Since the summer of 2011, the Region has grappled with the fact that BPA' spending on energy efficiency projects in fiscal year 2011 far exceeded our budget. In July 2011, as the severity of the energy efficiency budget overspend emerged, BPA commissioned an independent report from Moss-Adams to review what had happened and to discover lessons BPA could learn to improve our business practices and ensure a similar circumstance would not happen again. BPA has remained steadfastly focused on the BPA shortcomings identified in the report which is made available below.

As the report notes the Energy Efficiency Incentive (EEI) structure developed in concert with our customers and other interested parties already establishes a budget regimen for 2012 and beyond that was lacking under our previous approach. We now have clearly established both an overall BPA budget and the amounts that are available to each customer. BPA has also added improved budget management and reporting as a part of Energy Efficiency's key agency targets for this fiscal year and has made operational a new budget tracking system, EE Tracker that greatly enhances BPA's ability to manage and track the details of our budgets. In addition the Energy Efficiency organization has been incorporated into BPA's power organization which provides an additional level of oversight on our budgets as well as providing better alignment on resource acquisition decisions.

As you peruse the report know that BPA does not feel that the reference on the fourth page of the document regarding self-funding should be taken to mean that utilities were to blame as BPA believes it is accountable for the budget overspend. BPA asked for the report to obtain an independent review of the actions BPA should take, and that remains our focus. We look forward to continuing to partner with our customers to deliver savings and to help us make improvements to the EEI approach as we both gain experience under the delivery mechanism. BPA's backstop role would continue similar to today. BPA will provide a full complement of programs, which will be bolstered by individual utility programs. This has been sufficient historically to achieve and often exceed the public's share of the regional target. If the programs in place at any given time are insufficient to achieve the necessary level of savings, then new programs, as well as looking at other avenues, would be explored and evaluated, to meet the targets.

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Acumen. Agility. Answers.

December 6, 2011

Re: BPA Conservation Program Lessons Learned

At the Bonneville Power Administration's (BPA) request, we have performed interviews of Subject Matter Experts and Energy Efficiency (EE) staff to determine the lessons learned in the overspending of the Conservation Budget for FY 2011. Moss Adams ("we", "us", our" and "Consultant") performed our review in accordance with Statements on Standards for Consulting Services established by the American Institute of Certified Public Accountants (AICPA).

Engagement Objectives and Overview of Results
The primary objective of the procedures was to determine the lessons learned in the overspending of the conservation budget for FY 2011.

Historical Context
The Northwest Power and Conservation Council (Council) initiated an aggressive 6th power plan aMW savings targets. In response to this power plan, the regional goals doubled in two short years and EE purposefully expanded the portfolio of measures and introduced third party programs in order to achieve BPA's share of the regional targets. BPA had experienced a long history of not being invoiced for the amount of capital made available which led to a lower start of FY 2011 budget from expected spending. Because of the extended track record of customers not fully utilizing the budget amounts provided, the high level of self funding in FY 2010 and an expectation (because of customer comments made during the Post 2011 public process) of continued self funding, EE had reasons to believe the goal would be met via the availability of a variety of funding options.

Megawatts Focused
It must also be noted that the focus of the Conservation Department was on achieving energy savings. EE understood that entering into the Post 2011 environment is an untested model with limited ability to move funds to where the conservation potential exists and that EE's strategy was to buy resources ahead of this change, because (1) this would position them well for meeting the five year target and (2) by buying sooner conservation could be acquired at a lower cost. According to staff, EE's balanced scorecard is all green given their Megawatt and cost targets were met. Per information provided by the Conservation Department, targeted dollar per aMW was $2.2 million, while actual

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dollar per aMW was $1.7 million. BPA planned to save 99 aMW and as of October 1, 2011, aMW savings are estimated to be 117. The region has received a valuable long-term resource for the investment made.

FY 2011 Budget

The BPA Conservation Budget for FY 2011 was initially set at $80 million, however EE's internal assessment was $106 million. EE also anticipated that customers would self-fund 22 aMW worth approximately $44 million. Given that context, the total expected spending was approximately $150 million. The difference between the $106 million internal assessment and the $80 million budget was primarily due to an evaluation of historical savings. As the conservation department had consistently ran under the aMW savings and budget, the expectation was the same would occur in the current year. When determining expected spending, the conservation department was managing to their 5-year budget. As it was understood that allocation of spending were changing in FY 2012, the spending plan was front loaded in order to achieve significant aMW savings in the early part of the 5-year period.

In May of 2011, an additional $35 million was approved increasing the budget to $115 million. This increase in budget reduced future year's budgets and spending authority. Actual spending for FY 2011 is estimated to be approximately $47 million over the FY 2011 budget.

We conducted interviews of selected individuals throughout BPA who were identified as subject matter experts and EE staff to determine the lessons learned.

Observations

In FY 2011, a "perfect storm" of events appeared to have occurred. First, internal funding of conservation efforts by the utilities significantly decreased, most likely due to the economy and their own rate pressures. Second, spending allocation methods were changing significantly starting October 1, 2012. The new spending allocation were based on a Utility's consumption and individual utilities would not be able to exceed their allocated amount, therefore, it appears that utilities took advantage of the existing program to get conservation spending completed. Also, an aggressive aMW savings goal had been initiated by Council.

Lessons Learned

Identification of primary driver of conservation department

There are two competing principles in the conservation department: aMW savings and dollars spent. In FY 2011, the Conservation group had the single largest aMW savings target to deliver to the region. Therefore, an aggressive conservation program was implemented. There were indications throughout the year that the initial $80 million budget would be overspent. This appeared to be due to lack of internal funding by the Utilities and new third party programs that had been initiated in order to meet the aMW savings goal. An increase in the budget was not passed until May 2011, which increased the budget to $115 million. Actual spending exceeded the $115 million budget in August 2011. As the conservation group did not know what the increase in budget would be, business was conducted as if the budget dollars would be present. It should also be noted that budget certainty is a fixture of the Post 2011 model.

> ***Lessons Learned***: Though aMW savings are important, conservation efforts should remain within the budget. If the budget is going to be breached, immediate action should be taken to increase the budget, or approval of additional measures should be ceased until budget approval occurs. Also, we recommend EE's balanced scorecard should include a measure to budget.

Connection of conservation programs to the economic environment and future changes to the program

Management did not appear to connect management of the conservation programs (ie. Authorizing programs over the budget) to the current economic environment and upcoming changes to the program. In hindsight, there was a direct correlation between overspending the budget and the lack of expected self funding by the utilities (economic environment) and upcoming changes in the contract.

> ***Lessons Learned***: The current economy and significant changes to program should be taken into consideration when managing the program.

Discrepancy between budget and spending plan

EE's internal assessment at the beginning of FY 2011 exceeded the budget by approximately $26 million. Though it was exceeded, the spending patterns noted above were expected to reduce actual spending. It appears the internal assessment was used as a game plan for conservation efforts.

> ***Lessons Learned***: The budget and the internal assessment should be tied more closely together. If the internal assessment exceeds the budget, this assessment should be modified to reflect the budget.

Self funding by utilities

The self funding of the utilities fell extremely short of expectations of $44 million; however, BPA had very little ability to stimulate self funding activities to meet their overall aMW savings goals. Prior to FY 2012, the Utilities completed rate credit reports in April and October. These reports provided BPA with utilities self-funded results.

> ***Lessons Learned***: Consideration should be made to holding utilities accountable for their portion of aMW savings or have a mechanism in place to adjust the rate schedule if self funding is not occurring. Also, the reporting mechanism to BPA was not sufficient. By the time April 2011 results were compiled and BPA knew that self-funding was not occurring as expected, it was late in their fiscal year. Our recommendation is that reporting be completed to BPA monthly on utilities self funding. We have noted that a new system called EE Central is in development and utilities will be required to complete both requests for funds and self-funding amounts prior to invoicing. This will allow BPA to incorporate self-funding results in their management analysis tools on a timely basis.

Authorized measures vs. actual spending – timing differences

There is significant complexity of managing a regional wholesale conservation acquisition activity. BPA offers a portfolio of options to its regional preference customers who make individual capital investment decisions with the funding made available. BPA's portfolio is based in part upon the principle of "local control". That is, BPA customers design and offer programs in their service areas, they decide the level of marketing, and the incentive levels they will pay in their service areas. It is difficult to predict the possible permutations of invoicing that could occur. Therefore, predicting with absolute certainty the amount that would be invoiced in a given period of time is difficult.

For FY 2011, there did not appear to be a sufficient tracking system between authorized measures and when the funding will be expected to occur. Though such a report would not provide absolute certainty when spending will occur, it would identify trends in spending which would provide additional information to

management. Also, once a measure has been authorized, contracts did not provide a specified period of time when the measures will be funded by BPA. However, the allocation structure put in place for the Post 2011 provides a solution to this issue as customers can only spent what has been allocated to them. EE has is developing systems (EE Central and EE Tracker) that provide a greater level of budget and expenditure related information.

> ***Lessons Learned***: If BPA reverts back to an allocation system consistent to FY 2011, we recommend a high level tracking system be implemented that would track authorized measures and the probability of funding to determine if expected spending is within the budget. Though this would not provide absolutely certainty of spending levels, it would provide a look-forward forecast focusing on spending. BPA could also consider changing contracts to define a period of time that spending can occur, especially if the actual programs may be completed in multiple years.
>
> We believe that the new allocation methodology adopted for FY 2012 provides significant control on the amount of money BPA will make available for spending in a given period.

Accounting function

The conservation department does not have an external accounting function to track authorizations and actual spending.

> ***Lessons Learned***: We recommend an external accounting function that monitors conservation activity be implemented and reports directly to the Power Department.

Communication – transparency

Once the conservation department staff noticed overspending would occur, there did not appear to be timely communication to all levels of senior management. Warning signs were communicated by staff in December 2010; however, budget action did not occur until May 2010. There also appeared to be a lack of transparency to management in the amount of overspending that would occur.

> ***Lessons Learned***: Reports to senior management indicating authorized amounts, expected funding and anticipated aMW savings should be provided to the CEO, CFO and Energy Manager on a monthly basis. We recommend

that the new reporting systems initiated by the conservation department be used to provide timely reports to senior management.

Communication – staff

Though staff communicated budget overruns in December 2010, there did not appear to be appropriate communication between the team members in the conservation department as key personnel were not made aware of the amount of the budget increase until after it had passed. Once this was made known in May 2011, conservation staff were significantly concerned that spending would exceed the increased budget amount. This prompted the EE team to develop bottoms up forecast driven by authorized measures to determine if anticipated spending would exceed the current $115 million budget. This document was completed in June 2011 and the forecast for FY 2011 was $175 million. Staff worked with customers to reduce spending, and were successful to some extent, however, spending had already been approved. A revised forecast was prepared and certain measures were discounted by management. This revised forecast was $143 million, which exceeded the $115 million budget.

Lessons Learned: We recommend that budget become a part of the conservation department's balanced scorecard and these results are provided to all staff and senior management in a timely fashion. Communication should ensure that all personnel from management to staff are heading in the same direction.

aMW savings – exceeded expectations

Throughout this process it must be noted that the Conservation Department exceeded their annual aMW savings goal (99 aMW). As of _October 1, 2011, estimated aMW savings was 117. The measures implemented by the Conservation Department were also very cost efficient, approximately $0.5 million per aMW cheaper than expected. These savings created a valuable long-term resource for the investment made.

Lessons Learned: Exceeding the aMW savings goal should be celebrated, especially with a low cost per aMW savings. However, it is imperative that an eye always be kept on the budget and expected funding.

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Conclusion

There were many lessons learned through FY 2011. Many of the budget issues will be resolved in FY 2012 and beyond due to the allocation methodology that has been implemented.

The sufficiency of the procedures is solely the responsibility of BPA. Consequently, we make no representation regarding the sufficiency of the procedures performed in this engagement. We were not engaged to, and did not conduct an audit, examination or other attestation engagement under AICPA generally accepted auditing standards or standards applicable to attestation engagements, the objective of which would be the expression of an opinion on the transactions reviewed. Accordingly, we do not express such an opinion.

We appreciate your assistance and involvement in this engagement. We look forward to discussing with you further should you have any questions.

Very truly yours,

Moss Adams LLP

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