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STATE OF WASH.
UTIL. AND TRANSP.
COMMISSION

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-08 _____

DIRECT TESTIMONY OF

RONALD L. MCKENZIE

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

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Q. Please state your name, business address and present position with Avista Corporation ("Avista" or "Company").

A. My name is Ronald L. McKenzie and my business address is East 1411 Mission Avenue, Spokane, Washington. I am employed by Avista as Manager, Regulatory Accounting in the State and Federal Regulation Department.

Q. Would you briefly describe your educational background and professional experience?

A. I graduated from Eastern Washington University in 1973 with a Bachelor of Arts degree in Business Administration majoring in accounting. I joined the Company in September 1974. I obtained a Master of Business Administration Degree from Eastern Washington University in 1989. I have attended several utility accounting and ratemaking courses and workshops. I have held various accounting positions within the Company. I have served in the State and Federal Regulation Department for the majority of my career with the Company.

Q. Have you previously testified before this Commission?

A. Yes. I have testified before this Commission in several prior proceedings.

Q. What is the scope of your testimony in this proceeding?

A. My testimony addresses the accounting associated with the power cost deferrals under the Energy Recovery Mechanism ("ERM") approved by the Commission in Docket No. UE-011595. I also explain what is contained in the monthly reports that are filed with the Commission.

Q. Are you sponsoring any exhibits?

1 A. Yes. I am sponsoring Exhibit No. ___(RLM-2), which consists of a copy of the
2 December 2007 monthly ERM report for informational purposes.

3 **II. ACCOUNTING ASSOCIATED WITH ERM DEFERRALS**

4 **Q. Would you please describe the accounting associated with the Company's**
5 **ERM deferral mechanism?**

6 A. Yes. Company witness Mr. William G. Johnson discusses, in his direct
7 testimony, the procedure to calculate the monthly variations between actual and authorized
8 power supply revenues and expenses. The ERM deadband and sharing mechanism were
9 modified effective January 1, 2006 pursuant to Order 03 in Docket UE-060181 dated June 16,
10 2006. Under the revised mechanism, monthly variations are accumulated until the calendar-year
11 deadband of \$4.0 million is exceeded. Once the deadband is exceeded, 50% of the cumulative
12 variation between actual and authorized net power supply costs between \$4.0 million and \$10.0
13 million is deferred. Once the cumulative power supply cost variance from the amount included
14 in base rates exceeds \$10.0 million, 90% of the cost variance is deferred for future surcharge or
15 rebate. When actual net power supply costs exceed authorized costs, entries are made to record
16 the deferral amount by crediting Account 557.28 - Other Power Supply Expenses, thereby
17 decreasing recorded power supply expenses, and debiting Account 186.28 - Miscellaneous
18 Deferred Debits. If actual net power supply costs are less than authorized costs in a given month,
19 an entry is made to record the difference by debiting Account 557.28 - Other Power Supply
20 Expenses, thereby increasing recorded power supply expenses, and crediting Account 186.28 -
21 Miscellaneous Deferred Debits. An accumulated debit balance in Account 186.28 represents a
22 surcharge balance, while an accumulated credit balance represents a rebate balance.

1 **Q. How is interest recorded on the deferral balances?**

2 A. Interest is calculated pursuant to the Settlement Stipulation approved by the
3 Commission's Fifth Supplemental Order in Docket No. UE-011595, dated June 18, 2002.
4 Interest is applied to the average of the beginning and ending month balances in Account 186.28
5 net of associated deferred federal income tax. The Company's weighted cost of debt is used as
6 the interest rate. The interest rate is updated semi-annually and interest is compounded semi-
7 annually. The interest rate used for the period January 1, 2007 through June 30, 2007 was
8 7.825%, the Company's weighted cost of debt at December 31, 2006. The interest rate used for
9 the period July 1, 2007 through December 31, 2007 was 7.843%, the Company's weighted cost
10 of debt at June 30, 2007.

11 **Q. How are income taxes accounted for under the deferred power cost**
12 **mechanism?**

13 A. The power cost deferral entries are not recognized in the determination of taxable
14 income for federal income tax purposes. Therefore, deferred federal income taxes are recorded.
15 Account 283.28 – Accumulated Deferred Federal Income Tax reflects a credit balance of 35% of
16 the debit balances in Account 186.28. When Account 283.28 is credited, Account 410.10 –
17 Deferred FIT Expense is debited. Likewise, when Account 283.28 is debited, Account 410.10 is
18 credited.

19 **Q. In 2007 what were the amounts deferred, absorbed by the Company, and the**
20 **balance in the 2007 deferral account, Account 186.28, at December 31, 2007?**

21 A. For the 2007 calendar year actual net power costs exceeded authorized net power
22 costs for the Washington jurisdiction by \$24,826,407. Of that amount \$16,343,766 was deferred,

1 with the remaining \$8,482,641 being absorbed by the Company. The amount absorbed by the
2 Company consists of the \$4,000,000 deadband, plus 50% of the variation between \$4.0 million
3 and \$10.0 million, or \$3,000,000, plus 10% of the amount exceeding \$10.0 million, or
4 \$1,482,641 ($\$4,000,000 + \$3,000,000 + \$1,482,641 = \$8,482,641$ absorbed by Company). There
5 was a balance in the 2007 deferral account at December 31, 2007 of \$16,564,895, consisting of
6 the \$16,343,766 amount that was deferred during the year plus \$221,129 of interest on the
7 deferred costs.

8 III. ERM MONTHLY AND ANNUAL REPORTS

9 **Q. Would you please describe the monthly reports that the Company submits to**
10 **the Commission?**

11 A. The Company submits monthly reports to the Commission, Public Counsel, and
12 ICNU that include the monthly power cost deferral journal entries together with backup
13 workpapers and other supporting documentation. The cover letter to the monthly report contains
14 a brief explanation of the factors causing the variance between actual and authorized power costs.
15 The beginning of the month account balances, the recorded activity within the accounts, and the
16 ending month account balances are shown. The January and July reports contain the supporting
17 workpapers for the semi-annual updates of the weighted cost of debt used in the interest
18 calculations. The monthly reports also include any new power contracts of one-year or longer,
19 entered into during the month. Attached as Exhibit No. ___(RLM-2) is a copy of the December
20 2007 report for informational purposes.

21 **Q. What are the requirements associated with the annual filing to review**
22 **deferrals?**

1 A. The Company is required to make an annual filing, on or before April 1 of each
2 year, regarding the power costs deferred in the prior calendar year under the ERM. The filing
3 consists of testimony, exhibits, and supporting documentation. Since its inception in 2002, the
4 Company has made six such annual filings, including the present filing covering the 2007
5 calendar year.

6 **Q. What is the review period for the annual ERM filing?**

7 A. The Commission Staff and interested parties have the opportunity to review the
8 deferral information during a 90-day review period ending June 30th each year. The 90-day
9 review period may be extended by agreement of the parties participating in the review, or by
10 Commission order.

11 **Q. When was the last annual ERM filing addressed by the Commission?**

12 A. The annual ERM filing covering the 2006 calendar year was reviewed in Docket
13 No. UE-070623. Order 01 was issued in that docket on June 27, 2007, and the Commission
14 found that the power cost deferrals for 2006 were prudent.

15 **Q. Have the 2007 ERM calculations and accounting entries been made in a**
16 **manner consistent with the ERM methodology approved by the Commission?**

17 A. Yes.

18 **Q. Does this conclude your pre-filed direct testimony?**

19 A. Yes, it does.

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