BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UG-04_____________

DIRECT TESTIMONY OF

DON M. FALKNER

REPRESENTING AVISTA CORPORATION

CONTENTS

I. INTRODUCTION

Q. Please state your name, business address, and present position with Avista Corp.

A. My name is Don M. Falkner. My business address is 1411 East Mission Avenue, Spokane, Washington. I am employed by Avista Corp., doing business as Avista Utilities ("Avista" or "Company") and my current position is Manager of Revenue Requirements in the Department of State and Federal Regulation.

Q. Would you please describe your education and business experience?

A. I graduated from Washington State University in February of 1981 with a Bachelor of Arts Degree in Business Administration, majoring in Accounting. That same year, I sat for and passed the May Certified Public Accountant exam. I joined the Company in June of 1981. I have served in various positions within the sections of the Finance Department, including Power Supply Accounting, Subsidiary Accounting, Budget and Forecasting, Plant Accounting and Corporate Accounting. For the past 12 years, I have served in the Department of State and Federal Regulation. I have also attended several utility accounting and ratemaking courses.

Q. As Manager of Revenue Requirements, what are your responsibilities?

A. As Manager of Revenue Requirements, aside from special projects, I am responsible for preparation of normalized revenue requirement and pro forma studies for the various jurisdictions in which the Company provides utility services. During the last 5 to 6 years I have assisted in management and have been the lead rate analyst in the Company's electric and natural gas general rate filings in Washington, Idaho and Oregon.

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

A. My testimony and exhibits in this proceeding will generally cover accounting and financial data in support of the Company's need for the proposed increase in rates. I will explain pro formed operating results including expense and rate base adjustments made to actual operating results and rate base. Mr. Hirschkorn will explain the pro forma revenue adjustment and the pro forma gas benchmark transition adjustment. I will cover each of those adjustments briefly while his testimony will provide a more in-depth discussion.

Q. Are you sponsoring any exhibits to be introduced in this proceeding?

A. Yes. I am sponsoring Exhibit No._____(DMF-2) and Exhibit No. _____(DMF-3), which were prepared under my direction.

II. REVENUE REQUIREMENT SUMMARY

Q. Would you please summarize the results of the Company's pro forma study for the natural gas operating system for the Company's Washington jurisdiction?

A. Yes. After taking into account all standard Commission Basis adjustments, as well as additional pro forma and normalizing adjustments, the pro forma natural gas rate of return ("ROR") for the Company's Washington jurisdictional operations is 5.79%, substantially below the Company's requested rate of return of 9.86%. The incremental revenue requirement necessary to give the Company an opportunity to earn its requested ROR is $8,635,000, or a 6.21% increase over current base rates.

Q. **On what test period is the Company basing its need for additional revenue?**

A. The test period being used by the Company is the twelve-month period ending December 31, 2003, presented on a pro forma basis.

Q. **What is the Company's rate of return that was last authorized by this Commission for its gas operations in Washington?**

A. The Company's currently authorized rate of return for its Washington gas operations is 9.03%. That rate dates back to Case No. UG-991607, which became effective on December 1, 2000.

Q. **Have there been any changes to base gas rates in the Washington jurisdiction since 2000?**

A. No. The Company has not changed its base gas rates in Washington since 2000. However, a Schedule 91 Tariff Rider Adjustment (Tariff Rider) was implemented in the interim period in which a surcharge of 1.75% is being used to fund energy efficiency improvements and low-income energy assistance. The Company does have

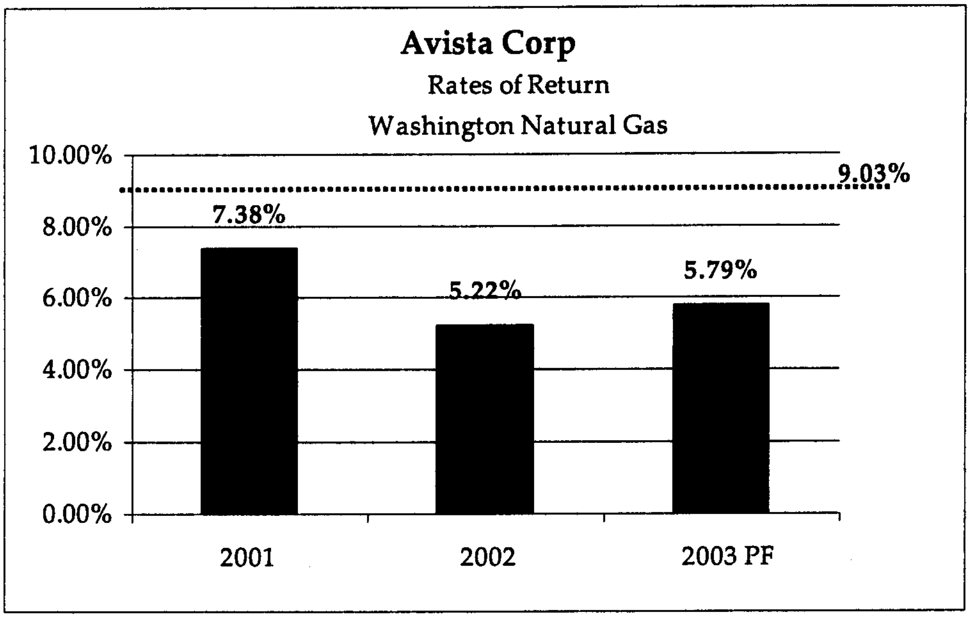
Purchased Gas Adjustments ("PGA") in all of its jurisdictions, including Washington, that periodically adjust customers' rates for the gas supply and transportation cost associated with procuring natural gas. The PGA rate changes do not impact utility earnings or general base rates.

Q. Does the Tariff Rider have any impact on the normalized level of Company earnings for its Washington jurisdiction?

A. No. The revenue generated by the Tariff Rider has a matching expense associated with it. The bottom line, or net operating income impact is zero, so there is no earnings impact. The actual management of the program disbursements is done through a balance sheet account.

Q. What level of earnings has the Company experienced since the rate change associated with Case No. UG-991607 was implemented in 2000?

A. Using the Company's Commission Basis, or normalized, natural gas information, the ROR for 2001, the first full twelve-month period after the rate change was 7.38%. The Company's Washington gas ROR then declined to 5.22% for 2002. As I noted earlier, our authorized ROR for Washington gas operations is 9.03%. Our pro forma natural gas rate of return, as outlined in this filing, is 5.79%. Below is a graph showing our historical and pro forma returns as compared to our currently authorized ROR.



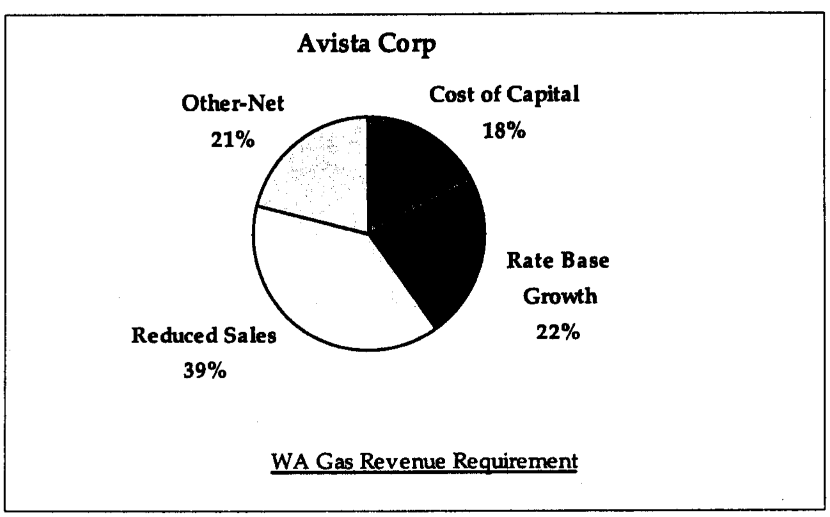
Q. Is there one main issue that contributed to the requested increase?

A. No. There is no one main item responsible for the requested increase. Average customers in our Washington gas jurisdiction have risen from 114,098 to 128,935, or 13% from 1998 through the end of 2003. Virtually all cost categories have increased in the last 5 years, including distribution, customer accounting and administrative and general.

On page 1 of my Exhibit No._____(DMF-3), I've set up a side-by-side comparison of the Company's authorized test year net operating income and rate base with our 2003 pro forma levels. At a high level, the Company's request reflects the impact of changes in net operating income components, rate base growth and increased cost of capital. As you can see on line 30, column (d), Net Operating Income has declined $3.2 million or 29% while line 42, Total Rate Base, has increased $12 million, or 10%. The $3.2 million reduction in net operating income translates into approximately $5.1 million of additional revenue requirement.

One of the factors contributing to the lower net operating income is that, although average customers increased 13%, gross margin only increased $1.9 million, or approximately 5%. Lower average customer usage and loss of certain industrial loads resulted in an approximate $3.3 million reduction in 2003 gross margins. The derivation of this amount is explained in more detail in Mr. Hirschkorn's testimony.

The $12 million increase in rate base adds an additional $1.9 million to the revenue requirement. Furthermore, cost of capital increases associated with the difference between the 9.03% authorized ROR and our 9.86% requested ROR contribute approximately $1.5 million to the overall revenue requirement. I will provide some additional detail regarding these items later, but the chart below shows this initial comparison as a percent of the total request:



Q. What are some of the other components of the Company's request?

A. Additional factors contributing to the need for rate relief include an increase in depreciation expense which has followed plant growth, an increase in pension cost which is impacting many companies, increased insurance costs reflecting heightened security concerns, and to a lesser degree, increases in customer accounting/service/sales costs and administrative and general expense.

<u>**Revenue Requirement**</u>

Q. Would you please explain what is shown in Exhibit No._____(DMF-2)?

A. Exhibit No._____(DMF-2) shows actual and pro forma gas operating results and rate base for the test period for the State of Washington. Column (b) of page 1 of Exhibit No._____(DMF-2) shows 2003 operating results and components of the average-of-monthly-average rate base as recorded; column (c) is the total of all adjustments to net operating income and rate base; and column (d) is pro forma results of operations, all under existing rates. Column (e) shows the revenue increase required which would allow the Company to earn a 9.86% rate of return. Column (f) reflects pro forma gas operating results with the requested increase of $8,635,000.

Q. Would you please explain page 2 of Exhibit No._____(DMF-2)?

A. Yes. Page 2 shows the calculation of the $8,635,000 revenue requirement at the requested 9.86% rate of return.

Q. Would you now please explain page 3 of Exhibit No._____(DMF-2)?

A. Yes. Page 3 shows the derivation of the net operating income to gross revenue conversion factor. The conversion factor takes into account uncollectible accounts receivable, Commission fees and Washington State excise taxes. Federal income taxes are reflected at 35%.

Q. Now turning to pages 4 through 9 of your Exhibit No._____(DMF-2), would you please explain what those pages show?

A. Page 4 begins with actual operating results and rate base for the 2003 test period in column (b). Individual normalizing adjustments that are standard components of our annual reporting to the Commission begin in column (c) on page 4 and continue through column (u) on page 7. Individual pro forma and additional normalizing adjustments begin in column (PF1) on page 8 and continue through column (PF7) on page 9. The final column on page 9 is the total pro forma operating results and rate base for the test period.

STANDARD COMMISSION BASIS ADJUSTMENTS

Q. Would you please explain each of these adjustments, the reason for the adjustment and its effect on test period State of Washington net operating income and/or rate base?

A. Yes, but before I begin, I will note that in addition to the explanation of adjustments provided herein, the Company has also provided workpapers outlining additional details related to each of the adjustments.

The first adjustment, column (c) on page 4, entitled **Deferred FIT Rate Base,** reflects the rate base reduction for Washington's portion of deferred taxes. The adjustment reflects the deferred tax balances arising from accelerated tax depreciation (Accelerated Cost Recovery System, or ACRS, and Modified Accelerated Cost Recovery, or MACRS), bond refinancing premiums, and contributions in aid of construction. The effect on Washington rate base is a reduction of $22,570,000.

Column (d), **Deferred Gain on Office Building,** reflects the rate base reduction for Washington's portion of the net of tax, unamortized gain on the sale of the Company's general office facility. The facility was sold in December 1986 and leased back by the Company. The treatment of the gain on the sale follows the Commission's Order Granting Application in Cause No. FR-86-150. The effect on Washington rate base is a reduction of $246,000.

Column (e), **Gas Inventory**, reflects the adjustment to rate base for the average of monthly average value of gas stored at the Company's Jackson Prairie underground storage facility and the Plymouth LNG Plant. This adjustment is consistent with the Third Supplemental Order in Docket No. U-88-2380-T. The effect on Washington rate base is an increase of $4,568,000.

Column (f), **Weatherization and DSM Investment**, includes in rate base the balances (net of amortization) of natural gas demand side management (DSM) programs consistent with agreements in Docket No. UG-941376 and UG-941378. The effect on Washington rate base is an increase of $2,275,000.

The adjustment in column (g), entitled **Customer Advances**, decreases rate base for funds advanced by customers for line extensions, as they are generally recorded as contributions in aid of construction at some future time. The effect on Washington rate base is a decrease of $14,000.

Q. Please turn to page 5 and explain the adjustments shown there.

A. The column marked by a dash, and labeled **Subtotal Actual**, is a subtotal of columns (b) through (g) and reflects the standard rate base adjustments that are included in Commission Basis reporting.

Column (h), entitled **Revenue Normalization & Gas Cost Adjustment**, is a 3-fold adjustment taking into account known and measurable changes that include revenue normalization, which reprices customer usage under presently effective rates, as well as weather normalization and an unbilled revenue calculation. Associated gas costs are replaced with gas costs computed using normalized volumes at the currently effective "weighted average cost of gas," or WACOG rates. Revenues associated with the Schedule 191 Tariff Rider are excluded from pro forma revenues, and the related amortization expense is eliminated as well. Mr. Hirschkorn is sponsoring this adjustment. The effect of this particular adjustment is to increase Washington net operating income by $1,273,000.

Column (i), **Eliminate B & O Taxes**, eliminates the revenues and expenses associated with local business and occupation taxes, which the Company is allowed to pass through to customers. The adjustment eliminates any timing mismatch that exists between the revenues and expenses by eliminating the revenues and expenses in their entirety. B & O Taxes are passed through on a separate schedule, which is not part of this proceeding. This restating adjustment is consistent with the Third Supplemental Order in Docket No. U-88-2380-T. The effect of this adjustment is to decrease Washington net operating income by $78,000.

Column (j), **Property Tax**, restates the 2003 test period accrued levels of property taxes to the actual amounts. This restating adjustment is consistent with the stipulation in Docket No. UE-900093. The effect of this particular adjustment is to increase Washington net operating income by $88,000.

Column (k), **Uncollectible Expense**, restates the accrued expense to the actual level of net write-offs for the test period. This restating adjustment is consistent with the Third Supplemental Order in Docket No. U-88-2380-T. The effect of this adjustment is to increase Washington net operating income by $43,000.

Column (l), entitled **Regulatory Expense Adjustment**, restates booked 2003 regulatory expense to reflect the WUTC assessment rates applied to revenues for the test period. The effect of this adjustment is to increase Washington net operating income by $19,000.

Q. Please turn to page 6 and explain the adjustments shown there.

A. Column (m), **Injuries and Damages,** is a restating adjustment that replaces the accrual with actuals to get the six-year rolling average of injuries and damages payments not covered by insurance. As a result of the Commission's Order in Docket No. U-88-2380-T, the Company changed to the reserve method of accounting for injuries and damages not covered by insurance. This adjustment is consistent with the Third Supplemental Order in Docket U-88-2380-T. The effect of this adjustment is to increase Washington net operating income by $10,000.

Column (n), **FIT**, is required to reflect the appropriate level of federal income tax expense for the test period. This adjustment removes the effect of certain Schedule M items, matches the jurisdictional allocation of other Schedule M items to related Results of Operations allocations and eliminates any prior period income tax expense. This adjustment also reflects the proper level of deferred tax expense for the test period. The effect of this adjustment, all based upon a Federal tax rate of 35%, is to decrease Washington net operating income by $171,000.

Column (o), **Restate Debt Interest**, restates debt interest using the Company's pro forma weighted average cost of debt, as outlined in the testimony and exhibits of Mr. Malquist, and applied to Washington's pro forma level of rate base, produces a pro forma level of tax deductible interest expense. The federal income tax effect of the restated level of interest for the test period decreases Washington net operating income by $966,000.

Column (p), **Payroll Clearing**, adjusts the payroll loading costs (benefits, payroll taxes and paid time off) expensed through a clearing account during the 2003 test period, to the actual payroll loading costs for the test period. The estimated payroll loading rates during the 2003 test period produced an expense level lower than the actual amount of employee benefits incurred for the test period. The impact of this true up to actual on the Washington gas jurisdiction decreased net operating income by $61,000.

Column (r), **Eliminate A/R Expenses**, A/R representing Accounts Receivable, removes expenses associated with the sale of customer accounts receivable. This restating adjustment is consistent with the Commission's Third Supplemental Order in Docket No. U-88-2380-T. The effect of this adjustment is to increase Washington net operating income by $81,000.

Q. Please turn to page 7 and continue with your explanation of the adjustments shown there.

A. Column (s), **Office Space Charged to Subs**, removes a portion of the office space costs (building lease and O&M costs, common area costs, copier expense and annual office furniture rental) using the percentage of labor dollars charged to subsidiary activities by employee compared to total labor dollars by employee. These percentages are applied to the employees' office space (expressed in square feet) and multiplied by office space costs/per square foot. This restating adjustment is made as a result of the Commission's Third Supplemental Order in Docket No. U-88-2380-T, which required the company to perform a space utilization study to allocate costs to subsidiaries. Due to the Company's efforts to further segregate subsidiary activities so that they operate more independently of the utility, this adjustment has historically been a relatively small adjustment. The effect of this adjustment is to increase Washington net operating income by $4,000.

Column (t), **Restate Excise/Franchise Taxes,** removes the effect of a one-month lag between collection and payment of taxes. This restating adjustment is consistent with the Third Supplemental Order in Docket No. U-88-2380-T. It should be noted that the City of Spokane gas franchise fee will expire on September 15, 2004 and accordingly, has been eliminated from the Company's pro forma results of operations. The effect of this adjustment is to increase Washington net operating income by $677,000.

Column (u), **Lease Expense Adjustment**, restates the straight-line accrual of lease payments for the Company's general office building to a cash basis. This restating adjustment is consistent with the Third Supplemental Order in Docket No. U-88-2380-T. The effect of this adjustment is to decrease Washington net operating income by $20,000.

The last column on page 7, entitled **Restated Total**, subtotals all the preceding columns (b) through column (u), exclusive of the previously discussed subtotal column. These totals represent actual operating results and rate base plus the standard normalizing adjustments that the Company includes in its annual Commission Basis reports.

PRO FORMA AND ADDITIONAL NORMALIZING ADJUSTMENTS

Q. Please explain the significance of the additional adjustments that begin on page 8 of your Exhibit No._____(DMF-2).

A. The adjustments starting on page 8 are either additional normalizing adjustments or pro forma adjustments to reflect material known and measurable changes between the test period and the pro forma period. In this case, they encompass only revenue and expense items, as there were no significant natural gas capital projects. These adjustments bring the operating results and rate base to the final pro forma level for the test year.

Q. Please continue with your explanation of the adjustments on page 8.

A. Column (PF1), **Pro Forma Pension**, reduces the actual 2003 pension expense to the expense projected to be accrued during the rate period starting in 2005. Pension expense, on a system basis, was $14.9 million during the 2003 test year and is projected to decrease to $12 million annually during the 2005/2006 period when new rates are anticipated to go into affect. To be conservative and reduce complexity, this adjustment only pro forms in the impact of reduced pension costs on labor charged to operating expense accounts, and ignores capitalized labor's impact on rate base. Pension costs that are properly charged to non-utility labor costs have also been excluded from this adjustment. The effect of this adjustment is to increase Washington net operating income by $153,000.

Q. Please describe the Company pension expense?

A. The Company's pension expense has consistently been determined in accordance with Financial Accounting Standard 87 ("FAS-87") since that standard's implementation date of January 1, 1987. Pension expense is determined by an outside actuarial firm, in accordance with FAS-87, and the calculations and assumptions are reviewed by the Company's outside accounting firm for reasonableness and comparability to other companies.

As is being experienced by many companies with funded pension plans, pension costs have increased due primarily to the investment performance of plan assets during the major downturn in the equity markets experienced in the last few years. The pension levels noted above are for the Company as a whole. Pension expense, as with other employee benefits, is "loaded" onto actual labor costs, which are then assigned to various functional expense categories and accounts through the payroll process. Historically, approximately 70% of labor goes to expense and 30% to capital. In our adjustment, a detailed analysis of 2003 labor charges was performed to more accurately determine the Washington gas percentage of overall labor.

Q. Please continue with the remaining adjustments on page 8?

A. Column (PF2), **Pro Forma Insurance**, updates the 2003 insurance expense for general liability, directors and officer liability, property insurance and other policies, to the actual cost of all signed ongoing and renewed policies providing insurance for 2004. Insurance costs are mainly expensed at a system level and allocated to electric and gas. Insurance costs that are properly charged to non-utility operations have been excluded from this adjustment. The effect of this adjustment decreases Washington net operating income by $130,000.

Column (PF3), **Pro Forma Labor-Non-Exec**, reflects known and measurable changes to test period union and non-union wages and salaries, and excludes executive salaries, which are handled separately in the next adjustment. Test period wages and salaries are restated as if the wage and salary increases for through March 2005 were in place during the entire pro forma test period. The methodology behind this adjustment is similar to what the Company used in the last Washington general case, Docket No. UG-99107, except for the separate treatment of executive salaries. The effect of this adjustment on Washington net operating income is a decrease of $346,000.

Column (PF4), **Pro Forma Labor-Executive**, reflects known and measurable changes to executive compensation. In the last few years several executives retired, a new chief financial officer was hired and responsibilities were re-assigned among the executive group. Compensation costs allocated to non-utility operations are excluded as executives routinely charge a portion of their time to non-utility operations, commensurate with the amount of time spent on such activities. The current executive group's salary allocations are set at their expected pro forma test period utility/non-utility percentage splits. The impact of this adjustment on Washington net operating income is an increase of $2,000.

Column (PF5), **Pro Forma Benchmark**, reflects the impact of hiring the employees necessary to manage the return of the natural gas procurement functions to the utility from Avista Energy. Mr. Hirschkorn explains this adjustment in more detail in his direct testimony. The impact of this adjustment on Washington net operating income is a decrease of $208,000.

The last column on page 8 (PF6), **Pro Forma Depreciation**, corrects 2003 recorded depreciation expense for computer hardware amounts that should have been retired since 1999. The adjustment was recorded in March of 2004 to reverse the depreciation expensed in error. The impact of this adjustment on Washington net operating income is an increase of $124,000.

Q. Please turn to page 9 and continue with your explanation of the final columns shown there.

A. Column (PF7), **Incentives Adjustment**, adjusts 2003 test year incentive expense to the actual 2003 incentive expense paid in 2004 for the 2003 incentive plan. Additionally, the adjustment removes any part of the 2003 executive incentive payout that was earnings per share based. The impact of this adjustment on Washington net operating income is an increase of $90,000.

The last column on page 9, Pro Forma Total, reflects total 2003 pro forma results of operations and rate base consisting of 2003 actual results and the total of all normalizing and pro forma adjustments.

Q. Referring back to page 1, line 43, of Exhibit No._____(DMF-2), what was the actual and pro forma gas rate of return realized by the Company during the test period?

A. For the State of Washington, the actual test period rate of return was 4.78%. The test period pro forma rate of return is 5.79% under present rates. Thus, the Company does not, on a pro forma basis for the test period, realize the 9.86% rate of return requested by the Company in this case.

Q. How much additional net operating income would be required for the State of Washington gas operations to allow the Company an opportunity to earn its proposed 9.86% rate of return on a pro forma basis?

A. The net operating income deficiency amounts to $5,372,000, as shown on line 5, page 2 of Exhibit No._____(DMF-2). The resulting revenue requirement is shown on line 7 and amounts to $8,635,000, or an increase of 6.21% over pro forma general business and transportation revenues.

III. <u>ALLOCATION PROCEDURES</u>

Q. Have there been any changes to the Company's system and jurisdictional procedures since the Company's last general gas case, Docket No. UG-991607?

A. No. For ratemaking purposes, the Company allocates revenues, expenses and rate base between electric and gas services and between Washington, Idaho, Oregon and California jurisdictions where electric and/or gas service is provided. The current methodology was implemented at the start of 1994 and has not changed. As a result of earlier reviews, the Staff has found that the allocation system was being applied properly and produced the proper allocation of financial data. Also as part of earlier reviews, Staff has stated that the Company's rate base was properly allocated between jurisdictions.

Q. Does that conclude your pre filed direct testimony?

A. Yes, it does.

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UG-04_______

EXHIBIT NO. ____ (DMF-2)

DON M. FALKNER

REPRESENTING AVISTA CORPORATION

AVISTA UTILITIES
GAS RESULTS OF OPERATION
WASHINGTON PRO FORMA RESULTS
TWELVE MONTHS ENDED DECEMBER 31, 2003
(000'S OF DOLLARS)

Line No.	DESCRIPTION	WITH PRESENT RATES: Actual Per Results Report	WITH PRESENT RATES: Total Adjustments	WITH PRESENT RATES: Pro Forma Total	WITH PROPOSED RATES: Proposed Revenues & Related Exp	WITH PROPOSED RATES: Pro Forma Proposed Total
	a	b	c	d	e	f
	REVENUES					
1	Total General Business	$132,469	$3,961	$136,430	$8,635	$145,065
2	Total Transportation	3,459	(837)	2,622		2,622
3	Other Revenues	2,183	0	2,183		2,183
4	Total Gas Revenues	138,111	3,124	141,235	8,635	149,870
	EXPENSES					
5	Exploration and Development					
	Production					
6	City Gate Purchases	91,098	6,387	97,485		97,485
7	Purchased Gas Expense	283	290	573		573
8	Net Nat Gas Storage Trans	0	0	0		0
9	Total Production	91,381	6,677	98,058	0	98,058
	Underground Storage					
10	Operating Expenses	342	1	343		343
11	Depreciation	309	0	309		309
12	Taxes	127	(9)	118		118
13	Total Underground Storage	778	(8)	770	0	770
	Distribution					
14	Operating Expenses	5,720	184	5,904		5,904
15	Depreciation	4,707	0	4,707		4,707
16	Taxes	11,437	(4,284)	7,153	332	7,485
17	Total Distribution	21,864	(4,100)	17,764	332	18,096
18	Customer Accounting	4,268	(74)	4,194	22	4,216
19	Customer Service & Information	2,747	(2,023)	724		724
20	Sales Expenses	489	13	502		502
	Administrative & General					
21	Operating Expenses	8,544	182	8,726	17	8,743
22	Depreciation	1,522	(191)	1,331		1,331
23	Taxes	22	2	24		24
24	Total Admin. & General	10,088	(7)	10,081	17	10,098
25	Total Gas Expense	131,615	478	132,093	371	132,464
26	OPERATING INCOME BEFORE FIT	6,496	2,646	9,142	8,264	17,406
	FEDERAL INCOME TAX					
27	Current Accrual	(857)	2,070	1,213	2,892	4,105
28	Deferred FIT	333	(8)	325		325
29	Amort ITC	(31)	0	(31)		(31)
						0
30	NET OPERATING INCOME	$7,051	$584	$7,635	$5,372	$13,007
	RATE BASE: PLANT IN SERVICE					
31	Underground Storage	13,712	0	13,712		13,712
32	Distribution Plant	191,970	2,261	194,231	0	194,231
33	General Plant	16,112	0	16,112		16,112
34	Total Plant in Service	221,794	2,261	224,055		224,055
	ACCUMULATED DEPRECIATION					
35	Underground Storage	6,495	0	6,495		6,495
36	Distribution Plant	60,239	0	60,239	0	60,239
37	General Plant	7,446	(289)	7,157		7,157
38	Total Accum. Depreciation	74,180	(289)	73,891		73,891
39	DEFERRED FIT	0	(22,438)	(22,438)		(22,438)
40	GAS INVENTORY	0	4,568	4,568		4,568
41	GAIN ON SALE OF BUILDING	0	(378)	(378)		(378)
					0	
42	TOTAL RATE BASE	$147,614	($15,698)	$131,916		$131,916
43	RATE OF RETURN	4.78%		5.79%		9.86%

AVISTA UTILITIES
Calculation of General Revenue Requirement
Washington - Gas System
TWELVE MONTHS ENDED DECEMBER 31, 2003
(000's OF DOLLARS)

Line No.	Description	
1	Pro Forma Rate Base	$131,916
2	Proposed Rate of Return	9.860%
3	Net Operating Income Requirement	$13,007
4	Pro Forma Net Operating Income	$7,635
5	Net Operating Income Deficiency	$5,372
6	Conversion Factor	0.622135
7	Revenue Requirement	$8,635
8	Total General Business Revenues	$139,052
9	Percentage Revenue Increase	6.21%

AVISTA UTILITIES
Revenue Conversion Factor
Washington - Gas System
TWELVE MONTHS ENDED DECEMBER 31, 2003

Line No.	Description	Factor
1	**Revenues**	1.000000
	Expense:	
2	Uncollectibles	0.002538
3	Commission Fees	0.001850
4	Washington Excise Tax	0.038422
5	Franchise Fees	0.000059
6	Total Expense	0.042869
7	Net Operating Income Before FIT	0.957131
8	Federal Income Tax @ 35%	0.334996
	REVENUE CONVERSION FACTOR	0.622135

AVISTA UTILITIES
GAS RESULTS OF OPERATION
WASHINGTON RESTATED RESULTS
TWELVE MONTHS ENDED DECEMBER 31, 2003
(000'S OF DOLLARS)

Line No.	DESCRIPTION	Per Results Report	Deferred FIT Rate Base	Deferred Gain on Office Building	Gas Inventory	Weatherization and DSM Investment	Customer Advances
	a	b	c	d	e	f	g
	REVENUES						
1	Total General Business	$132,469					
2	Total Transportation	3,459					
3	Other Revenues	2,183					
4	Total Gas Revenues	138,111	0	0	0	0	0
	EXPENSES						
5	Exploration and Development	0					
	Production						
6	City Gate Purchases	91,098					
7	Purchased Gas Expense	283					
8	Net Nat Gas Storage Trans	0					
9	Total Production	91,381	0	0	0	0	0
	Underground Storage						
10	Operating Expenses	342					
11	Depreciation	309					
12	Taxes	127					
13	Total Underground Storage	778	0	0	0	0	0
	Distribution						
14	Operating Expenses	5,720					
15	Depreciation	4,707					
16	Taxes	11,437					
17	Total Distribution	21,864	0	0	0	0	0
18	Customer Accounting	4,268			0	0	
19	Customer Service & Information	2,747					
20	Sales Expenses	489					
	Administrative & General						
21	Operating Expenses	8,544					
22	Depreciation	1,522					
23	Taxes	22					
24	Total Admin. & General	10,088	0	0	0	0	0
25	Total Gas Expense	131,615	0	0	0	0	0
26	OPERATING INCOME BEFORE FIT	6,496	0	0	0	0	0
	FEDERAL INCOME TAX						
27	Current Accrual	(857)					
28	Deferred FIT	333					
29	Amort ITC	(31)					
30	NET OPERATING INCOME	$7,051	$0	$0	$0	$0	$0
	RATE BASE: PLANT IN SERVICE						
31	Underground Storage	13,712					
32	Distribution Plant	191,970				2,275	(14)
33	General Plant	16,112					
34	Total Plant in Service	221,794	0	0	0	2,275	(14)
	ACCUMULATED DEPRECIATION						
35	Underground Storage	6,495					
36	Distribution Plant	60,239					
37	General Plant	7,446					
38	Total Accum. Depreciation	74,180	0	0	0	0	0
39	DEFERRED FIT	0	(22,570)	132			
40	GAS INVENTORY	0			4,568		
41	GAIN ON SALE OF BUILDING	0		(378)			
42	TOTAL RATE BASE	$147,614	($22,570)	($246)	$4,568	$2,275	($14)
43	RATE OF RETURN						

AVISTA UTILITIES
GAS RESULTS OF OPERATION
WASHINGTON RESTATED RESULTS
TWELVE MONTHS ENDED DECEMBER 31, 2003
(000'S OF DOLLARS)

Line No.	DESCRIPTION	Subtotal Actual	Revenue Normalization & Gas Cost Adjust	Eliminate B & O Taxes	Property Tax	Uncollectible Expense	Regulatory Expense Adjustment
	a	-	h	i	j	k	l
	REVENUES						
1	Total General Business	$132,469	$7,375	$ (3,414)			
2	Total Transportation	3,459	(770)	(67)			
3	Other Revenues	2,183					
4	Total Gas Revenues	138,111	6,605	(3,481)	0	0	0
	EXPENSES						
5	Exploration and Development	0					
	Production						
6	City Gate Purchases	91,098	6,387				
7	Purchased Gas Expense	283					
8	Net Nat Gas Storage Trans	0					
9	Total Production	91,381	6,387	0	0	0	0
	Underground Storage						
10	Operating Expenses	342					
11	Depreciation	309					
12	Taxes	127			(9)		
13	Total Underground Storage	778	0	0	(9)	0	0
	Distribution						
14	Operating Expenses	5,720					
15	Depreciation	4,707					
16	Taxes	11,437	254	(4,552)	(128)		
17	Total Distribution	21,864	254	(4,552)	(128)	0	0
18	Customer Accounting	4,268	17	0	0	(66)	0
19	Customer Service & Information	2,747	(2,023)				
20	Sales Expenses	489					
	Administrative & General						
21	Operating Expenses	8,544	12	1,191			(29)
22	Depreciation	1,522					
23	Taxes	22			2		
24	Total Admin. & General	10,088	12	1,191	2	0	(29)
25	Total Gas Expense	131,615	4,647	(3,361)	(135)	(66)	(29)
26	OPERATING INCOME BEFORE FIT	6,496	1,958	(120)	135	66	29
	FEDERAL INCOME TAX						
27	Current Accrual	(857)	685	(42)	47	23	10
28	Deferred FIT	333					
29	Amort ITC	(31)					
30	NET OPERATING INCOME	$7,051	$1,273	($78)	$88	$43	$19
	RATE BASE: PLANT IN SERVICE						
31	Underground Storage	13,712					
32	Distribution Plant	194,231					
33	General Plant	16,112					
34	Total Plant in Service	224,055	0	0	0	0	0
	ACCUMULATED DEPRECIATION						
35	Underground Storage	6,495					
36	Distribution Plant	60,239					
37	General Plant	7,446					
38	Total Accum. Depreciation	74,180	0	0	0	0	0
39	DEFERRED FIT	(22,438)					
40	GAS INVENTORY	4,568					
41	GAIN ON SALE OF BUILDING	(378)					
42	TOTAL RATE BASE	$131,627	$0	$0	$0	$0	$0
43	RATE OF RETURN	5.36%					

AVISTA UTILITIES
GAS RESULTS OF OPERATION
WASHINGTON RESTATED RESULTS
TWELVE MONTHS ENDED DECEMBER 31, 2003
(000'S OF DOLLARS)

Line No.	DESCRIPTION	Injuries and Damages	FIT	Restate Debt Interest	Payroll Clearing	blank	Eliminate A/R Expenses
	a	m	n	o	p	q	r
	REVENUES						
1	Total General Business						
2	Total Transportation						
3	Other Revenues						
4	Total Gas Revenues	0	0	0	0	0	0
	EXPENSES						
5	Exploration and Development						
	Production						
6	City Gate Purchases						
7	Purchased Gas Expense				2		
8	Net Nat Gas Storage Trans						
9	Total Production	0	0	0	2	0	0
	Underground Storage						
10	Operating Expenses						
11	Depreciation						
12	Taxes						
13	Total Underground Storage	0	0	0	0	0	0
	Distribution						
14	Operating Expenses				42		
15	Depreciation						
16	Taxes						
17	Total Distribution	0	0	0	42	0	0
18	Customer Accounting				23	0	(124)
19	Customer Service & Information						
20	Sales Expenses				3		
	Administrative & General						
21	Operating Expenses	(15)			24		
22	Depreciation						
23	Taxes						
24	Total Admin. & General	(15)	0	0	24	0	0
25	Total Gas Expense	(15)	0	0	94	0	(124)
26	OPERATING INCOME BEFORE FIT	15	0	0	(94)	0	124
	FEDERAL INCOME TAX						
27	Current Accrual	5	179	966	(33)		43
28	Deferred FIT		(8)				
29	Amort ITC						
30	NET OPERATING INCOME	$10	($171)	($966)	($61)	$0	$81
	RATE BASE: PLANT IN SERVICE						
31	Underground Storage						
32	Distribution Plant						
33	General Plant						
34	Total Plant in Service	0	0	0	0	0	0
	ACCUMULATED DEPRECIATION						
35	Underground Storage						
36	Distribution Plant						
37	General Plant						
38	Total Accum. Depreciation	0	0	0	0	0	0
39	DEFERRED FIT						
40	GAS INVENTORY						
41	GAIN ON SALE OF BUILDING						
42	TOTAL RATE BASE	$0	$0	$0	$0	$0	$0
43	RATE OF RETURN						

AVISTA UTILITIES
GAS RESULTS OF OPERATION
WASHINGTON RESTATED RESULTS
TWELVE MONTHS ENDED DECEMBER 31, 2003
(000'S OF DOLLARS)

Line No.	DESCRIPTION	Office Space Charges to Subs	Restate Excise/Franchise Taxes	Lease Expense Adjustment	Restated Total
	a	s	t	u	-
	REVENUES				
1	Total General Business				$136,430
2	Total Transportation				2,622
3	Other Revenues				2,183
4	Total Gas Revenues	0	0	0	141,235
	EXPENSES				
5	Exploration and Development				0
	Production				
6	City Gate Purchases				97,485
7	Purchased Gas Expense				285
8	Net Nat Gas Storage Trans				0
9	Total Production	0	0	0	97,770
	Underground Storage				
10	Operating Expenses				342
11	Depreciation				309
12	Taxes				118
13	Total Underground Storage	0	0	0	769
	Distribution				
14	Operating Expenses				5,762
15	Depreciation				4,707
16	Taxes		142		7,153
17	Total Distribution	0	142	0	17,622
18	Customer Accounting	0	0	0	4,118
19	Customer Service & Information				724
20	Sales Expenses				492
	Administrative & General				
21	Operating Expenses	(6)	(1,183)	31	8,569
22	Depreciation				1,522
23	Taxes				24
24	Total Admin. & General	(6)	(1,183)	31	10,115
25	Total Gas Expense	(6)	(1,041)	31	131,610
26	OPERATING INCOME BEFORE FIT	6	1,041	(31)	9,625
	FEDERAL INCOME TAX				
27	Current Accrual	2	364	(11)	1,381
28	Deferred FIT				325
29	Amort ITC				(31)
30	NET OPERATING INCOME	$4	$677	($20)	$7,950
	RATE BASE: PLANT IN SERVICE				
31	Underground Storage				13,712
32	Distribution Plant				194,231
33	General Plant				16,112
34	Total Plant in Service	0	0	0	224,055
	ACCUMULATED DEPRECIATION				
35	Underground Storage				6,495
36	Distribution Plant				60,239
37	General Plant				7,446
38	Total Accum. Depreciation	0	0	0	74,180
39	DEFERRED FIT				(22,438)
40	GAS INVENTORY				4,568
41	GAIN ON SALE OF BUILDING				(378)
42	TOTAL RATE BASE	$0	$0	$0	$131,627
43	RATE OF RETURN				6.04%

AVISTA UTILITIES
GAS RESULTS OF OPERATION
WASHINGTON RESTATED RESULTS
TWELVE MONTHS ENDED DECEMBER 31, 2003
(000'S OF DOLLARS)

Line No.	DESCRIPTION	Pro Forma Pension Adjustment	Pro Forma Insurance	Pro Forma Labor Non-Exec	Pro Forma Labor Executive	Pro Forma Benchmark Adjustment	Pro Forma Depreciation Adjustment
	a	PF1	PF2	PF3	PF4	PF5	PF 6
	REVENUES						
1	Total General Business						
2	Total Transportation						
3	Other Revenues						
4	Total Gas Revenues	0	0	0	0	0	0
	EXPENSES						
5	Exploration and Development						
	Production						
6	City Gate Purchases						
7	Purchased Gas Expense	(5)		10	9	274	
8	Net Nat Gas Storage Trans						
9	Total Production	(5)	0	10	9	274	0
	Underground Storage						
10	Operating Expenses			1			
11	Depreciation						
12	Taxes						
13	Total Underground Storage	0	0	1	0	0	0
	Distribution						
14	Operating Expenses	(105)		247			
15	Depreciation						
16	Taxes						
17	Total Distribution	(105)	0	247	0	0	0
18	Customer Accounting	(57)		133			
19	Customer Service & Information	(1)		1			
20	Sales Expenses	(8)		18			
	Administrative & General						
21	Operating Expenses	(60)	$200	122	(12)	46	
22	Depreciation						(191)
23	Taxes						
24	Total Admin. & General	(60)	200	122	(12)	46	(191)
25	Total Gas Expense	(236)	200	532	(3)	320	(191)
26	OPERATING INCOME BEFORE FIT	236	(200)	(532)	3	(320)	191
	FEDERAL INCOME TAX						
27	Current Accrual	83	$ (70)	(186)	1	(112)	67
28	Deferred FIT						
29	Amort ITC						
30	NET OPERATING INCOME	$153	($130)	($346)	$2	($208)	$124
	RATE BASE: PLANT IN SERVICE						
31	Underground Storage						
32	Distribution Plant						
33	General Plant						
34	Total Plant in Service	0	0	0	0	0	0
	ACCUMULATED DEPRECIATION						
35	Underground Storage						
36	Distribution Plant						
37	General Plant						(289)
38	Total Accum. Depreciation	0	0	0	0	0	(289)
39	DEFERRED FIT						
40	GAS INVENTORY						
41	GAIN ON SALE OF BUILDING						
42	TOTAL RATE BASE	$0	$0	$0	$0	$0	$289
43	RATE OF RETURN						

AVISTA UTILITIES
GAS RESULTS OF OPERATION
WASHINGTON RESTATED RESULTS
TWELVE MONTHS ENDED DECEMBER 31, 2003
(000'S OF DOLLARS)

Line No.	DESCRIPTION	Incentives Adjustment	Pro Forma Total
	a	PF 7	-
	REVENUES		
1	Total General Business		$136,430
2	Total Transportation		2,622
3	Other Revenues		2,183
4	Total Gas Revenues	0	141,235
	EXPENSES		
5	Exploration and Development		0
	Production		
6	City Gate Purchases		97,485
7	Purchased Gas Expense		573
8	Net Nat Gas Storage Trans		0
9	Total Production	0	98,058
	Underground Storage		
10	Operating Expenses		343
11	Depreciation		309
12	Taxes		118
13	Total Underground Storage	0	770
	Distribution		
14	Operating Expenses		5,904
15	Depreciation		4,707
16	Taxes		7,153
17	Total Distribution	0	17,764
18	Customer Accounting		4,194
19	Customer Service & Information		724
20	Sales Expenses		502
	Administrative & General		
21	Operating Expenses	(139)	8,726
22	Depreciation		1,331
23	Taxes		24
24	Total Admin. & General	(139)	10,081
25	Total Gas Expense	(139)	132,093
26	OPERATING INCOME BEFORE FIT	139	9,142
	FEDERAL INCOME TAX		
27	Current Accrual	49	1,213
28	Deferred FIT		325
29	Amort ITC		(31)
30	NET OPERATING INCOME	$90	$7,635
	RATE BASE: PLANT IN SERVICE		
31	Underground Storage		13,712
32	Distribution Plant		194,231
33	General Plant		16,112
34	Total Plant in Service	0	224,055
	ACCUMULATED DEPRECIATION		
35	Underground Storage		6,495
36	Distribution Plant		60,239
37	General Plant		7,157
38	Total Accum. Depreciation	0	73,891
39	DEFERRED FIT		(22,438)
40	GAS INVENTORY		4,568
41	GAIN ON SALE OF BUILDING		(378)
42	TOTAL RATE BASE	$0	$131,916
43	RATE OF RETURN		5.79%

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UG-04_______

EXHIBIT NO. ____ (DMF-3)

DON M. FALKNER

REPRESENTING AVISTA CORPORATION

AVISTA UTILITIES
GAS RESULTS OF OPERATION
WASHINGTON RESTATED RESULTS

Line No.	DESCRIPTION	2003 Pro Forma Total	1998 Test Year In Rates	Difference	Percentage	Cost Per Customer 2003 Pro Forma	Cost Per Customer 1998 Test Year	Difference	Percentage
	a	b	c	d	e	f	g	h	i
	Average Customers	128,935	114,098	14,837	13.00%	128,935	114,098	14,837	13.00%
	* Includes $1,672,000 rate increase impacts.								
	REVENUES								
1	Total General Business	$136,430	$73,307 *	$63,123	86.11%	$1,058.13	$642.49	$415.64	64.69%
2	Total Transportation	2,622	3,401	(779)	-22.91%	20.34	29.81	$ (9.47)	-31.77%
3	Other Revenues	2,183	1,952	231	11.83%	16.93	17.11	$ (.18)	-1.05%
4	Total Gas Revenues	141,235	78,660	62,575	79.55%	1,095.40	689.41	$405.99	58.89%
	Est Gross Margin - Line 4-Line 6-Line 16a	38,287	36,355	1,932	5.31%	296.95	318.63	$ (21.68)	-6.80%
	EXPENSES								
5	Exploration and Development								
	Production								
6	City Gate Purchases	97,485	39,245	58,240	148.40%	756.08	343.96	$412.12	119.82%
7	Purchased Gas Expense	573	121	452	373.55%	4.44	1.06	$3.38	318.87%
8	Net Nat Gas Storage Trans	0	0	0		0.00	0.00		
9	Total Production	98,058	39,366	58,692	149.09%	760.52	345.02	$415.50	120.43%
	Underground Storage								
10	Operating Expenses	343	319	24	7.52%	2.66	2.80	$ (.14)	-5.00%
11	Depreciation	309	320	(11)	-3.44%	2.40	2.80	$ (.40)	-14.29%
12	Taxes	118	101	17	16.83%	0.92	0.89	$.03	3.37%
13	Total Underground Storage	770	740	30	4.05%	5.97	6.49	$ (.52)	-8.01%
	Distribution								
14	Operating Expenses	5,904	4,025	1,879	46.68%	45.79	35.28	$10.51	29.79%
15	Depreciation	4,707	3,666	1,041	28.40%	36.51	32.13	$4.38	13.63%
16	Taxes-Excluding WA Excise Tax	1,690	1,115 *	575	51.57%	13.11	9.77	$3.34	34.19%
16a	WA Excise Tax (tracked in gross rev)	5,463	3,060 *	2,403	78.53%	42.37	26.82	$15.55	57.98%
17	Total Distribution	17,764	11,866	5,898	49.71%	137.77	104.00	$33.77	32.47%
18	Customer Accounting	4,194	2,948 *	1,246	42.27%	32.53	25.84	$6.69	25.89%
19	Customer Service & Information	724	588	136	23.13%	5.62	5.15	$.47	9.13%
20	Sales Expenses	502	302	200	66.23%	3.89	2.65	$1.24	46.79%
	Administrative & General								
21	Operating Expenses	8,726	7,292 *	1,434	19.67%	67.68	63.91	$3.77	5.90%
22	Depreciation and Amortization	1,331	1,124	207	18.42%	10.32	9.85	$.47	4.77%
23	Taxes	24	15	9	60.00%	0.19	0.13	$.06	46.15%
24	Total Admin. & General	15,501	12,269	3,232	26.34%	120.22	107.53	$12.69	11.80%
25	Total Gas Expense	132,093	64,241	67,852	105.62%	1,024.49	563.03	$461.46	81.96%
25a	Total Oper Exp excluding Gas Purchased	34,608	24,996	9,612	38.45%	268.41	219.07	$49.34	22.52%
25b	O&M and A&G Combined	20,393	15,474	4,919	31.79%	158.16	135.62	$22.54	16.62%
26	OPERATING INCOME BEFORE FIT	9,142	14,419	(5,277)	-36.60%	70.90	126.37	$ (55.47)	-43.89%
	FEDERAL INCOME TAX								
27	Current Accrual	1,213	1,528	(315)	-20.62%	9.41	13.39	$ (3.98)	-29.72%
28	Deferred FIT	325	2,093	(1,768)	-84.47%	2.52	18.34	$ (15.82)	-86.26%
29	Amort ITC	(31)	(31)	0	0.00%	(0.24)	(0.27)	$.03	-11.11%
30	NET OPERATING INCOME	$7,635	$10,829	($3,194)	-29.49%	$59.22	$94.91	$ (35.69)	-37.60%
	RATE BASE: PLANT IN SERVICE								
31	Underground Storage	13,712	14,091	(379)	-2.69%	$106.35	$123.50	$ (17.15)	-13.89%
32	Distribution Plant	194,231	153,910	40,321	26.20%	1,506.43	1,348.93	$157.50	11.68%
33	General Plant	16,112	12,868	3,244	25.21%	124.96	112.78	$12.18	10.80%
34	Total Plant in Service	224,055	180,869	43,186	23.88%	1,737.74	1,585.21	$152.53	9.62%
	ACCUMULATED DEPRECIATION								
35	Underground Storage	6,495	5,934	561	9.45%	50.37	52.01	$ (1.64)	-3.15%
36	Distribution Plant	60,239	40,743	19,496	47.85%	467.20	357.09	$110.11	30.84%
37	General Plant	7,157	5,106	2,051	40.17%	55.51	44.75	$10.76	24.04%
38	Total Accum. Depreciation	73,891	51,783	22,108	42.69%	573.09	453.85	$119.24	26.27%
39	DEFERRED FIT	(22,438)	(10,090)	(12,348)	122.38%	(174.03)	(88.43)	$ (85.60)	96.80%
40	GAS INVENTORY	4,568	1,458	3,110	213.31%	35.43	12.78	$22.65	177.23%
41	GAIN ON SALE OF BUILDING	(378)	(535)	157	-29.35%	(2.93)	(4.69)	$1.76	-37.53%
42	TOTAL RATE BASE	$131,916	$119,919	$11,997	10.00%	$1,023.12	$1,051.02	$ (27.90)	-2.65%
43	RATE OF RETURN	5.79%	9.03%						