Exhibit 1

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

Reply Refer To:
Office of Enforcement
Docket No. PA18-2-000
September 19, 2019

Ms. Marian Durkin
Sr. Vice President, General Counsel,
Chief Compliance Officer, and Corporate Secretary
Avista Corporation
1411 East Mission Avenue
Spokane, WA 99220-3727

Dear Ms. Durkin:

1. The Division of Audits and Accounting (DAA) within the Office of Enforcement (OE) of the Federal Energy Regulatory Commission (Commission) has completed an audit of Avista Corporation (Avista). The audit covered the period January 1, 2015 to December 31, 2018.

2. The audit evaluated Avista's compliance with: (1) the terms, conditions, and rates of its Open Access Transmission Tariff (OATT); (2) the accounting requirements of the Uniform System of Accounts for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1; and (4) the regulations regarding Open Access Same-Time Information Systems prescribed in 18 C.F.R. Part 37. The enclosed audit report contains 6 findings, one other matter, and 23 recommendations that require Avista to take corrective action.

3. On September 4, 2019, you notified DAA that Avista does not contest the 6 findings, one other matter, and 23 recommendations in the draft audit report and will submit within 30 days of the issuance of the final audit report a plan for implementing the audit recommendations. A copy of your verbatim response is included as an appendix to this report. I hereby approve the audit report.

4. Avista should submit its implementation plan to comply with the recommendations within 30 days of this letter order. Avista should make quarterly submissions to DAA describing the progress made to comply with the recommendations,

20190919-3007 FERC PDF (Unofficial) 09/19/2019

including the completion date for each corrective action. As directed by the audit report, these submissions should be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after this audit report is issued, and continuing until all the corrective actions are completed.

5. The Commission delegated the authority to act on this matter to the Director of OE under 18 C.F.R. § 375.311. This letter order constitutes final agency action. Avista may file a request for rehearing with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713.

6. This letter order is without prejudice to the Commission's right to require hereafter any adjustments it may consider proper from additional information that may come to its attention. In addition, any instance of non-compliance not addressed herein or that may occur in the future may also be subject to investigation and appropriate remedies.

7. I appreciate the courtesies extended to the auditors. If you have any questions, please contact Mr. Steven D. Hunt, Director and Chief Accountant, Division of Audits and Accounting at (202) 502-6084.

Sincerely,

Larry R. Parkinson
Director
Office of Enforcement

Enclosure

20190919-3007 FERC PDF (Unofficial) 09/19/2019

Federal Energy Regulatory Commission
Office of Enforcement
Division of Audits and Accounting

AUDIT REPORT

Audit of Avista Corporation's Compliance with its Open Access Transmission Tariff; the Open Access Same-Time Information Systems regulations; the accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees; and the reporting requirements of the FERC Form No. 1, Annual Report

Docket No. PA18-2-000
September 19, 2019

20190919-3007 FERC PDF (Unofficial) 09/19/2019

TABLE OF CONTENTS

I. Executive Summary 1

- **A. Overview 1**
- **B. Avista Corporation 1**
- **C. Summary of Compliance Findings and Other Matter 2**
- **D. Summary of Recommendations 4**
- **E. Compliance and Implementation of Recommendations 7**

II. Background 8

- **A. Avista Transmission Operations 8**
- **B. Ancillary Services 9**
- **C. Trading Activities 10**
- **D. Transmission Rates 10**
- **E. Available Transfer Capability Calculation 11**
- **F. Mid-Columbia Hub Operations 12**

III. Introduction 13

- **A. Objectives 13**
- **B. Scope and Methodology 13**

IV. Findings and Recommendations 17

- **1. Secondary Network Transmission Service 17**
- **2. Allowance for Funds Used During Construction 20**
- **3. Accounting for Deferred Income Taxes - AFUDC 28**
- **4. Capitalization of System Planning Costs 32**
- **5. Asset Retirement Obligations 35**
- **6. FERC Form No. 1 Reporting 38**

V. Other Matter 40

20190919-3007 FERC PDF (Unofficial) 09/19/2019

1. Use of Transmission Service Numbers 40

VI. Avista's Response to the Draft Audit Report 42

I. Executive Summary

A. Overview

The Division of Audits and Accounting (DAA) within the Office of Enforcement of the Federal Energy Regulatory Commission (Commission) has completed an audit of Avista Corporation (Avista). The audit evaluated Avista's compliance with: (1) the terms, conditions, and rates of its Open Access Transmission Tariff (OATT); (2) the accounting requirements of the Uniform System of Accounts for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others (Form 1) and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1; and (4) the regulations regarding Open Access Same-Time Information Systems (OASIS) prescribed in 18 C.F.R. Part 37. The audit covered the period January 1, 2015 to December 31, 2018. This period was expanded to cover years prior to 2015, where necessary, based on DAA's reviews and DAA's recommendations for corrective actions.

B. Avista Corporation

Avista, which was incorporated in the state of Washington in 1889 as Washington Water Power Company, is primarily an electric and natural gas utility with certain other business ventures.

Avista Utilities is an operating division of Avista comprising of its regulated utility operations in the Pacific Northwest. Avista Utilities generates, transmits, and distributes electricity and distributes natural gas, serving electric and natural gas customers in eastern Washington and northern Idaho, and natural gas customers in parts of Oregon. Avista Utilities also supplies electricity to a small number of customers in Montana. Avista Utilities generates electricity from facilities that it owns and purchases capacity, energy, and fuel for generation under long-term and short-term contracts to meet Avista's retail customer load obligations. Avista Utilities also sells electric capacity and energy, as well as surplus fuel, in the wholesale market as part of its resource optimization activities. Avista also provides retail electric service in Juneau, Alaska through its wholly-owned subsidiary, Alaska Energy and Resources Company (AERC). AERC and its operating subsidiary, Alaska Electric Light and Power Company, merged with Avista on July 1, 2014.

Avista has a non-regulated business segment, which includes sheet metal fabrication, venture fund investments, real estate investments, and a company that explores markets that could be served with liquefied natural gas, as well as certain other investments of Avista Capital, Inc., a direct, wholly-owned subsidiary of Avista.

C. Summary of Compliance Findings and Other Matter

Audit staff's compliance findings and other matter are summarized below. A detailed discussion of audit staff's findings and the other matter are in Sections IV and V of this report. Audit staff found 6 areas of noncompliance and one other matter as follows:

Noncompliance

1. Secondary Network Transmission Service – Avista improperly reserved hourly secondary network transmission service 61 times, representing 5,233 MWh, to support off-system sales to non-network customers. Of the 61 requests, 34 requests remained confirmed, representing 3,353 MWh, while 27 requests were annulled. Of these 34 requests, 11 were scheduled for energy delivery, representing 1,395 MWh. As a result, Avista's merchant function was not charged point-to-point (PTP) transmission charges and obtained service with a higher service priority.

2. Allowance for Funds Used During Construction – Avista's methods for calculating and accounting for its AFUDC rate were deficient and caused Avista's AFUDC to exceed the maximum AFUDC permitted by the Commission's regulations, as follows:

    - Avista included revolving credit facility commitment fees (up-front and quarterly) as part of short-term debt interest expense to compute its AFUDC rate. Avista did not have Commission approval, required by Order No. 561-A, to include revolving credit facility commitment fees in the calculation of its AFUDC rate.

    - Avista incorrectly included Account 216.1, Unappropriated Undistributed Subsidiary Earnings, as part of the equity component for the purpose of computing its AFUDC rate.

    - Avista incorrectly included Account 219, Accumulated Other Comprehensive Income (AOCI), as part of the equity component for the purpose of computing its AFUDC rate.

    - Avista used monthly Equity and Long-Term Debt balances in AFUDC rate development instead of the using the balances for Equity and Long-Term Debt existing at the end of the prior year.

- Avista excluded Account 234, Notes Payable to Associated Companies, in the computation of its AFUDC rate instead of including Account 234 as a short-term financing source – i.e., in the short-term debt component for purposes of calculating its AFUDC rate.

- Avista accounted for the excess arising from higher state-approved AFUDC over AFUDC as computed in accordance with the Commission's accounting regulations as a cost of plant in Account 101, Electric Plant in Service, through Account 107, Construction Work In Progress, instead of recording the excess in Account 182.3, Other Regulatory Assets.

As a result of these methods, Avista overstated AFUDC by approximately $19.7 million for the period 2015 through 2017.

3. Accounting for Deferred Income Taxes – AFUDC – Avista's methods for accounting for Deferred Income Taxes related to the equity component of the AFUDC rate were deficient as follows:

   - Avista incorrectly recorded a debit in Account 410.1, Provision for Deferred Income Taxes, based on the amount of the equity component of AFUDC included in income Account 419.1, Allowance for Other Funds Used During Construction, and credited Account 282, Accumulated Deferred Income Taxes – Other Property. Avista should have recorded the deferred tax debit amount in Account 182.3, Other Regulatory Assets.

   - Avista should have recorded a gross up for the income taxes related to the equity component of AFUDC in Account 182.3, Other Regulatory Assets, and a related offset as a deferred income tax liability in Account 283, Accumulated Deferred Income Taxes – Other.

   As a result of the foregoing improper accounting, Avista overstated the Deferred Income Tax expense included in its Income Statement for 2015 through 2017 by approximately $8.4 million.

4. Capitalization of System Planning Costs – Avista improperly capitalized system planning costs of approximately $2.8 million as a cost of plant through its CWIP between 2014 and 2017. When subsequently correcting this error, by removing approximately $2.6 million from the cost of plant, Avista did not remove the related accumulated provision for depreciation, current and deferred income taxes, and AFUDC.

5. Asset Retirement Obligations – Avista improperly accounted for certain items related to its Asset Retirement Obligations (ARO). Specifically, Avista did not record Asset Retirement Cost (ARC) depreciation expense in Account 403.1, Depreciation Expense, and ARO accretion expense in Account 411.10, Accretion Expense. Instead, Avista recorded those expenses directly in Account 182.3, Other Regulatory Assets.

6. FERC Form No. 1 Reporting – Avista did not comply with the instructions on page 398, Purchase and Sale of Ancillary Services, on its FERC Form No. 1 filings. This deficient reporting affected the reliability of information reported in Avista's FERC Form No. 1 submissions.

The Other Matter

1. Use of Transmission Service Numbers – Avista used Transmission Service Numbers (TSN), in addition to Transmission Service Requests (TSR) created in OASIS, to facilitate scheduling of transmission service under certain circumstances. TSRs created in OASIS provide more transparency than TSNs, which are created outside of OASIS. During the audit, Avista significantly reduced the number of active TSNs, and Avista should continue to evaluate TSN use and reduce the use of TSNs when possible.

D. Summary of Recommendations

Audit staff's recommendations to remedy the audit findings are summarized below. Details are in Sections IV and V of this report. Audit staff recommends that Avista:

Secondary Network Transmission Service

1. Develop and implement controls to ensure that Avista neither requests nor approves network transmission service and secondary network transmission service for any purpose other than to serve network customers.

2. Enhance training for its marketing function employees responsible for reserving and/or scheduling secondary network service to ensure that secondary network service is only reserved to serve Avista's native load customers, unless reserved on behalf of another network customer pursuant to an executed agent agreement.

3. Enhance training for its transmission function employees responsible for approving transmission schedules to ensure network transmission customers,

including Avista's marketing function, properly use secondary network service.

Allowance for Funds Used During Construction

4. Revise and implement procedures to ensure its AFUDC rate calculation is consistent with Electric Plant Instructions No. 3(17), Order Nos. 561 and 561-A, and other applicable Commission accounting regulations.

5. Revise and implement procedures to ensure that Account 216.1 and Account 219 are excluded from the equity components used to derive the AFUDC rate.

6. Revise and implement procedures to ensure that the year-end amounts reported on Avista's FERC Form No. 1 filings are used to compute the AFUDC rate in accordance with the Commission's accounting regulations.

7. Revise and implement procedures to ensure that the AFUDC amount capitalized as a cost of plant is computed in accordance with the Commission's accounting regulations.

8. Provide training to appropriate employees on AFUDC computation in accordance with the Commission's accounting regulations and Avista's revised procedures.

9. Recalculate AFUDC amounts in accordance with the Commission's accounting regulations from January 1, 2010 (effective date of current fixed transmission rates) to the present, determine the excess amount capitalized by Avista, determine the impacts on other accounts due to over-capitalization, and submit correcting journal entries to the DAA for review and approval.

Accounting for Deferred Income Taxes - AFUDC

10. Revise and implement Avista's accounting policies and procedures relating to Deferred Income Taxes to comply with the Commission's accounting regulations.

11. Provide training to appropriate employees on accounting procedures related to AFUDC and related income taxes.

12. Provide the amount of Deferred Income Taxes on the AFUDC Equity Component flowed through since January 1, 2010 (effective date of current fixed transmission rates), and the amount that should have been included in

Account 182.3, Other Regulatory Assets, as of December 31, 2017, and submit detailed analyses to the DAA for review and approval.

13. Report the accounting change in 2018 including the impact on annual balances reported on prior Form No. 1 filings as a note on the next Form No. 1.

14. Inform DAA about any state rate treatment addressing Avista's incorrect accounting for Deferred Income Tax Expense prior to January 1, 2018. Provide details of any such state actions with supporting documentation.

15. Submit journal entries, if appropriate, related to any state commissions' actions to the DAA for review and approval.

Capitalization of System Planning Costs

16. Revise and implement procedures to effect correction of errors including corrections to accounts which require Commission approval.

17. Provide enhanced training to appropriate staff on procedures for corrections including requirements to get Commission approval.

18. Submit journal entries to a) remove the remaining over-capitalized system planning costs from the cost of plant, b) remove appropriate accumulated depreciation from accumulated provision for depreciation, and c) correct related Accumulated Deferred Income Tax Account balances, for DAA review and approval.

Asset Retirement Obligations

19. Revise and implement policies and procedures to ensure Avista properly accounts for ARO-related costs in accordance with the Commission's accounting regulations.

FERC Form No. 1 Reporting

20. Revise and strengthen documented policies, procedures, and practices to help ensure information in its FERC Form No. 1 submissions is correct, accurate, and consistent with the instructions of the form.

21. Provide training to staff on the revised FERC Form No. 1 policies, procedures, and practices. Also, develop a training program that supports the provision of periodic training in this area, as needed.

20190919-3007 FERC PDF (Unofficial) 09/19/2019

Use of Transmission Service Numbers

22. Continue to evaluate and take actions to reduce the use of TSNs.

23. Provide training to transmission employees on OATT requirements and implement an ongoing process to ensure that TSNs are used for limited scheduling purposes where a valid adjacent commercial path TSR is not available in OASIS.

E. Compliance and Implementation of Recommendations

Audit staff further recommends that Avista submit the following for audit staff's review:

- A plan for implementing the audit recommendations within 30 days after the final audit report is issued in this docket;

- Quarterly reports to DAA describing Avista's progress in completing each corrective action recommended in the final audit report. Quarterly nonpublic submissions should be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after the final audit report in this docket is issued, and continuing until completion of all recommended corrective actions; and

- Copies of any written policies and procedures developed in response to the recommendations in the final audit report. These documents should be submitted for audit staff's review in the first quarterly filing after Avista completes such written policy or procedure.

II. Background

A. Avista Transmission Operations

Avista maintains a Commission-approved OATT defining terms, conditions, and rates under which Avista provides services related to its transmission facilities.[1] Under its OATT, Avista offers two types of transmission service, Point-to-Point Transmission Service (PTP) and Network Integration Transmission Service (NITS), and seven types of ancillary services. PTP allows Avista customers to receive capacity and energy at designated point(s) of receipt and transfer such capacity and energy to designated point(s) of delivery on either a firm or non-firm basis. The minimum term of firm PTP is one day. In addition, Avista offers non-firm PTP for periods ranging from one hour to one month. NITS allows a network customer to deliver capacity and energy, either from its designated network resources to service its designated network load on a firm basis, or from its non-designated resources to service its designated network load on a non-firm basis.

Avista owns and operates approximately 19,000 miles of primary and secondary electric distribution lines providing service to retail customers. It has an electric transmission system consisting of 685 miles of 230 kV line and 1,565 miles of 115 kV line. It also owns an 11 percent interest in approximately 500 miles of a 500 kV line between Colstrip, Montana and Townsend, Montana.[2] Avista's transmission and distribution systems also include numerous substations with transformers, switches, monitoring and metering devices, and other equipment. The 230 kV lines are the backbone of Avista's transmission grid and are used to transmit power from generation resources – including the Noxon Rapids, Cabinet Gorge, and Mid-Columbia hydroelectric projects – to the major load centers in Avista's service area, as well as to transfer power between points of interconnection with adjoining electric transmission systems. These 230 kV lines interconnect at various locations with the systems of the Bonneville Power Administration (BPA), Grant County PUD, PacifiCorp, NorthWestern Energy, and Idaho Power Company. These interconnection locations serve as points of delivery for power from generating facilities outside of Avista's service area, including the Colstrip Generating Plant near Colstrip, Montana,[3] the Coyote Springs 2 Generating

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[1] *See* Avista Corp., FERC Electric Tariff Volume No. 8 (7.0.0).

[2] The other owners of the 500 kV Colstrip Transmission Line are Puget Sound Energy, Portland General Electric, NorthWestern Corporation and PacifiCorp.

[3] Colstrip Generating Station consists of four separate coal-fired generating units with a combined nameplate capacity of 2,272 MW. Colstrip is jointly owned by Puget Sound Energy, Talen Energy, Portland General Electric, Avista, NorthWestern

Plant near Boardman, Oregon, and the Lancaster Plant near Rathdrum, Idaho. These 230 kV lines also provide a means for Avista to optimize resources by entering into short-term purchases and sales of power with entities within and outside of the Pacific Northwest.

Avista's 115 kV lines provide for transmission of energy and the integration of smaller generation facilities with Avista's service-area load centers, including the Spokane River hydroelectric projects, Kettle Falls projects, Rathdrum, Boulder Park, and Northeast facilities. These lines interconnect with the systems of BPA, Chelan County PUD, Columbia Basin Hydropower (which operates the hydroelectric facilities owned by three Columbia Basin Irrigation Districts), Grant County PUD, NorthWestern Energy, PacifiCorp, and Pend Oreille County PUD.

B. Ancillary Services

Ancillary services are services that are necessary to support the transmission of capacity and energy from resources to loads while maintaining reliable operation of Avista's transmission system. Avista is required under its OATT to provide, and the transmission customer is required to purchase, the following ancillary services: (i) Scheduling, System Control and Dispatch, and (ii) Reactive Supply and Voltage Control from Generation or Other Sources. Avista has not determined the cost of providing these services, and these services are not separately billed by Avista.

Avista is also required to offer to a transmission customer serving load within Avista's control area, these other ancillary services: (i) Regulation and Frequency Response, (ii) Energy Imbalance, (iii) Operating Reserve - Spinning, and (iv) Operating Reserve - Supplemental. In addition, Avista provides Generator Imbalance Service when a difference occurs between the output of a generator in Avista's control area and the delivery schedule of the generator. The Energy Imbalance and Generator Imbalance Services charges are based on the Intercontinental Exchange (ICE) Mid-Columbia Index and various deviations bands established by Avista, whereas the other ancillary services are billed at predetermined rates.[4] Transmission customers serving load within Avista's control area are required to acquire these ancillary services, whether from Avista, from a third party, or by self-supply. BPA, Avista's sole NITS customer, has made certain alternative arrangements and does not acquire all ancillary services offered by Avista.

Corporation, and PacifiCorp. Avista owns 15% of Colstrip generating plant units 3 and 4, which have 778 MW of nameplate capacity each.

[4] ICE is an American company that owns exchanges for financial and commodity markets, and operates 12 regulated exchanges and marketplaces.

C. Trading Activities

Avista engages in energy trading activities to optimize its energy resources. Avista's merchant function has organized a power supply front office responsible for term and day ahead trading, power scheduling, settlement analysis, and real-time merchant operations. Avista's trading activities involve securing least-cost power for its native load, as well as engaging in cost-effective energy trades with third parties.

The term and day ahead trading transactions are governed by Avista's electric position and hedging strategy approved by Avista's Risk Management Committee. These transactions, comprising financial and physical power products, are executed through ICE, third-party brokers or bilateral counter-party transactions.

The power scheduling and settlement functions coordinate to obtain the required transmission to facilitate term and preschedule transactions. These functions determine any temporary resource undesignations and deliver preschedule plans to Avista's real-time merchant function employees who are responsible for real-time generation dispatch and optimization, and several other related activities.

Avista's back office, led by Avista's Director of Finance, monitors the creditworthiness of counterparties. Avista has written policies and procedures that require Avista to confirm that counterparties are approved for credit, and appropriate contractual terms have been agreed to between Avista and a counterparty before trading transactions can occur. The back office is also responsible for billings, collections, and appropriate accounting for trading transactions. All wholesale transactions are captured in Avista's system of records, called Nucleus, for purposes of tracking credit exposure, accounting, and invoice processing, in addition to scheduling.

D. Transmission Rates

Avista established its current PTP rates as fixed rates in 2009 based on its historical expenses and rate base. Avista's PTP rates were approved by the Commission on December 16, 2009,[5] and became effective on January 1, 2010. Avista's PTP customers pay a separate charge for PTP on the Colstrip segment, which is comprised of 500 kV transmission facilities between Colstrip and Townsend, Montana, based on fixed rates effective January 1, 2010.

Avista's NITS rates also became effective on January 1, 2010 and were derived from a predetermined revenue requirement of $49.4 million, which is allocated to

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[5] *Avista Corp.*, Docket No. ER10-169-000 (Dec. 16, 2009) (delegated letter order).

Avista's NITS customers based on their share of loads. NITS rates on the Colstrip segment were approved with a predetermined revenue requirement of $3.2 million, which is allocated to NITS customers on their share of loads on that segment.

Avista's ancillary service rates for Regulation and Frequency Response, Energy Imbalance, Operating Reserve - Spinning, and Operating Reserve - Supplemental became effective on January 1, 2010. The Commission approved a modification to these rates in 2012[6] and an increase to these rates in 2016.[7]

E. Available Transfer Capability Calculation

Avista posts the Available Transfer Capability (ATC) values for all transmission paths on its OASIS, and the ATC value informs transmission customers about the amount of power available to move across a transmission path for commercial activity. Mathematically, ATC is defined as Total Transfer Capability (TTC) less Transmission Reliability Margin (TRM) less Capacity Benefit Margin (CBM) less existing transmission commitments. TTC indicates the amount of power that can be transferred over the interconnected transmission network in a reliable manner while meeting a specific set of pre-and post-contingency system conditions. Avista's TTC calculation must conform to the Western Electricity Coordinating Council's (WECC's) "Procedures for Regional Planning Project Review and Rating Transmission Facilities" and WECC's Reliability Criteria.[8] TRM indicates the amount of transmission transfer capability needed to ensure that the interconnected transmission network is secure under a reasonable range of uncertainties in system conditions. CBM is the amount of transmission transfer capability reserved by load serving entities to ensure access to generation from interconnected systems to meet generation reliability requirements. Avista currently sets TRM and CBM to zero for the purpose of its ATC calculation.

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[6] *Avista Corp.*, Docket No. ER12-1940-000 (July 24, 2012) (delegated letter order).

[7] *Avista Corp.*, Docket No. ER16-2090-000 (August 17, 2016) (delegated letter order).

[8] WECC promotes Bulk Electric System reliability in the Western Interconnection. WECC is the Regional Entity responsible for compliance monitoring and enforcement. In addition, WECC provides an environment for the development of Reliability Standards and the coordination of the operating and planning activities of its members as set forth in the WECC Bylaws.

Avista calculates ATC on a contract basis, consistent with its posted ATC Implementation Document. Avista conducts Seasonal Operating Studies, at least two times per year, to evaluate the expected operating conditions and system configuration for the upcoming summer and winter operating seasons. Data from these studies is reflected in the determination of TTC; thus, any changes to TTC will result in a change to ATC.

F. Mid-Columbia Hub Operations

Avista's transmission network is connected to the Mid-Columbia hub (Mid-C), which is a common point for commercial energy trading in the West. Avista uses pseudo ties to integrate its contracted generation resources at Mid-C with its system loads into a single balancing authority. Avista's contracted generation resources for the audit period at Mid-C included a total of 180 MW of capability from Grant PUD, Chelan PUD, and Douglas PUD hydro-electric projects. Pseudo ties and dynamic schedules are dynamic transfers that define how an entity schedules power over an arranged transmission path. Avista uses pseudo ties to connect power generation from the Colstrip Generating Plant and the Coyote Springs 2 Generating Plant. Avista uses dynamic schedules over reserved transmission capacity to transfer the energy at the Mid-C to its major load centers. At the end of each hour, Avista records the actual energy flow between the Mid-C and the Avista system and updates the dynamic schedules according to established e-Tagging protocols.

III. Introduction

A. Objectives

The audit evaluated Avista's compliance with the requirements of its OATT and with the Commission's accounting, financial reporting, and OASIS rules and regulations. The audit covered the period January 1, 2015 to December 31, 2018.

B. Scope and Methodology

Audit staff performed these actions to facilitate testing and evaluating Avista's compliance with Commission requirements relevant to audit objectives:

- *Reviewed Public Information* – Conducted an extensive review of public information before commencing the audit. The review provided audit staff with an understanding of Avista's operations and finances, merger, significant contracts, prior audit issues, and other key regulatory and business activities. Examples of materials reviewed include Avista's annual reports and SEC Forms 10-K and 10-Q, FERC Form No. 1, prior FERC audit reports, company-related websites, and other relevant regulatory and media sources.

- *Identified Audit Criteria* – Identified audit criteria including Commission rules, regulations, and other requirements necessary to evaluate compliance with the audit objectives.

- *Issued Data Requests* – Issued data requests to Avista to collect audit evidence and information. The information related to internal policies; transmission operations, procedures, and controls; business practices; risk management; corporate structure; contractual agreements; financial accounting and reporting activities; corporate compliance; regulatory filings; and other pertinent information. The evidence and information were used to test and evaluate compliance with Commission requirements relevant to audit objectives.

- *Conducted Teleconferences* – Held multiple teleconferences with Avista employees to discuss audit objectives, testing, data request responses, technical and administrative matters, and compliance concerns.

- *Attended Site Visits* – Made two site visits to Avista's headquarters in Spokane, WA to discuss and observe controls and procedures related to audit objectives.

- *Internal Commission Collaboration* – Conferred with other Commission staff on compliance issues to ensure audit findings were consistent with Commission precedent and policy.

Audit staff performed specific actions to evaluate Avista's compliance with select OATT requirements, including review of:

- *Transmission Planning* – Reviewed Avista's transmission planning process and cost allocation study cases to determine whether Avista followed the principles adopted in Order No. 1000 for new projects. Audit staff also reviewed Avista's compliance with requirements in its OATT's Attachment K, Transmission Planning Process.

- *Point-to-Point and Network Integrated Transmission Service* – Reviewed Avista's merchant function's activities to determine whether Avista properly used network service only to serve native load customers and not to support off-system sales.

- *Network Resource Designation/Undesignation Process* – Reviewed Avista's network resource designation/undesignation practice to determine whether Avista properly undesignated network resources when using those resources to supply off-system sales. Audit staff also reviewed the transmission services related to these off-system sales.

- *ATC Calculation Inputs* – Reviewed inputs into Avista's ATC calculation including, but not limited to, transmission capacity set-aside amounts and other ATC components to determine whether Avista timely and accurately updated ATC values posted on its OASIS.

- *Generation Interconnection Requests* – Reviewed generator interconnection requests and the associated queue to determine whether Avista met its obligations to timely communicate with customers pertaining to their requests consistent with the generation interconnection procedures contained in OATT Attachments M, N, and O.

- *Mid-Columbia Hub* – Reviewed Avista's Mid-C activities and related transmission services to understand how Avista operates resources and moves power at this major regional hub. Specifically, audit staff reviewed Avista's own generation and purchases at Mid-C and determined whether Avista was providing the proper transmission services to its merchant function and other customers in moving power from these resources.

- *Transmission Service Requests* – Reviewed Avista's transmission function's activities to determine whether it provided transmission/ancillary services on a non-discriminatory basis to affiliates, including Avista's merchant function, and non-affiliates.

- *Dynamic Schedules and Unreserved Transmission Service (After-the-Fact Tags)* –Reviewed Avista's transmission operations to see whether after-the-fact tags are used at Avista and, if so, determine whether there were any related compliance concerns around the possible misuse of transmission services.

- *Ancillary Services* – Reviewed Avista's compliance with the rates, terms, and conditions under its different OATT Ancillary Service Schedules. As part of this review, audit staff reviewed Avista's processes and procedures for ancillary services to determine whether Avista allowed its customers to make a comparable arrangement themselves (self-supply) for certain ancillary services specified in Avista's OATT.

- *Electric-Gas Coordination* – Reviewed Avista's processes and procedures for electric-gas coordination as natural gas makes up 35 percent of Avista's total generation mix.

- *Open Access Same-Time Information System* – Reviewed information posted on Avista's OASIS to determine compliance with Part 37 of the Commission's regulations. Specifically, audit staff reviewed select items, including, but not limited to: transmission capacity information; designation/re-designation/termination of network resources; curtailments; transmission schedules; discretionary logs; and information on transmission planning and interconnections. Other items reviewed included:

    - *Posted Paths* – Verified whether Avista posted all paths that should be posted, such as paths involving interconnections.

    - *Study List* – Verified whether Avista posted on its OASIS a list of system-planning studies, facilities studies, and specific network impact studies performed for customers or the entity's own network resources.

    - *Unavailability of ATC* – Verified whether Avista posted a narrative explanation of the reason for the unavailability of ATC when the monthly and yearly capability remained unchanged at a value of zero for a period of six months.

- *Daily Load* – Verified whether Avista posted on a daily basis, its load forecast, including underlying assumptions, and actual daily peak load for the prior day.

- *Ancillary Service Offerings and Prices* – Verified whether Avista posted any ancillary service provided or offered under Avista's OATT with the price of that service.

- *Denied Service Request* – Verified whether Avista posted the reason for any denied service request and kept the information to support the denial.

- *Transaction Curtailment* – Verified whether Avista posted a notice of each transaction curtailment and stated the reason why the transaction could not be continued or completed.

- *Notice of Transfers of Personnel* – Verified whether Avista posted the notices of transfers of personnel between transmission function and merchant function.

- *Discretionary Logs* – Verified whether Avista posted a log detailing any circumstance in which Avista or its agents exercised its discretion under any terms of Avista's OATT.

- *Generation Interconnection Queue* – Verified whether Avista posted a list of all interconnection requests consistent with its OATT requirements and kept the list up to date.

• *Standards of Conduct* – Reviewed off-OASIS communications between Avista's transmission function and merchant function employees, such as e-mails, instant messages, and voice recordings, to determine whether sufficient controls were in place to prevent merchant function employees from obtaining non-public transmission function information.

• *Accounting and Financial Reporting* – Reviewed Avista's accounting and financial reporting for items included in Avista's Annual Transmission Revenue Requirement in its OATT's Attachment H. Audit staff also reviewed the operational aspects of those revenue requirement items to understand how Avista's transmission operations feed into the revenue requirement and, ultimately, feed into Avista's stated transmission rates in Schedules 7 and 8. As part of this review, audit staff determined whether Avista was complying with the Commission's accounting and financial reporting regulations for select items.

IV. Findings and Recommendations

1. Secondary Network Transmission Service

Avista improperly reserved hourly secondary network transmission service 61 times, representing 5,233 MWh, to support off-system sales to non-network customers. Of the 61 requests, 34 requests remained confirmed, representing 3,353 MWh, while 27 requests were annulled. Of these 34 requests, 11 were scheduled for energy delivery, representing 1,395 MWh. As a result, Avista's merchant function was not charged PTP transmission charges and obtained service with a higher service priority.

Pertinent Guidance

Avista's OATT, Part III, Network Integration Transmission Service – Preamble, states, in part:

> Network Integration Transmission Service also may be used by the Network Customer to deliver economy energy purchases to its Network Load from non-designated resources on an as-available basis without additional charge. Transmission service for sales to non-designated loads will be provided pursuant to the applicable terms and conditions of Part II of the Tariff.[9]

Avista's OATT, section 28.4, Secondary Service, states, in part:

> The Network Customer may use the Transmission Provider's Transmission System to deliver energy to its Network Loads from resources that have not been designated as Network Resources. Such energy shall be transmitted, on an as-available basis, at no additional charge. Secondary Service shall not require the filing of an Application for Network Integration Transmission Service under the Tariff. However, all other requirements of Part III of the Tariff (except for transmission rates) shall apply to secondary service.[10]

Avista's OATT, section 28.6, Restrictions on Use of Service, states, in part:

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[9] Avista Corp., FERC Electric Tariff Volume No. 8, Part III, Network Integration Transmission Service, Preamble (6.0.0).

[10] Avista Corp., FERC Electric Tariff Volume No. 8, Part III, Network Integration Transmission Service, Section 28.4, Secondary Service (6.0.0).

> The Network Customer shall not use Network Integration Transmission Service for (i) sales of capacity and energy to non-designated loads, or (ii) direct or indirect provision of transmission service by the Network Customer to third parties. All Network Customers taking Network Integration Transmission Service shall use Point-To-Point Transmission Service under Part II of the Tariff for any Third-Party Sale which requires use of the Transmission Provider's Transmission System.[11]

Background

Avista's OATT provides secondary network transmission service to its network customers to serve network load from non-designated network resources on an as-available basis at no additional charge. A network customer can only reserve secondary network transmission service in this manner to serve its designated network load and cannot reserve secondary network transmission service to support a sale to non-designated load, which is referred to as an off-system sale. In accordance with Avista's OATT, PTP transmission service, which involves a charge and has a lower priority than secondary network transmission service, must be used to support an off-system sale.

In its review of secondary network transmission service used by Avista's merchant function, audit staff determined that Avista's merchant function reserved and confirmed 61 secondary network transmission service hourly requests during the audit period to deliver energy from Avista's transmission system to non-network customers, representing a combined total of 5,233 MWh of off-system sales. Of the 61 confirmed requests, 27 were annulled while 34 remained confirmed, representing 3,353 MWh. Of the 34 requests, 11 were scheduled for energy delivery, representing 1,395 MWh. All 34 confirmed reservations had higher curtailment priority that would potentially displace any other non-affiliated, non-firm PTP requests. However, audit staff did not identify any evidence that showed improper displacement of other requests and, hence, concluded that there had been no harm to competition.

The fact that these improper reservations were scheduled/requested and approved demonstrated that the controls Avista had in place to prevent the misuse of secondary network transmission service could be enhanced. Avista's merchant function should have requested, and its transmission function subsequently should have approved, short-term firm PTP transmission service instead of secondary network transmission service since the use of transmission service was for sales to non-designated loads. Audit staff determined that by improperly requesting and confirming the use of secondary network

[11] Avista Corp., FERC Electric Tariff Volume No. 8, Part III, Network Integration Transmission Service, Section 28.6, Restrictions on Use of Service (6.0.0).

transmission service, Avista's merchant function did not pay short-term PTP transmission charges and obtained service with a higher service priority.

Avista's billings to network customers were not impacted by the use of secondary network transmission service as Avista had a predetermined NITS revenue requirement since January 1, 2010. However, revenues from short-term PTP transmission service are applied as an offset in determining Avista's network service revenue requirement. Audit staff points out that such errors may impact the PTP transmission service revenue data used in Avista's future transmission rate developments.

Recommendations

We recommend that Avista:

1. Develop and implement controls to ensure that Avista neither requests nor approves network transmission service and secondary network transmission service for any purpose other than to serve network customers.

2. Enhance training for its marketing function employees responsible for reserving and/or scheduling secondary network service to ensure that secondary network service is only reserved to serve Avista's native load customers, unless reserved on behalf of another network customer pursuant to an executed agent agreement.

3. Enhance training for its transmission function employees responsible for approving transmission schedules to ensure network transmission customers, including Avista's marketing function, properly use secondary network service.

2. Allowance for Funds Used During Construction

Avista's methods for calculating and accounting for its AFUDC rate were deficient and caused Avista's AFUDC to exceed the maximum AFUDC permitted Avista by the Commission's regulations, as follows:

- Avista included revolving credit facility commitment fees (up-front and quarterly) as part of short-term debt interest expense to compute its AFUDC rate. Avista did not have Commission approval, required by Order No. 561-A, to include revolving credit facility commitment fees in the calculation of its AFUDC rate.

- Avista incorrectly included Account 216.1, Unappropriated Undistributed Subsidiary Earnings, as part of the equity component for the purpose of computing its AFUDC rate.

- Avista incorrectly included Account 219, Accumulated Other Comprehensive Income (AOCI), as part of the equity component for the purpose of computing its AFUDC rate.

- Avista used monthly Equity and Long-Term Debt balances in AFUDC rate development instead of the using the balances for Equity and Long-Term Debt existing at the end of the prior year.

- Avista excluded Account 234, Notes Payable to Associated Companies, in the computation of its AFUDC rate instead of including Account 234 as a short-term financing source – i.e., in the short-term debt component for purposes of calculating its AFUDC rate.

- Avista accounted for the excess arising from higher state-approved AFUDC over AFUDC as computed in accordance with the Commission's accounting regulations as a cost of plant in Account 101, Electric Plant in Service, through Account 107, Construction Work In Progress, instead of recording the excess in Account 182.3, Other Regulatory Assets.

As a result of these methods, Avista overstated AFUDC by approximately $19.7 million for the period 2015 through 2017.

Pertinent Guidance

Order No. 561, Order Adopting Amendment to Uniform System of Accounts for Public Utilities and Licensees and for Natural Gas Companies, states in part:

20190919-3007 FERC PDF (Unofficial) 09/19/2019

> The balances of long-term debt, preferred stock, and common equity for use in the formula for the current year will be the balances in such accounts at the end of the prior year…
>
> We agree that in some instances, [compensating balances and commitment fees] could properly be considered in determining the effective cost rate for short-term debt for use in the formula. However, primarily because of measurement problems, we do not believe that specific recognition should be given in the general rule. Instead, where an individual company has a written agreement and can support the fact that compensating balances and commitment fees are necessary in order to obtain favorable short-term financing and are not considered in its rate proceedings, we will permit an adjustment to the nominal short-term interest rates to reflect this additional cost.[12]

18 C.F.R. Part 101, Electric Plant Instructions 3(A)(17), Allowance for Funds Used during Construction, states in part:

> Allowance for funds used during construction includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds.
>
> The rates shall be determined annually. The balances for long-term debt, preferred stock and common equity shall be the actual book balances as of the end of the prior year.

Order No. 469, Order Amending Uniform System of Accounts for Public Utilities and Licensees (Class A and Class B) and Natural Gas Companies (Class A and Class B) and FPC Annual Report Forms No. 1 and No. 2, states in part:

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[12] *Amendments To Uniform System of Accounts for Public Utilities and Licensees and for Natural Gas Companies (Classes A, B, C and D) to Provide for the Determination of Rate for Computing the Allowance for Funds Used During Construction and Revision of Certain Schedule Pages of FPC Reports*, Order No. 561, 57 FPC 608, at 610-611 (1977), *reh'g denied*, Order No. 561-A, 59 FPC 1340 (1977), *order on clarification*, 2 FERC ¶ 61,050 (1978).

> It will continue to be the Commission's policy that the undistributed earnings of subsidiaries are to be excluded from the common stockholder's equity in determining rate of return.[13]

18 C.F.R. Part 101, General Instruction No. 23(C), Accounting for Other Comprehensive Income, states:

> When it is probable that an item of other comprehensive income will be included in the development of cost-of-service rates in subsequent periods, that amount of unrealized losses or gains will be recorded in Accounts 182.3 or 254 as appropriate.

Background

Audit staff reviewed Avista's process and policy for computing AFUDC rate and the application of such rates to construction projects. Through its review, audit staff identified deficiencies in Avista's methods for calculating and accounting for AFUDC in the areas described below. These deficiencies caused AFUDC calculated by Avista to exceed the maximum AFUDC permitted by the Commission's regulations.

Revolving Credit Facility

Avista had a practice of using revolving credit facilities to finance its operations. A revolving credit facility of $400 million was available to Avista during the audit period to finance its operations. Avista's daily average use of the revolving credit facility during 2015 through 2017 was approximately $178 million. The terms of the credit agreement required Avista to pay both an up-front fee and additional quarterly commitment fees based on the *unused* balance at the end of each quarter. When Avista used the revolving credit facility, it was also charged interest on the amount outstanding each month until Avista paid off the outstanding balance.

Avista accounted for the upfront fee and the quarterly commitment fees on the unused balance as well as the monthly interest payments for the credit balances outstanding by debiting Account 431, Other Interest Expense, and ultimately crediting Account 131, Cash.

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[13] *Revisions in Uniform System of Accounts, and Annual Report Forms No. 1 and No. 2 to Adopt the Equity Method of Accounting for Long-Term Investments in Subsidiaries*, Order No. 469, 49 FPC 326, at 327 (1973).

20190919-3007 FERC PDF (Unofficial) 09/19/2019

In light of Avista's short-term financing arrangements, audit staff reviewed the individual components and calculations of Avista's AFUDC rate to determine whether Avista was in compliance with the Commission's accounting regulations. Audit staff determined that Avista's components of short-term interest expense included amortization of the total of the up-front fee and the quarterly commitment fees for the $400 million revolving credit facility agreement obtained by Avista. By including the total of the up-front fee and the quarterly commitment fees on unused credit balances, Avista overstated the short-term interest component in its calculation of its AFUDC rate during the audit period.

The Commission, in Order No. 561 and Order No. 561-A, stated that compensating balance and commitment fees should be excluded from the short-term debt interest component of the AFUDC rate computation, unless an entity obtains Commission approval to include these items.[14] Avista did not provide audit staff with any evidence that it had obtained Commission approval to include these costs in its AFUDC rate calculations. Since Avista did not seek or obtain Commission approval to include commitment fees in its AFUDC calculation, or otherwise deviate from the Commission's express prohibition on including these items in an AFUDC rate calculation, it was improper for Avista to include these amounts in its AFUDC rate calculation.

Equity Component of AFUDC Rate

In its review of the equity component that was included in Avista's AFUDC rate calculations, audit staff determined that Avista incorrectly used balances from Account 219 and Account 216.1 in deriving the equity component of the AFUDC rate calculation. AFUDC includes the net cost of borrowed funds used for construction purposes and an allowed rate on other funds. Since the gains and losses in Account 219 were *unrealized*, and amounts in Account 216.1 were *undistributed* by Avista's subsidiaries and therefore not available to finance construction, those amounts should not have been considered as

[14] In Order No. 561, the Commission stated that, "we do not believe that specific recognition should be given in the general rule. Instead, where an individual company has a written agreement and can support the fact that compensating balances and commitment fees are necessary in order to obtain favorable short-term financing and are not considered in its rate proceedings, we will permit an adjustment to the nominal short-term interest rates to reflect this additional cost." 57 FPC 608, at 611. In Order No. 561-A, the Commission stated that "Order No. 561 neither changes the Commission's policy with respect to treatment of short-term debt in capitalization used for rate of return purposes nor does it grant blanket approval for recognition of compensating balances and commitment fees in costing short-term debt. The burden of proof is upon the companies to justify such items before they will be permitted." 59 FPC 1340, at 1342.

equity available to Avista for construction in deriving Avista's AFUDC rate. In Order No. 469, the Commission stated that undistributed earnings of subsidiaries are to be excluded from common stockholder equity in determining rate of return.[15] Avista's Account 219 and Account 216.1 had debit, *i.e.*, negative, balances during the audit period, and Avista's inclusion of these debit balances did not result in an overstatement of its equity component in its AFUDC rate calculations.

Additionally, the Commission's accounting regulations require the use of actual book balances as of the end of the previous year in the appropriate equity accounts when computing the AFUDC rate. However, in its equity component for calculating its AFUDC rate during the audit period, Avista used varying monthly amounts that were different from what was reported as prior year ending balances on Avista's FERC Form No. 1 for Account 201, Common Stock Issued, Account 211, Miscellaneous Paid-In Capital, and Account 216, Unappropriated Retained Earnings. Avista should have used the prior year ending balances as reported on its FERC Form No. 1 filings.

Short-Term Borrowings from Associated Companies

The Commission's accounting regulations require use of short-term financing as the first source of financing for construction work in progress in deriving the AFUDC rate. Avista had short-term borrowings from its associated companies during the audit period, and it reported those liabilities in Account 234. However, Avista's computation of its AFUDC rate did not include its short-term borrowings from associated companies, leading to Avista understating the short-term debt component in its AFUDC rate calculations. Exclusion of the short-term notes payable to associated companies resulted in an overstatement of the AFUDC in excess of the maximum permitted by the Commission's regulations.

AFUDC Rate Approved by State Regulators

Avista operates in Washington, Oregon, and Idaho to provide retail electric and gas distribution services. The guidelines provided by the state commissions for calculating AFUDC rate varied significantly from the Commission's accounting regulations. For example, the Commission's accounting regulations require a regulated entity's short-term financing to be considered as the first source of financing for construction work in progress (meaning that only where an entity's CWIP exceeds its short-term financing will long-term (usually more expensive) financing be used in

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[15] *Revisions in Uniform System of Accounts, and Annual Report Forms No. 1 and No. 2 to Adopt the Equity Method of Accounting for Long-Term Investments in Subsidiaries*, Order No. 469, 49 FPC 326, at 327 (1973).

calculating the AFUDC rate), whereas the states' regulations did not have that requirement. Avista computed its AFUDC rate for purposes of its Commission-jurisdictional transmission rates following the states' guidelines, rather than the Commission's regulations, which resulted in AFUDC rate that exceeded the maximum AFUDC rate computed in accordance with the Commission's accounting regulations due to the significantly lower cost of Avista's short-term borrowings compared to its long-term financing. Avista did not provide any evidence of Commission approval for using AFUDC rate that exceeded the maximum AFUDC rate permitted under the Commission's accounting regulations, as indicated in the following table:

AFUDC Capitalization Rate Overstatement Due to All Noncompliant Items

Year	Maximum Rate per Commission Regulations	Rate Used by Avista	Rate Overstatement
2015	3.67%	7.32%	3.65%
2016	1.44%	7.29%	5.85%
2017	2.67%	7.29%	4.62%

Accounting for AFUDC

Avista recorded the AFUDC that it calculated in accordance with state, rather than Commission, guidelines as a cost of the plant in service in Account 101, by initially debiting Account 107, Construction Work in Progress – Electric, and crediting Account 432, Allowance for Borrowed Funds Used During Construction, with the AFUDC interest amount as calculated by Avista, and also crediting Account 419.1, Allowance for Other Funds Used During Construction, with any remaining of the total AFUDC amount calculated by Avista that were permitted by state commissions. Instead of debiting its incorrectly calculated AFUDC amount to Account 107, Avista should have recorded – as a debit in Account 107 – the maximum AFUDC permitted under the Commission's accounting regulations, and recorded any surplus amount allowed for retail rate making purposes as a debit to Account 182.3, Other Regulatory Assets. Using the maximum amounts of AFUDC permitted under the Commission's regulations and using the correct accounting entries results in the following AFUDC capitalization for the years in the audit period, compared to that recorded by Avista:

AFUDC Capitalization Overstatement Due to All Noncompliant Items and Accounting

Year	Maximum Amount of AFUDC per Commission Regulations	AFUDC capitalized	Excess AFUDC capitalized
2015	5,260,639	10,965,750	5,705,111
2016	1,872,872	9,651,510	7,778,638
2017	3,443,376	9,695,827	6,252,451
Total	$ 10,576,887	$ 30,313,087	$ 19,736,200

Recommendations

We recommend that Avista:

4. Revise and implement procedures to ensure its AFUDC rate calculation is consistent with Electric Plant Instructions No. 3(17), Order Nos. 561 and 561-A, and other applicable Commission accounting regulations.

5. Revise and implement procedures to ensure that Account 216.1 and Account 219 are excluded from the equity components used to derive the AFUDC rate.

6. Revise and implement procedures to ensure that the year-end amounts reported on Avista's FERC Form No. 1 filings are used to compute the AFUDC rate in accordance with the Commission's accounting regulations.

7. Revise and implement procedures to ensure that the AFUDC amount capitalized as a cost of plant is computed in accordance with the Commission's accounting regulations.

8. Provide training to appropriate employees on AFUDC computation in accordance with the Commission's accounting regulations and Avista's revised procedures.

9. Recalculate AFUDC amounts in accordance with the Commission's accounting regulations from January 1, 2010 (effective date of current fixed transmission rates) to the present, determine the excess amount capitalized by Avista, determine the impacts on other accounts due to over-

20190919-3007 FERC PDF (Unofficial) 09/19/2019

capitalization, and submit correcting journal entries to the DAA for review and approval.

3. Accounting for Deferred Income Taxes - AFUDC

Avista’s methods for accounting for Deferred Income Taxes related to the equity component of the AFUDC rate were deficient as follows:

- Avista incorrectly recorded a debit in Account 410.1, Provision for Deferred Income Taxes, based on the amount of the equity component of AFUDC included in income Account 419.1, Allowance for Other Funds Used During Construction, and credited Account 282, Accumulated Deferred Income Taxes – Other Property. Avista should have recorded the deferred tax debit amount in Account 182.3, Other Regulatory Assets.

- Avista should have recorded a gross up for the income taxes related to the equity component of AFUDC in Account 182.3, Other Regulatory Assets, and a related offset as a deferred income tax liability in Account 283, Accumulated Deferred Income Taxes - Other.

As a result of the foregoing improper accounting, Avista overstated the Deferred Income Tax expense included in its Income Statement for 2015 through 2017 by approximately $8.4 million.

Pertinent Guidance

Commission Accounting Instructions AI93-5-000, Accounting for Income Taxes, Section 1, Early Adoption, states in part:

> Entities shall implement SFAS 109 for FERC accounting and reporting purposes no later than fiscal years beginning after December 15, 1992.

Commission Accounting Instructions AI93-5-000, Accounting for Income Taxes, Section 6, Equity AFUDC, states in part:

> An entity shall record the deferred tax liability for the equity component of AFUDC in Account 282, Accumulated Deferred Income Taxes – Other Property, and any corresponding regulatory asset in Account 182.3, Other Regulatory Assets. The regulatory asset is itself a temporary difference for which deferred income taxes shall be recognized and recorded in Account 283, Accumulated Deferred Income Taxes – Other. This accounting shall be followed for the adjustments required upon initial application of the statement and for all amounts of equity AFUDC capitalized in subsequent periods.

Commission Accounting Instructions AI93-5-000, Accounting for Income Taxes, Section 12, Regulatory Assets and Liabilities, states in part:

> Under the final rule issued in that proceeding (Commission Order No. 552 issued March 31, 1993), an entity is not required to use income statement accounts to recognize regulatory assets and liabilities related to changes in deferred tax assets or liabilities when an equal and corresponding deferred tax asset or liability is recorded.

Background

Following issuance of the Statement of Financial Accounting Standards (SFAS) No. 109, the Commission issued Accounting Instructions AI93-5-000, Accounting for Income Taxes, on April 23, 1993, in Docket No. AI93-5-000. The Commission's accounting instruction required public utilities to implement SFAS 109, which required regulated enterprises to recognize a deferred tax liability (1) for tax benefits that are flowed through to customers when temporary differences originate, and (2) for the equity component of AFUDC. Also, SFAS 109 stated that if, as a result of an action by a regulator, it was probable that the future increase or decrease in taxes payable for the above mentioned items would be recovered from or returned to customers through future rates, an asset or liability would be recognized for that probable future revenue, or reduction in future revenue. That asset or liability also is a temporary difference for which a deferred tax liability or asset shall be recognized.

Deferred Income Taxes on Equity Component of AFUDC

Avista recorded AFUDC equity components totaling $21,701,905 as allowances for other funds used during construction by debiting Account 107, Construction Work in Progress - Electric (CWIP), and crediting Account 419.1, Allowance for Other Funds Used During Construction, from 2015 through 2017. In addition, Avista recorded a debit of $8,370,405 in Account 410.1 and credited Account 282, to account for the deferred income taxes related to the AFUDC equity component between 2015 and 2017. The amounts debited to CWIP have become or would become a cost component of plant in service and would get recovered through depreciation in different future periods. Accordingly, audit staff finds that the deferred income taxes for AFUDC equity should have been recorded as a regulatory asset in Account 182.3, consistent with the accounting instruction in Docket No. AI93-5-000, rather than Account 410.1 and included in current year net income. Additionally, Avista should have recorded a gross up for the income taxes related to the AFUDC equity by debiting Account 182.3, and crediting Account 283, Accumulated Deferred Income Taxes – Other, as specified in Docket No. AI93-5-000.

AFUDC Equity Component Capitalized and Deferred Income Taxes Flow Through

Year	AFUDC Equity Component Capitalized	AFUDC Equity Deferred Income Tax Expense	AFUDC Equity Regulatory Asset Recognized
2015	7,961,552	2,786,543	-
2016	7,298,983	2,890,402	-
2017	6,441,370	2,693,460	-
Total	$ 21,701,905	$ 8,370,405	$ -

As shown on the above table, Avista flowed through $8,370,405 as deferred income tax expense through net income, instead of recording the entire amount of $8,370,405 in a regulatory asset account, as required. Avista's overstatement of current year deferred income tax expense may have impacted its state jurisdictional customer rates and its effective income tax rates. Avista agreed to revise its accounting for deferred income taxes to comply with the Commission's accounting guidelines effective January 1, 2018.

Recommendations

We recommend that Avista:

10. Revise and implement Avista's accounting policies and procedures relating to Deferred Income Taxes to comply with the Commission's accounting regulations.

11. Provide training to appropriate employees on accounting procedures related to AFUDC and related income taxes.

12. Provide the amount of Deferred Income Taxes on the AFUDC Equity Component flowed through since January 1, 2010 (effective date of current fixed transmission rates), and the amount that should have been included in Account 182.3, Other Regulatory Assets, as of December 31, 2017, and submit detailed analyses to the DAA for review and approval.

13. Report the accounting change in 2018 including the impact on annual balances reported on prior Form No. 1 filings as a note on the next Form No. 1.

14. Inform DAA about any state rate treatment addressing Avista's incorrect accounting for Deferred Income Tax Expense prior to January 1, 2018. Provide details of any such state actions with supporting documentation.

15. Submit journal entries, if appropriate, related to any state commissions' actions to the DAA for review and approval.

4. Capitalization of System Planning Costs

Avista improperly capitalized system planning costs of approximately $2.8 million as a cost of plant through its CWIP between 2014 and 2017. When subsequently correcting this error, by removing approximately $2.6 million from the cost of plant, Avista did not remove the related accumulated provision for depreciation, current and deferred income taxes, and AFUDC.

Pertinent Guidance

18 C.F.R. Part 101, Electric Plant Instructions, Section 4, Overhead Construction Costs, states in part:

> A. All overhead construction costs, such as engineering, supervision, general office salaries and expenses, construction engineering and supervision by others than the accounting utility, law expenses, insurance, injuries and damages, relief and pensions, taxes and interest, shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto, to the end that each job or unit shall bear its equitable proportion of such costs and that the entire cost of the unit, both direct and overhead, shall be deducted from the plant accounts at the time the property is retired.
>
> B. As far as practicable, the determination of pay roll charges includible in construction overheads shall be based on time card distributions thereof. Where this procedure is impractical, special studies shall be made periodically of the time of supervisory employees devoted to construction activities to the end that only such overhead costs as have a definite relation to construction shall be capitalized. The addition to direct construction costs of arbitrary percentages or amounts to cover assumed overhead costs is not permitted.

18 C.F.R. Part 101, Account 561.5, Reliability, Planning and Standards Development, states in part:

> This account shall include the cost of labor, materials used and expenses incurred for the system planning of the interconnected bulk electric transmission systems within a planning authority area.

Background

As part of its plant construction activities, Avista recorded engineering and project management overheads related to its plant construction in clearing accounts that were regarded as capital overhead pools and allocated the accumulated balances in those accounts to construction work in progress as overheads. During the audit, Avista disclosed to audit staff that it had improperly capitalized certain system planning costs associated with reliability and load forecasts by including those costs in the capital overheads pool. Avista detected the error in 2017 and determined that the error did not impact capitalization in years prior to 2014. In addressing this error, Avista removed $2,609,186 from the cost of plant to correct over-capitalization.

During site visit interviews and reviews of supporting documents for the correction of over-capitalization, audit staff determined that Avista's correction of the accounting error was incomplete. Avista did not address other items related to the over-capitalization, including an overstatement of AFUDC of $35,032 and impacts on current and deferred income taxes. Audit staff also determined that the amount removed from the cost of plant reflected in Account 101, Electric Plant in Service, was an amount net of depreciation recorded in Account 108, Accumulated Provision for Depreciation. Instead, Avista should have removed: (1) the gross amount over-capitalized from Account 101 ($2,799,261) and (2) the related depreciation amount credited to Account 108 ($156,375). Adjustments to the balance in Account 108 require the Commission's approval.[16]

Recommendations

We recommend that Avista:

16. Revise and implement procedures to effect correction of errors including corrections to accounts which require Commission approval.

17. Provide enhanced training to appropriate staff on procedures for corrections including requirements to get Commission approval.

18. Submit journal entries to a) remove the remaining over-capitalized system planning costs from the cost of plant, b) remove appropriate accumulated

[16] *See* 18 C.F.R. Part 101, Account 108, Accumulated Provision for Depreciation of Electric Utility Plant, subpart E (stating: "The utility is restricted in its use of the accumulated provision for depreciation to the purposes set forth above (in subparts A-D of the Account 108 provision). It shall not transfer any portion of this account to retained earnings or make any other uses thereof without authorization by the Commission.").

depreciation from accumulated provision for depreciation, and c) correct related Accumulated Deferred Income Tax Account balances, for DAA review and approval.

5. Asset Retirement Obligations

Avista improperly accounted for certain items related to its Asset Retirement Obligations (ARO). Specifically, Avista did not record Asset Retirement Cost (ARC) depreciation expense in Account 403.1, Depreciation Expense, and ARO accretion expense in Account 411.10, Accretion Expense. Instead, Avista recorded those expenses directly in Account 182.3, Other Regulatory Assets.

Pertinent Guidance

18 C.F.R. § 35.18, Asset Retirement Obligations, states in part:

> (c) A public utility that has recorded asset retirement obligations on its books, but is not seeking recovery of the asset retirement costs in rates, must remove all asset-retirement-obligations-related cost components from the cost of service supporting its proposed rates.

18 C.F.R. Part 101 - Uniform System of Accounts, Account 182.3, Other Regulatory Assets, states in part:

> B. The amounts included in this account are to be established by those charges which would have been included in net income, or accumulated other comprehensive income, determinations in the current period under the general requirements of the Uniform System of Accounts but for it being probable that such items will be included in a different period(s) for purposes of developing rates that the utility is authorized to charge for its utility services.

18 C.F.R. Part 101 - Uniform System of Accounts, Account 403.1, Depreciation Expense for Asset Retirement Costs, states:

> This account shall include the depreciation expense for asset retirement costs included in electric utility plant in service.

18 C.F.R. Part 101 - Uniform System of Accounts, Account 411.10, Accretion Expense, states:

> This account shall be charged for accretion expense on the liabilities associated with asset retirement obligations included in Account 230, Asset retirement obligations, related to electric utility plant.

Background

In Order No. 631, the Commission adopted accounting, reporting, and rate requirements for AROs.[17] An ARO is a legal obligation to retire a tangible long-lived asset. Pursuant to the requirements of Order No. 631, public utilities subject to the Commission's accounting regulations are required to calculate and record an ARO liability in Account 230, Asset Retirement Obligation, and an ARC asset in the electric utility or nonutility plant account, as appropriate, that is associated with the ARO liability.

Audit staff reviewed Avista's accounting processes and procedures to determine whether it accounted for AROs in accordance with the Commission's accounting regulations. As part of this review, audit staff examined the accounting procedures Avista used to recognize AROs, record depreciation of ARCs and accretion of AROs, and record adjustments to costs related to AROs to reflect different periods of recovery of those costs in rates.

Avista initially recorded an ARO by debiting the amount of the ARC to Account 101, Electric Plant in Service, and crediting an equal amount of ARO to Account 230. Avista's AROs were for obligations associated with river structures, PCB-contaminated transformers, ash ponds/landfills, and plant decommissioning.

To record the depreciation on the ARCs, Avista debited Account 182.3 and credited Account 108, Accumulated Provision for Depreciation of Electric Utility Plant. Avista should have debited Account 403.1, Depreciation Expense for Asset Retirement Costs, and credited Account 108, Accumulated Provision for Depreciation of Electric Utility Plant, and recorded adjustments in Account 403.1 to reflect recovery of depreciation in rates in different periods.

To record the accretion expense of AROs, which recognizes the increase in the cost of removing an asset over its useful life, Avista debited Account 182.3 and credited Account 230. Avista should have debited Account 411.10, Accretion Expense, and then recorded adjustments in Account 411.10 to reflect recovery of accretion expense in rates in different periods.

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[17] *See Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*, Order No. 631, FERC Stats. & Regs. ¶ 31,142, at P 30 (2003), *order on reh'g,* Order No. 631-A, 104 FERC ¶ 61,183 (2003).

Lastly, to defer the total ARC depreciation and ARO accretion, Avista should have debited Account 182.3 and credited Accounts 403.1 and 411.10.

Recommendations

We recommend that Avista:

19. Revise and implement policies and procedures to ensure Avista properly accounts for ARO-related costs in accordance with the Commission's accounting regulations.

6. FERC Form No. 1 Reporting

Avista did not comply with the instructions on page 398, Purchase and Sale of Ancillary Services, on its FERC Form No. 1 filings. This deficient reporting affected the reliability of information reported in Avista's FERC Form No. 1 submissions.

Pertinent Guidance

18 C.F.R. § 141.1(b)(2)(iii), which discusses FERC Form No. 1, states:

> This report must be filed with the Federal Energy Regulatory Commission as prescribed in § 385.2011 of this chapter and as indicated in the General Instructions set out in this form, and must be properly completed and verified. Filing on electronic media pursuant to § 385.2011 of this chapter is required.

The filing instructions on FERC Form No. 1, Page 398, Ancillary Services Schedule, state in part:

> Report the amounts for each type of ancillary service shown in column (a) for the year as specified in Order No. 888 and defined in the respondents Open Access Transmission Tariff.

Background

Audit staff reviewed Avista's FERC Form No. 1 reports during the audit period for compliance with the filing instructions for the form. During the review, audit staff found that the data reported as Purchases and Sales of Ancillary Services on page 398 of Avista's Form No. 1 filings did not agree with the actual amount of services provided under Avista's OATT. Audit staff conducted additional interviews and discussions on how Avista determined that data and reported that data on the FERC Form No. 1 submissions.

Form 1, Page 398, captures all purchases and sales of the ancillary services specified in Order No. 888 and defined in Avista's OATT.[18] Each line on Page 398

[18] *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036 (1996) (cross-referenced at 77 FERC ¶ 61,080), *order on reh'g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048 (cross-referenced at 78 FERC ¶ 61,220), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998),

defines the type of ancillary service that public utilities should report. Instructions to Page 398 require public utilities to provide the billing determinant and unit of measure used to determine the dollar amount of ancillary services reported on each line.

Based on discussions with Avista staff, audit staff determined that Avista inadvertently reported purchases of ancillary services on Line 1 (ancillary services purchased and sold), Line 5 (operating reserve spinning and supplement services purchased and sold), and Line 6 (all other types ancillary services purchased or sold) of Page 398. Avista stated that it did not purchase any ancillary services for use in its provision of services under its OATT; therefore, Avista should not have reported any purchases on those lines. Avista also informed audit staff that the amount reported on Page 398, Line 7 was overstated due to an error. Specifically, the amount reported was in kilowatts instead of the stated unit of measure which was megawatts, and, therefore, related amounts reported were overstated by approximately 1000 times.

Recommendations

We recommend that Avista:

20. Revise and strengthen documented policies, procedures, and practices to help ensure information in its FERC Form No. 1 submissions is correct, accurate, and consistent with the instructions of the form.

21. Provide training to staff on the revised FERC Form No. 1 policies, procedures, and practices. Also, develop a training program that supports the provision of periodic training in this area, as needed.

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aff'd in relevant part sub nom. Transmission Access Policy Study Group v. FERC, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002).

V. Other Matter

1. Use of Transmission Service Numbers

Avista used Transmission Service Numbers (TSN), in addition to Transmission Service Requests (TSR) created in OASIS, to facilitate scheduling of transmission service under certain circumstances. TSRs created in OASIS provide more transparency than TSNs, which are created outside of OASIS. During the audit, Avista significantly reduced the number of active TSNs, and Avista should continue to evaluate TSN use and reduce the use of TSNs when possible.

Background

In Order No. 889, the Commission stated that open access non-discriminatory transmission service requires that information about the transmission system must be made available to all transmission customers at the same time.[19] This means that public utilities must make available to others the same transmission information that is available to their own employees, including their own merchant function, and that is pertinent to decisions they make involving the sale or purchase of electricity.

In its review of Avista's transmission operations, audit staff learned about Avista's use of TSNs, which were created by Avista's transmission function and assigned to its customers, including its own merchant function. Avista assigned TSNs to its customers to schedule transmission service under two primary circumstances: 1) scheduling transmission between two adjacent points for which a transmission segment must exist for scheduling purposes though no such transmission path is posted on OASIS; or 2) accommodating certain pre-Order No. 888 or non-conforming services. The TSNs created for scheduling transmission between two adjacent points were available to multiple customers, and these TSNs were intended for use along with an associated TSR for an adjacent path that was available in OASIS. The TSNs created for certain pre-Order No. 888 or non-conforming services were limited to specific customers, and Avista had a system validation process in place for those customers' specific TSNs to avoid improper use.

Avista had nineteen active TSNs during the audit period. As requested by audit staff, Avista provided a validation check on eight TSNs that were used for scheduling

[19] *Open Access Same-Time Information System and Standards of Conduct*, Order No. 889, FERC Stats. & Regs. ¶ 31,035, at III.A (1996) (cross-referenced at 75 FERC ¶ 61,078), *order on reh'g*, Order No. 889-A, FERC Stats & Regs. ¶ 31,049 (cross-referenced at 78 FERC ¶ 61,221), *reh'g denied*, Order No. 889-B, 81 FERC ¶ 61,253 (1997).

purposes between July 2016 and June 2017. Those eight TSNs were associated with 8,163 transactions during that period. Further review of those transactions showed that all but twenty had valid TSRs from customers for an adjacent path in OASIS. The twenty transactions without a TSR for an adjacent path in OASIS were made by a single non-affiliate customer in error and did not result in actual transmission service. Therefore, customer billings were not impacted. However, to mitigate this weakness identified during the audit, Avista implemented additional system checks to validate customer requests when scheduling TSNs with TSRs for an adjacent path in OASIS to ensure appropriate and limited use of those TSNs.

In 2017, Avista implemented a program to reduce the number of TSNs by replacing pre-Order No. 888 TSNs with customer-submitted TSRs in OASIS or discontinuing the use otherwise. The number of active TSNs has been reduced from nineteen to eight during the audit. Avista plans to continue to use those eight TSNs solely for the purpose of facilitating scheduling of transmission service. As part of its review, audit staff noted several items: (1) Avista provided transparency of its TSN practice by identifying and discussing its active TSNs in section 19 of its Transmission Business Practices document posted on OASIS, (2) the purpose of these TSNs was to facilitate scheduling in limited circumstances, (3) audit staff did not identify any instances of improper use by Avista's merchant function, and (4) Avista made substantive efforts to reduce the use of TSNs during the audit period.

Recommendations

We recommend that Avista:

22. Continue to evaluate and take actions to reduce the use of TSNs.

23. Provide training to transmission employees on OATT requirements and implement an ongoing process to ensure that TSNs are used for limited scheduling purposes where a valid adjacent commercial path TSR is not available in OASIS.

VI. Avista's Response to the Draft Audit Report

September 4, 2019

Steven D. Hunt
Director and Chief Accountant
Division of Audits and Accounting
Office of Enforcement
Federal Energy Regulatory Commission
888 First Street NE. Room 5K-13
Washington, DC 20426

RE: Docket No. PA18-2-000
FERC Compliance Audit of Avista Corporation

Dear Mr. Hunt:

Avista Corporation ("Avista") submits this response to the draft audit report dated August 20, 2019. Avista agrees with the six findings and one other matter, and agrees to implement the 23 recommendations for the findings and the other matter. Corrective actions have been implemented, are in the process of being implemented, or are planned for all recommendations in the draft audit report.

In response to the recommendations identified in the draft audit report, the attached table outlines Avista's corrective actions taken or planned, and target completion dates for these actions.

Within 30 days after receiving the final audit report, Avista will submit an implementation plan addressing the status of the 23 recommendations, both completed and in progress, and a timeline for completion. Quarterly progress reports to the Division of Audits and Accounting will be provided, with the first report to be submitted by January 31, 2020.

The audit process has provided useful direction to facilitate our compliance with the Commission's policies and requirements. Avista appreciates the audit team's professional, constructive and collaborative approach to this audit.

Respectfully,

Marian Durkin
Sr. Vice President, General Counsel, Corporate Secretary, and
Chief Compliance Officer
Avista Corporation

cc: Nicholas Coughlan
Subramaniam Narthana
Kristen Fleet

Enclosure

Document Content(s)

Exhibit 1

PA18-2-000.PDF...1-47