Electric Board has reviewed year-end results;

WHEREAS, the financial policies have been reviewed and updated based on 2014, year-end results, the Board's targets, associated financial metrics, and accounting standards.

WHEREAS, the Board of Commissioners has reviewed a modification to Board Policy SD6, Financial Policies and has determined that the modification is appropriate and necessary.

THEREFORE BE IT RESOLVED that the Eugene Water & Electric Board hereby authorizes the General Manager to adopt and enforce the financial polices as updated.

Dated this 21st day of July 2015.

THE CITY OF EUGENE, OREGON
Acting by and through the
Eugene Water & Electric Board

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President

I, TARYN M. JOHNSON, the duly appointed, qualified, and acting Assistant Secretary of the Eugene Water & Electric Board, do hereby certify that the above is a true and exact copy of the Resolution adopted by the Board at its July 21, 2015 Regular Board Meeting.

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Assistant Secretary

Eugene Water & Electric Board

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Financial Policies

TABLE OF CONTENTS

1.0 RESERVE POLICIES

1.1 Rate Sufficiency Policy

Rates and charges will be adequate to provide revenues sufficient to maintain a degree of financial soundness over and above requirements for compliance with existing bond covenants. *(BP SD6)*

Discussion:

EWEB bond resolutions contain a rate sufficiency covenant that is a standard provision in municipal utility bond contracts. The covenant requires that rates and charges be set at a level that is high enough to pay the costs of operating and maintaining the utilities. This rate sufficiency policy is a higher standard than that required by the standard rate covenant contained in the bond resolutions. The policy is intended to supplement the weaker financial performance standards set out as minimum requirements in the bond resolutions. The financial standard implied by this policy is that rates and charges will be maintained at a level consistent with an average credit rating of A for the Electric Utility and AA rating for the Water Utility.

Credit rating agencies evaluate creditworthiness by assessing an organization's ability to adequately address issues of strategic importance. Credit analysis includes the track record of performance as reflected in widely used ratios and statistics. These measurements are compared with other similarly situated utilities to determine relative financial strength within the industry. An example of such a statistic is "debt service coverage ratio" which shows how many times debt service can be paid from net operating revenues. Minimum legal debt service coverage requirements are 1.35 times debt service for issuing new debt. EWEB's long term target for debt service coverage ratio for the Electric Utility is 1.75 to 2.0 and the Water Utility is 2.00 to 2.50 times debt service.

Performance standards, where established, are based on review with our Financial Advisor and what they are observing in the financial markets and rating agency reviews of public utilities that own generating facilities.

	Performance <u>Standard</u>
Electric Utility	
Working Capital Days Cash	90 to 149 days
Current Ratio	3.250x
Debt Service Coverage	1.75 to 2.0x
Water Utility	
Working Capital Days Cash	90 to 120 days
Current Ratio	3.250x
Debt Service Coverage	2.0 to 2.50

Working cash balances are based on the amount of cash needed to pay for ongoing operational expenditures during the year and maintain an amount of working capital to support the day's cash ratio sufficient to maintain higher than average credit rating. The target for working cash is $24 million and $3.4 million for the Electric and Water Utility, respectively.

1.2 Rate Stability Policy

Certain funds will be held in reserve for the purpose of mitigating the customer rate impact of unanticipated events. *(BP SD6)*

Discussion:

It is the nature of budgets, financial projections, and other statements about the future to contain uncertainty. The intent of this policy is to set aside funds or other financial instruments to smooth out the financial impact on customers when assumptions about the future do not comport with actual events as they transpire.

The Electric Utility owns or has contracted for power resources that exceed the amounts needed to serve customer load, and is exposed to certain power portfolio and retail load risks that can have significant adverse effects on financial stability. Those risks include, generation, power price, retail load, and credit risks. EWEB has established a power reserve that is designed to provide funds sufficient to cover operational costs in the event of adverse fluctuations in these risks. The funds needed to mitigate financial impacts of fluctuations are estimated annually based upon the measurement criteria specific to each of the major risks. Generation risk is calculated by measuring the impact to revenues if water available for generation is at Firm levels which is approximately 70% of median. Power price risk is calculated by assuming prices decrease 30% from budget expectations, and retail load risk is calculated assuming a 4% decrease from budgeted load. Credit risk is a flat dollar amount that represents approximately 50% of counterparty exposure. The combined amounts are intended to cover operational cost for one calendar year and prevent sudden and significant impacts to customer rates. The Board of Commissioners may elect to supplement the calculated amounts at their discretion.

The Water and Electric Operating Reserve accounts are used in similar fashion to smooth out the effects of revenue shortfalls or unforeseen expenses. The Self Insurance Reserve is to fund the out-of pocket liability costs of third party claims.

The target for the Self-Insurance Reserve combined for both the Electric and Water Utilities totals $2,000,000, which is based on the amount EWEB is self-insured. Excess liability insurance protects EWEB after the self-insurance limit is exhausted.

	Performance Standard
Electric Utility	
Power Reserve	$22,100,000
Operating Reserve	$ 2,000,000
Self-Insurance Reserve	$ 1,720,000
Water Utility	
Operating Reserve	$1,000,000
Self-Insurance Reserve	$ 280,000

1.3 Capital Improvement Funding and Reserve Policy

Utility plant assets will be maintained, including such capital additions as may be necessary to support growth in loads and customer base, and associated infrastructure. *(BP SD6)*

Discussion:

EWEB's approach to financing capital assets uses a combination of current rate revenue, capital improvement reserves, contributions in aid of construction, system development charges, and debt financing.

Capital projects are classified as Type 1, Type 2, or Type 3. Each year, an amount is budgeted from rate revenues to provide ongoing funding for a base level of capital additions and replacements. The base level amount is determined through an evaluation of the age and condition of basic capital infrastructure of the Electric and the Water Utilities taking into consideration capital reserve levels. This amount represents what is needed annually to maintain the desired level of service reliability on a long-term basis. These are considered Type 1 capital projects; projects that are ongoing capital infrastructure replacements.

Type 2 capital projects include capital improvement projects which are large rebuilding or expansion projects that occur periodically and may be funded with rates or bonds. Type 3 capital projects are major strategic projects and are funded with bonds and/or reserves.

Capital funding requirements are determined by a Capital Improvement Plan (CIP). The CIP is a ten-year projection of capital needs that is updated annually and approved by the Board. The CIP sets out, for each utility, the anticipated need for utility and support infrastructure to meet customer demands and system reliability standards. Identified in the CIP is an indication of the proportion of funding from 1) rates, 2) accumulated reserves, 3) interest and other earnings on accumulated reserves, and 4) debt proceeds.

The target amount for the Electric and Water Utility Capital Improvement Reserve is based on one year's depreciation expense adjusted for service reliability needs.

The Targets are:

Electric Utility: 20 million

Water Utility: $7 million

1.4 Retirement Benefits Funding Policy

All long-term liabilities that must be either disclosed and/or accounted for in the financial statements will be funded according to a rational and consistent plan that targets full funding of the liabilities over a specified period of time. *(BP SD6)*

Discussion:

Financial reporting requirements for governmental and private sector concerns continue to converge regarding the consistency and transparency of unfunded retirement liabilities. For EWEB, unfunded retirement liabilities result from pension and other postemployment benefit programs. The primary financial strategy with these plans is to pay the actuarially determined annual required contribution, which pays for the current costs and unfunded liabilities over a designated period of years. However, if the funded status of the plans reach 70% funded status or less, an assessment of accelerated funding will be performed. When the funding status of the plan is at or below 70% of funded status, the plan is financially unstable as the plan is no longer self-funding based on actuarially determined contribution rates. Below is a summary of the three plans.

1) **Pension Plan** - The Oregon PERS (OPERS) continues to experience volatility in regard to the rates employers pay to the state pension plan for benefits. EWEB pays the actuarially determined rate. In years where there is a difference between the PERS ordered contribution rate and the amount provided for in the annual budget, the excess amounts will be set aside in a Board reserve for reduction of unfunded retirement liabilities in the future.

2) **Other Post-employment Benefits** – EWEB created a trust in November 2007 as a means through which assets are accumulated and benefits are paid for other postemployment benefits (OPEB), other than pension benefits. Eligible retirees and beneficiaries of EWEB receive health care and life insurance benefits.

3) **Supplemental Retirement Plan** – EWEB created a pension plan in 1968 to provide supplemental retirement benefits to employees. The objective of the plan was to provide a benefit on retirement, which together with benefit from the OPERS, will provide 1.67% of the highest 36-month average salary for each year of service. The plan was closed in 1988. EWEB contributes actuarially determined amounts to a designated pension fund that pays the annual cost for this closed plan. Due to the nature of the closed plan, it is more cost effective to pay-as-you go, than set up a trust.

2.0 FINANCIAL MANAGEMENT POLICIES

2.1 Cost Management Policy

EWEB will take cost management actions that provide for authorized budgets and include actions to maintain expenditures within authorized budget levels. *(BP SD6)*

Discussion:

The annual budget is the primary tool for setting rates and controlling costs within a given year. For accounting and budgetary purposes, the budgets are broken into operating and capital components for each Utility. The operating budget of the Electric Utility further separates power and related costs as distinct from non-power operating costs. The reason for this is that the cost of power and related items generally varies with changes in sales volume. Non-power items are composed of mostly labor, services and materials that are less susceptible to variations in sales volumes.

The annual budgets are the maximum level of expenditure authorized by the Board. Conditions may arise during any given budget year that cause projected expenditures for either Utility operations & maintenance and/or capital budgets to be higher than those approved by the Board. If any of the specific conditions occur as defined in Board Policy EL1 - Financial Controls, Management is required to propose a budget amendment.

The budget amendment proposal must state the causes of the projected non-budgeted expenditures, the offsetting actions taken to mitigate the increase, and the source of any additional funding requested. The Board will consider each proposed budget amendment and either approve or disapprove. In the event of disapproval, the General Manager will exercise established authorities in taking actions necessary to curtail spending within authorized levels.

To monitor the budget, cost management procedures involve the monthly review of variances from the authorized budget by the Leadership Team. The review of power-related items is performed by the Power Risk Management Committee and is separate from non-power items. Actual and projected capital and other non-power expenditures are monitored by the Leadership Team. With the assistance of financial staff, the Leadership Team determines what degree unfavorable variances in one department can be offset by favorable variances in another. In the event of a shortfall, the Leadership Team will determine whether to bring a budget amendment forward or curtail other activities to remain within authorized spending levels.

2.2 Budget Policy

The authorized annual spending plan will be balanced such that resources meet or exceed requirements in each fiscal year. *(BP SD6)*

Discussion:

Long-term financial stability can be assured only if, in each year, the annual spending plan is fully funded and results in a balanced budget. The budget is considered balanced when the following four conditions are met:

1) Expected annual operating revenues and use of reserves for one-time expenses equal or exceed anticipated operation and maintenance expenses.

2) Budgeted capital outlays are funded in full from a combination of net operating revenues, capital improvement reserves, accumulated system development charges, and debt proceeds.

3) Pro forma presentation of debt service coverage shows a ratio at or above the Board established performance standard (Rate Sufficiency Policy 1.1).

2.3 Debt Policy

Funds to acquire major capital improvements will be provided in accordance with the estimated useful lives of such assets. *(BP SD6)*

Discussion:

Prudent financial practice dictates the use of debt financing only in those cases where public policy, ratepayer equity, and economic efficiency favor the use of debt over current financing. In EWEB's case, debt is considered an appropriate funding option for Type 2 and Type 3 capital projects. (See the discussion under Capital Reserve Policy 1.3.) Debt service payments shall not exceed the useful life of the asset and should be structured to mirror the stream of benefits from the facility or project being funded.

Long-term debt financing will be considered for those major system improvements that meet two general criteria:

- The asset has a relatively long useful economic life (at least 10 years);
- The asset is a significant item included within the capital budget portion of the electric and water project plans.

However, if debt levels are too high the utility could become over-leveraged relative to its asset base and revenue producing capability. In all cases, management will balance the benefit of long term financing with the overall health of the organization as determined by appropriate measures of financial leverage.

Performance standards, where established, are based on review with our Financial Advisor and what they are observing in the financial markets and rating agency reviews of public utilities that own generating facilities.

	Performance Standard
Electric Utility	
Debt/Asset Ratio	60% or less
Debt/Equity Ratio	91% or less

Water Utility

Debt/Asset Ratio	60% or less
Debt/Equity Ratio	89% or less

2.4 Billing and Collection Policy

Services will be billed in an accurate and timely manner and collected with fair and equitable consideration for all customers. *(BP SD6)*

Discussion:

Sound business and collection practices will be applied uniformly to all customers. EWEB maintains a customer credit rating system to provide fair and equitable consideration in deposit and collection practices for all customers. Decisions to extend payment terms for anyone are based on the customer's good faith, ability to pay, and payment history.

EWEB provides cost-effective customer assistance programs (*e.g.,* Average Payment Plan, Customer Care, payment extension options, dispute/appeals recourse, *etc*.). EWEB will also cooperate with customers participating in social service programs such as the Limited Income Home Energy Assistance Program (LIHEAP) and other resources available to customers.

EWEB makes every reasonable and cost-effective attempt to secure payment of all accounts receivable. In accordance with bond covenants, products and services are not provided free of charge. Bills are issued based upon actual use of products and services, except that billings are estimated when EWEB service meters are inaccessible, or other considerations necessitate issuing estimated billings.

EWEB employees make a concerted effort to inform customers about the options available to them regarding payment for and controlled use of EWEB products and services as situations may deem advisable. In addition, EWEB has built strong partnerships with community social service organizations that create preventive strategies for avoiding disconnection of services.

Performance standards are as follows:

	Performance <u>Standard</u>
Write-offs as a % of Rate Revenue	.5% or less

3.0 FINANCIAL RISK MANAGEMENT POLICIES

3.1 Financial Risk Management Policy

Financial risks associated with EWEB operations will be proactively managed in a cost-effective and efficient manner consistent with prudent utility practice. *(BP SD6)*

Discussion:

The objective of financial risk management is ongoing identification and mitigation of the risk of financial losses including power risk, property damage and other insurable risks, vendor contract development and administration, and risks associated with administering Oregon Public Contracting laws and statutes. EWEB will transfer as much as is reasonably possible of its liability contractually, and retain those risks that can be self-assumed without seriously affecting the financial condition of the organization. EWEB will purchase sufficient insurance coverage when the risk is of a catastrophic nature or beyond the capacity of the organization to absorb, or when it is required by law or contract. However, insurance shall, of necessity, be limited to availability of coverage at reasonable cost, consistent with the probable frequency, severity and impact of losses on the financial stability of the organization.

Due to the nature and extent of commodity risks, power supply related risk management policies are separately addressed in the Power Risk Management Policy.

3.2 Power Risk Management Policy

Purchases and sales of electric power and related financial instruments will be managed to maximize the benefits to customers from wholesale transactions while minimizing the risk that wholesale activities will adversely affect retail prices. *(BP SD6)*

Discussion:

For many years the staff at EWEB has worked to reduce power purchase costs while managing or avoiding risks that might result in price shocks or supply interruptions. Rapid changes in the electric power industry since 2000 have challenged traditional methods and prompted EWEB to migrate with power management systems and controls similar to those used in commodity trading organizations.

The Board has established a power risk management policy to provide direction and oversight as referenced in Board Policy SD8 - Power Risk Management Policies.

3.3 Investment Policy

EWEB's investment portfolio will be managed to achieve safety of capital, achieve market rates of return, and provide sufficient liquidity to meet disbursement schedules. *(BP SD6)*

Discussion:

EWEB's investment policy calls for the investment of excess funds in a manner which will preserve capital and provide sufficient liquidity to meet cash flow demands while conforming with all State statutes governing investment of public funds and bond covenants. The policy includes provisions with respect to diversification and the credit quality of securities purchased. EWEB's primary objectives are, in order of priority: safety of principal, liquidity and achieving a rate of return at least equal to the return on a comparably maturing U.S. Treasury bill. EWEB attempts to match its investments to anticipated cash flow requirements. Securities are intended to be held to maturity, unless the quality, yield or maturity characteristics of the portfolio can be improved by replacing one security with another.

4.0 ACCOUNTING POLICIES

4.1 Financial Entity Policy

EWEB will account for separate financial entities and will clearly define relationships among those entities to facilitate management decision-making. *(BP SD6)*

Discussion:

1) Financial Reporting and Budget

Financial accounting standards and Bond covenants require that EWEB maintain separate financial records for the Electric Utility and the Water Utility. Each entity has separate legal standing and revenues backing their respective bond issues and separate budgets. Often, the Utilities share personnel or other resources. The shared resources are allocated between the systems for accounting and ratemaking purposes.

2) Reporting Entity

For external reporting purposes, EWEB is required to follow Governmental Accounting Standards Board (GASB) definition of a reporting entity as EWEB is considered a primary government. The Electric and Water Utilities are reported separately with a combined total for both systems.

For internal reporting purposes, the results and financial position of the Electric Utility and the Water Utility will be reported separately. In addition, any component of either Utility, which can be separately reported, and for which separate reporting would be useful, such as a major line of business, class of customer, or new operation will be separately reported as required by EWEB management from time to time.

EWEB also has various relationships with other parties, such as 1) Western Generation Agency, an Intergovernmental Agency cogeneration project, 2) Trojan Nuclear Project, a jointly owned decommissioned nuclear plant and 3) Harvest Wind, a joint ownership with an equity investment in a wind generating facility and 4) OPEB Trust, post-employment health care and life insurance benefits trust. These projects or investments are separate legal entities that are properly recorded within the Electric System and are fully disclosed in the footnotes of the financial statements.

4.2 Capitalization Policy

Major utility expenditures for labor, materials and/or services that result in revenue or benefits in future reporting periods will be capitalized and allocated to match such future revenue or benefits through periodic amortization or depreciation, using methodologies acceptable under accounting standards. Additions, renewals, and betterments with a minimum cost of $5,000 are capitalized. Repairs and minor replacements are recorded as operating expenses. *(BP SD6)*

Discussion:

1) Utility Plant in Service

The physical assets that make up the electric and water production, transmission and distribution systems, including the acquisition of land or construction of a building are capitalized and included in plant in service.

2) Preliminary Investigations and Regulatory Accounting

It is accepted utility practice to accumulate Preliminary Investigations, costs of projects the utility believes will be viable in the future. An example of this for EWEB is relicensing costs for the Carmen-Smith Project. Preliminary investigations are recorded as an “Other Asset” on the Statement of Net Position.

EWEB policy also permits the use of regulatory accounting, which allows for revenues and expenses to be charged to future periods to match the time periods when the revenue and expenses are included in rates. Revenues and expenses that are recorded using regulatory accounting may be treated as other assets or liabilities or deferred inflows or outflows, depending on the nature of the revenue or expense. An example of a regulatory other asset is unamortized bond issuance costs. An example of deferred inflows and outflows is the recording of the change in market value of hedging derivative instruments. Board approval, either by resolution or by inclusion in the annual budget, is required prior to using regulatory accounting.

Source: Board Approved 01/18/2000, Ratified 04/19/2005, Amended 07/19/2005, Amended 06/04/2013, Resolution No. 1308 07/16/13.

5.0 APPENDIX A: CASH AND RESERVE TARGETS SUMMARY

6/2/15

Cash and Reserve Accounts	Electric Utility Target	Water Utility Target
1) Working Cash	$24,000,000	$3,400,000
2) Power Reserve	22,100,000	
3) Operating Reserve	2,000,000	1,000,000
4) Self-Insurance Reserve	1,720,000	280,000
5) Capital Improvement Reserve	20,000,000	7,000,000
Total	$69,820,000	$11,680,000

1) Working Cash – amount of cash needed to pay for ongoing operational costs during the year.

2) Power Reserve – amount of reserves to offset fluctuations due to the effects of risk exposures, and any budgeted draw on the reserve.

3) Operating Reserve – reserve for emergency operating costs.

4) Self-Insurance Reserve – reserve to pay for claims incurred during the year and target is based on the $2 million self-insurance coverage limit for both utilities combined.

5) Capital Improvement Reserve – reserve for capital improvements and target is based on at least one year's depreciation.