BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of Avista Corporation, d/b/a Avista Utilities For an Order Authorizing Deferral of Costs Associated with AFUDC (Allowance for Funds Used During Construction).	)))))))	Docket No. UE-19______ Docket No. UG-19______ PETITION OF AVISTA CORPORATION

I. INTRODUCTION

1 In accordance with WAC 480-100-203(3) and WAC 480-90-203(3), Avista Corporation, doing business as Avista Utilities ("Avista" or "Company"), at 1411 East Mission Avenue, Spokane, Washington, hereby petitions the Commission for an order authorizing it to utilize deferred accounting for a portion of its calculated Allowance for Funds Used During Construction ("AFUDC") and for a portion of associated federal income taxes.

2 Avista is a utility that provides service to approximately 387,000 electric customers and 251,000 natural gas customers in a 26,000 square-mile area in eastern Washington and northern Idaho. Avista Utilities also serves approximately 103,000 natural gas customers in Oregon. The largest community served by Avista is Spokane, Washington, which is the location of its corporate headquarters. Please direct all correspondence related to this Petition as follows:

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3 Rules and statutes that may be brought at issue in this Petition include RCW 80.01.040, RCW 80.28.020, and WAC 480-07-370(1)(b).

II. SUMMARY OF APPLICATION

Avista requests Commission approval to defer a portion of the costs related to AFUDC, as follows:

I. Authorize the Company to defer the AFUDC difference calculated between using the State AFUDC rate and the FERC AFUDC rate as a regulatory asset (i.e. FERC Account No. 182.3), which would be included in rate base, and amortize this regulatory asset over the composite remaining life of the plant-in-service, as described in this Application. This proposed treatment would result in no impact to overall rate base.

II. Authorize the deferred accounting treatment detailed in this Application related to the decrease in DFIT expense that will result from the change in accounting for the equity portion of AFUDC. Avista will address the return of these deferred costs to customers (approximately $1.7 million on a system basis) in its next general rate case filing or other future proceeding, as appropriate.

III. BACKGROUND

4 The Federal Energy Regulatory Commission (FERC) notified Avista in December 2017 that they would be auditing the Company's compliance with Form 1 and 3-Q, and accounting requirements of the Uniform System of Accounts under CFR part 101.

5 During the course of the audit (which is ongoing), FERC staff made recommendations regarding the recording of AFUDC and the tax treatment of the equity component of AFUDC. Neither of the recommended changes will result in changes to Avista's overall rate base. Once the new method of recording income taxes is built into rates, deferred federal income taxes ("DFIT") will decline, which will reduce customers' rates. This decrease is only a timing difference as customer's rates will be higher in future years. Avista will defer this tax benefit beginning in 2018 until such time that the new method of calculating DFIT on equity AFUDC is built into rates.[1]

IV. EXPLANATION OF DEFERRAL AND PROPOSED ACCOUNTING TREATMENT

6 The following discusses the current accounting and proposed revised accounting related to (1) AFUDC and (2) Tax Treatment of AFUDC.

1. AFUDC

7 AFUDC represents the cost of both the debt and equity funds used to finance utility plant additions during the construction period. As prescribed by regulatory authorities, AFUDC is capitalized, during construction, as part of the cost of utility plant. The offsetting entries are recorded in the income statement as follows: a) the debt component of AFUDC is credited to FERC Account No. 432 - Allowance for Borrowed Funds Used During Construction and b) the

[1] As Avista is still under audit by FERC, no adjustments have been agreed upon or made for years prior to 2018 for either item noted above. Upon the audit's conclusion, if deemed necessary, Avista will make adjusting entries.

equity component of AFUDC is credited to FERC Account No. 419.1 - Allowance for Other Funds Used During Construction. The Company is permitted, under established regulatory practices, to recover the capitalized AFUDC through its inclusion in rate base and the provision for depreciation after the related utility plant is placed in service. Avista capitalizes AFUDC in Washington, Idaho and Oregon on a monthly basis using the Washington Utilities and Transportation Commission (WUTC) approved Rate of Return (ROR) from the most recent general rate case.[2] The most recent approved ROR (7.50%) was from the 2017 general rate case (Docket Nos. UE-170485 and UG-170486) effective May 1, 2018.

8 The following represents how Avista currently accounts for AFUDC. These amounts are based on actual results for 2018 ($ in millions). All of the amounts in this memo are on a system basis. The Washington electric share would be approximately 48% of the system amounts and the Washington natural gas share would be approximately 15% of the system amounts.

FERC	FERC Description	Debit	Credit	Activity
107/101	CWIP/UPIS	$10.2		Record AFUDC using state approved rate – 7.29% Jan. – Apr and 7.5% May – Dec.
432000	AFUDC - DEBT		$3.9	
419100	AFUDC - EQUITY		$6.3	

9 On the other hand, the AFUDC FERC rate (6.12% for 2018) is calculated based on guidance in the Uniform System of Accounts under CFR part 101. FERC has indicated that <u>if</u> the FERC AFUDC rate is different than the state approved rate, the AFUDC capitalized should be split between utility plant and regulatory asset. The amount capitalized in utility plant would be based on the FERC AFUDC rate. The amount included in the regulatory asset would be the difference between the State AFUDC rate (7.50%) and the FERC AFUDC rate (6.12% for 2018). The example below represents Avista's proposed accounting entries for the difference

[2] The use of Avista's ROR authorized by the Washington Commission, its major jurisdiction, as the AFUDC rate has been consistently used in Washington since the 1980's.

between the state and FERC AFUDC rates. The amount is based on actual results for 2018 ($ in millions).

FERC	FERC Description	Debit	Credit	Activity
107/101	CWIP/UPIS	$8.3		Record AFUDC using FERC rate.
432000	AFUDC - DEBT		$4.0	
419100	AFUDC – EQUITY		$4.3	
182311	REG ASSET (AFUDC)	$1.9		Record difference between state and FERC AFUDC rate as a regulatory asset.
407313	REG DEBIT (AFUDC DEBT)	$0.2		
407412	REG CREDIT (AFUDC EQUITY)		$2.1	
407311	REG DEBIT (AFUDC AMORT)	$0.1		Amortize the regulatory asset using a composite amortization rate.
182318	REG ASSET (AFUDC ACCUM AMORT)		$0.1	

10 Using the proposed accounting described above, the Company's level of rate base and depreciation/amortization expense does not change. The Company will include $10.2 million in rate base, including $8.3 million in FERC Account No. 101 – Plant in Service and $1.9 million in FERC Account No. 182.3 - Regulatory Asset (AFUDC).

11 Avista has proposed to make changes, on a prospective basis, starting January 1, 2018 related to the difference between the AFUDC rates. The following adjusting entry was recorded with the year-end close, resulting in a regulatory asset of approximately $1.9 million that will be amortized over a calculated composite amortization rate of approximately 30 years ($ in millions).

FERC	FERC Description	Debit	Credit	Activity
101	UPIS		$1.9	Reverse AFUDC recorded in UPIS and AFUDC accounts (and associated depreciation expense) for the incremental difference between state and FERC rates.
432000	AFUDC – DEBT		$0.2	
419100	AFUDC – EQUITY	$2.1		
108000	ACCUMULATED DEPRECIATION	$0.1		
404000	DEPRECIATION EXPENSE		$0.1	
182311	REG ASSET (AFUDC)	$1.9		Record regulatory asset for the incremental difference between state and FERC AFUDC rates.
407313	REG DEBIT (AFUDC DEBT)	$0.2		
407412	REG CREDIT (AFUDC EQUITY)		$2.1	
407311	REG DEBIT (AFUDC AMORT)	$0.1		Amortize the regulatory asset using a composite amortization rate.
182318	REG ASSET (AFUDC ACCUM AMORT)		$0.1	

2. **Tax Treatment of AFUDC**

12 For income tax purposes, the IRS provides guidance with respect to the capitalization of interest. Using this guidance, Avista's calculated capitalized debt interest (i.e., AFUDC) for tax purposes varies from the amount capitalized for book purposes. In addition, the IRS does not allow any equity interest to be capitalized for tax purposes. The table below summarizes the estimated amount of AFUDC allowed for book purposes and tax purposes for 2018 and the associated federal income tax impact on those differences. ($ in millions)

	Debt	Equity	Total
AFUDC Capitalized for Book	$3.9	$6.3	$10.2
AFUDC Capitalized for Tax	9.4	0.0	9.4
Book-Tax Difference	$(5.5)	$6.3	$ 0.8
Tax Impact of Book-Tax Difference at 21%	$1.15	$(1.33)	$(0.18)

13 Avista has recorded the tax impact of this book-tax difference for both the debt AFUDC and equity AFUDC on a normalized basis. The following represents the accounting that Avista has used to record the impact of the book-tax difference related to AFUDC for the 2018 activity ($ in millions).

FERC	FERC Description	Debit	Credit	Activity
410100	DFIT EXPENSE		$1.15	Record deferred tax expense on debt AFUDC.
282900	ADFIT	$1.15		
410100	DFIT EXPENSE	$1.33		Record deferred tax expense on equity AFUDC
282900	ADFIT		$1.33	

14 FERC has indicated that Avista should be using the flow-through method for equity AFUDC rather than the normalized method.

15 Equity AFUDC increases the book basis of assets. It originates as book income and reverses as an expense through book depreciation. Over the book life of the related asset, equity AFUDC has no net impact on book income. Equity AFUDC also has no impact on taxable income because the income created by equity AFUDC is never taxable and the book depreciation attributable to equity AFUDC is never deductible for income tax purposes. Accounting guidance indicates that equity AFUDC be tracked as a temporary book-tax difference for income tax accounting purposes. Equity AFUDC is a temporary book-tax difference in the sense that it ultimately has the same impact on book income and taxable income – zero. For income tax accounting purposes, the temporary book-tax difference for equity AFUDC generates a deferred income tax liability upon origination, with a corresponding debit to regulatory asset. As the temporary book-tax difference reverses over the book life of the related asset, the income tax accounting entry is to debit the deferred income tax liability and credit the regulatory asset until the deferred income tax liability is brought down to zero.

16 Deferred income taxes are included in the revenue requirement under a policy of income tax normalization. Under flow-through accounting, the deferred income taxes generated by equity AFUDC never impact revenue requirement, which is appropriate since there is no corresponding income tax payable or receivable between the Company and the IRS.

17 The Company will use flow-through accounting for the deferred income taxes generated

by equity AFUDC in all of its regulatory jurisdictions on a prospective basis, beginning January 1, 2018.

18 The table below shows an example of the AFUDC income tax accounting entries that will be recorded beginning in December 2018 based on the tax calculations above ($ in millions).

FERC	FERC Description	Debit	Credit	Activity
410100	DFIT EXPENSE		$1.15	Record deferred tax expense for AFUDC Debt and Tax Capitalized Interest.(Normalization)
282900	ADFIT	$1.15		
182319	REG ASSET AFUDC EQUITY	$1.33		Record AFUDC Equity. (Flow-through)
282919	ADFIT-PLANT AFUDC EQ		$1.33	
182319	REG ASSET AFUDC EQUITY	$0.40		Record regulatory asset gross-up.
283319	AFUDC EQUITY GROSS UP		$0.40	

19 The entry above also records a gross-up amount on the regulatory asset since the future recovery in rates will increase tax expense, therefore increasing the amount Avista will need to collect from customers.

20 Because Avista's customers rates currently being collected include recovery of the deferred income tax expense computed using the normalized method (which is $1.73 million in 2018, including the gross-up) the Company will defer this amount when it changes to the flow-through method, until such time that the flow-through method is built into base rates. Avista will work with Commission staff in each state to determine when this deferral will be returned to customers. The table below shows the entry, using estimated 2018 data as an example, that will be recorded to defer the collection of these taxes on an annual basis ($ in millions).

FERC	FERC Description	Debit	Credit	Activity
407319	AFUDC EQUITY TAX DEFERRAL	$1.73		Defer DFIT expense included in customers' rates for equity AFUDC change in tax method.
254319	REG LIABILITY AFUDC EQUITY TAX DEFERRAL		$1.73	
190319	DFIT AFUDC EQUITY TAX DEFERRAL	$0.36		Deferred taxes on AFUDC equity deferral FERC Account 407319
410100	DFIT EXPENSE		$0.36	

21 The amounts included above represents the actual deferrals for 2018. Avista estimates that the amounts deferred in 2019 will be consistent with these amounts recorded for 2018. Interest will not accrue on the above deferral.

V. OTHER CONSIDERATIONS

22 Avista has made similar filings with the Idaho Public Utilities Commission and the Public Utility Commission of Oregon concurrently with this filing. It is critical that the Company maintain uniform utility accounts and AFUDC methodology for common plant that are consistent among the Company's regulatory jurisdictions. In the event different AFUDC rates or methods were to be ordered for common plant, it would result in multiple sets of depreciation accounts and records that would need to be adjusted annually for changes in allocation factors, which would impose a costly administrative burden on the Company and unnecessary expense for the Company's ratepayers.

VI. REQUEST FOR RELIEF

23 WHEREFORE, Avista respectfully requests that the Commission issue an Order approving the following:

1. Authorize the Company to defer the AFUDC difference calculated between using the state AFUDC rate and the FERC AFUDC rate as a regulatory asset (i.e. FERC Account No. 182.3), which would be included in rate base, and amortize this regulatory asset over the composite remaining life of the plant-in-service, as described in this Petition.
2. Authorize the deferred accounting treatment detailed in this Petition related to the decrease in DFIT expense that will result from the change in accounting for the equity

portion of AFUDC. Avista will address the return of these deferred costs in its next general rate case filing or other future proceeding, as appropriate.

DATED this 31st day of January 2019

By: ______________________________
Patrick D. Ehrbar
Director of Regulatory Affairs

VERIFICATION

STATE OF WASHINGTON)
)
County of Spokane)

Patrick D. Ehrbar, being first duly sworn on oath, deposes and says: That he is a Director of Regulatory Affairs of Avista Corporation and makes this verification for and on behalf of said corporation, being thereto duly authorized;

That he has read the foregoing Petition, knows the contents thereof, and believes the same to be true.

SIGNED AND SWORN to before me on this 31st day of January 2019.

PATTY L HANSON
COMMISSION EXPIRES
NOTARY
PUBLIC
11-23-21
STATE OF WASHINGTON

Patty L. Hanson

NOTARY PUBLIC in and for the State of Washington, residing at Spokane.

Commission Expires: 11-23-21