B O N N E V I L L E   P O W E R   A D M I N I S T R A T I O N

Financial Reserves Workshop

March 11, 2019

AGENDA

- Reserves review recap – where are we
- Business unit cash split review
- Review IPAC findings
- Share leanings for correction
- Financial Reserve Policy
- Next steps

SUMMARY

- During the detailed review of the financial reserves forecasting process, one focus area was the process for allocating cash by business unit.
- Our analysis found a cash allocation issue for a certain type of transactions in the cash split model. A full review revealed reserves misallocations from 2002 through 2018 for most federal to federal payments for goods and services.
- The total impact is approximately $300 million from 2002, more when interest is considered.
- Internal audit is working on validation of misallocated amounts; a secondary review will be completed by an external party.

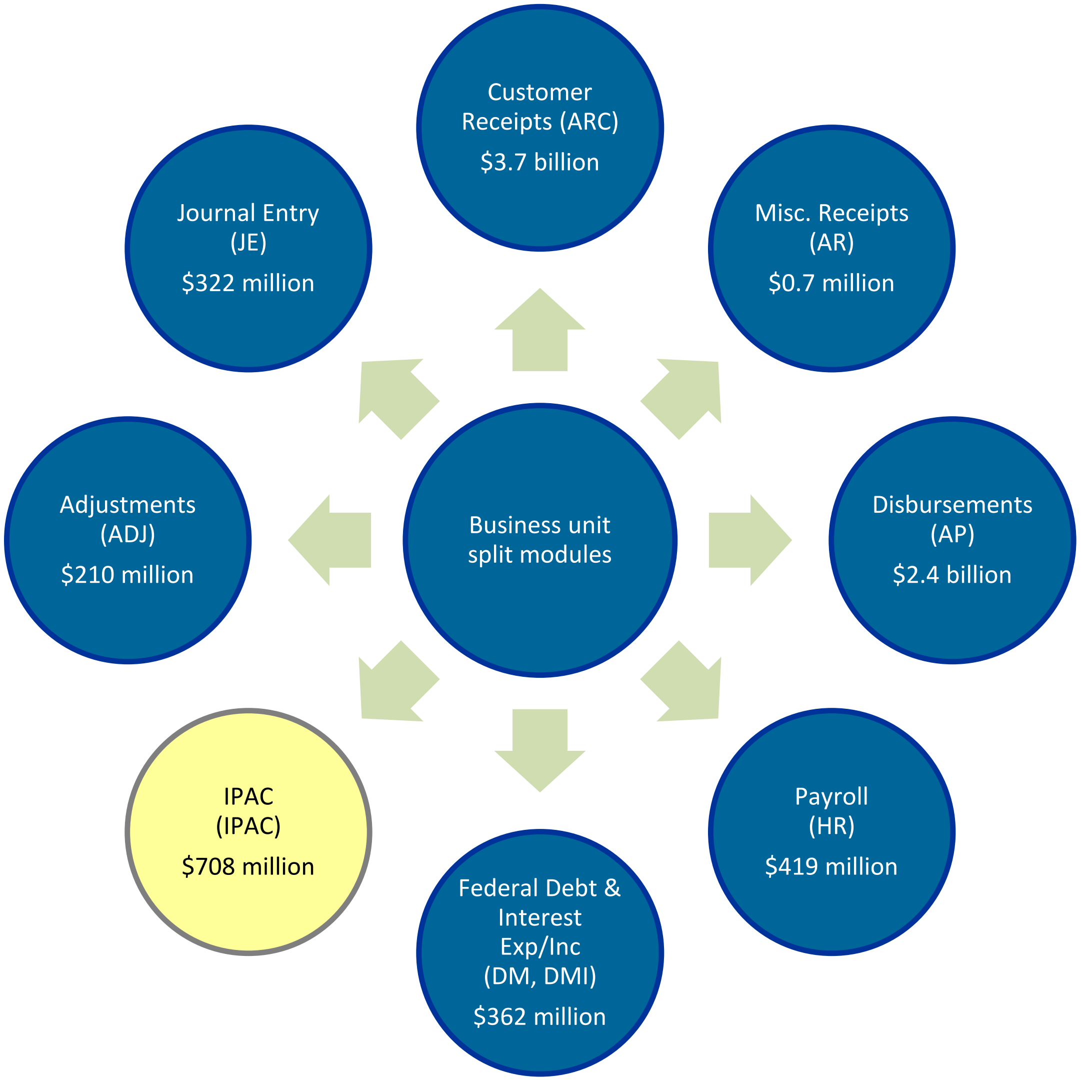
RESERVES RECAP – WHERE ARE WE

- **July 28, 2018:** Discovered $70 million forecast reserves error reported at Q3 Quarterly Business Review.
- **Sept. 28, 2018:** Discovered $36 million forecast reserves error in prepping for reserves distribution clause workshop. Error reported at workshop.
- **October 2018:** BPA kicks off multi-phased reserves review; team is assembled and scoping begins.
- **November 2018:** Scoping work reveals a critical model used for the allocation of cash between Power and Transmission -- the ***business unit split*** model. At the end-of-year QBR, BPA discusses reserves review including digging into actuals and allocations.
- **Late January 2019:** Review reveals an error in one of the allocations in the business unit split model – allocations pertaining to federal to federal transactions made through the intergovernmental payments and collections (IPAC) system.
- **Feb. 19, 2019:** BPA announced $200+ million allocation error discovered in phase one of the review process. Review ongoing.
- **March 11, 2019:** Public meeting to share IPAC allocation error findings, proposal to correct and next steps.

BUSINESS UNIT CASH SPLIT – BACKGROUND

- BPA does not maintain separate cash accounts for Power and Transmission.
- In the early 2000s, BPA undertook a new effort to “split” cash between Power and Transmission outside of the accounting system.
- The process, termed the business unit split, was intended to mimic how transactions were split between the Power and Transmission income statements.
- Records of the business unit split report date back to 2002. However, fiscal year 2002 and 2003 reports show limited annual data only.
- Beginning in FY 2004, the monthly details of the receipts, disbursements and adjustments are available in each report for each fiscal year.
- The process was automated in 2015. The model automated the manual process of querying and assembling data, with continued embedded assumptions.

APPROACH TO BUSINESS UNIT SPLIT REVIEW – HIGH-LEVEL OVERVIEW



The business unit split model has a number of modules that automatically generate output each month. As a result, the review approach was:

- Gain an understanding of what happens in each module. Use a risk-based approach to determine areas to validate.
- Focus areas include Corporate-allocated amounts, manual entries, and other areas deemed higher risk.
- Compare amounts/output from each module to income statement records to determine whether differences exist.
- Employ additional reviews of work. BPA's internal audit is performing a review for completeness and reasonableness. An external firm will also perform this check.

Module refers to a category of cash transactions.

Amounts shown in diagram are FY 2018 figures.

IPAC MODULE FINDINGS

IPAC

IPAC is the intergovernmental payments and collections system used to perform financial transactions between federal agencies (e.g., BPA pays Bureau of Land management for the purchase of property). Transactions associated with Power, Transmission and Corporate flow through this system.

- The review showed there was an error in how transactions processed through the IPAC system were allocated in the business unit split of agency reserves. IPAC transactions were allocated 100 percent to Power in all instances except for one large transaction in 2010.

- The IPAC allocation issue has resulted in average of $18 million per year of Transmission-related costs being erroneously deducted from Power's financial reserves. Thus, reserves attributed to Power were lower than they should have been.

- The review has validated that this error dates back to FY 2004. The error results in Power Services paying for roughly $277 million of Transmission-related costs over this period – based on what we know today. See the following slide for more details.

- The review has not uncovered any impacts to its combined audited financial statements.

IPAC DETAILED FINDINGS

Table 1: Summary of amounts erroneously deducted from Power reserves

	A	B	C	D	E	F		G
Fiscal Year	Corp Allocated Amts to Transmission /1	Worker's Comp IPAC Payments	IPAC Payments Costed Directly to Transmission	GSA Fleet - Transmission Costs	Adjustments for Amts Correctly Assigned	Total Amount Erroneously Deducted from Power Reserves (A+B+C+D)		Cumulative Amounts - Starting in FY18
2002	5,663,668	3,016,982	730,374	5,375,302	-	14,786,326		305,853,818
2003	5,407,337	3,225,566	770,412	5,097,841	-	14,501,156		291,067,492
2004	5,265,130	3,192,098	1,491,966	5,047,443	-	14,996,638		276,566,336
2005	5,163,043	3,307,567	1,167,854	5,264,142	-	14,902,606		261,569,698
2006	4,671,563	3,244,677	1,109,514	5,317,569	-	14,343,323		246,667,093
2007	6,405,408	3,593,991	1,073,008	5,758,320	-	16,830,726		232,323,770
2008	5,361,687	3,549,435	1,147,212	5,981,200	-	16,039,533		215,493,043
2009	5,197,109	3,206,273	4,273,585	5,374,351	-	18,051,318		199,453,511
2010	5,705,231	3,476,044	19,587,115	6,176,271	(16,184,318)	18,760,342	*	181,402,193
2011	8,465,224	3,118,967	3,538,301	6,324,314	-	21,446,806		162,641,850
2012	8,468,394	3,185,733	1,088,989	6,445,469	-	19,188,584		141,195,044
2013	8,809,726	3,366,742	2,613,271	6,233,622	-	21,023,361		122,006,460
2014	10,043,721	3,246,481	2,143,569	6,173,879	-	21,607,651		100,983,099
2015	8,689,172	3,074,754	2,444,018	5,743,216	-	19,951,160		79,375,448
2016	7,406,354	3,423,041	3,091,715	5,930,921	-	19,852,032		59,424,288
2017	7,922,869	2,851,687	3,585,206	5,747,502	-	20,107,265		39,572,257
2018	7,535,465	2,986,693	2,772,802	6,170,032	-	19,464,992		19,464,992
	$ 116,181,100	$ 55,066,732	$ 52,628,911	$ 98,161,393	$ (16,184,318)	$ 305,853,818		

* In FY2010, one large Transmission transaction for $16.2 million, paid via IPAC, was correctly charged to Transmission in the business unit split model.

See Appendix A for more details on Table 1.

CONSIDERATION FOR CORRECTION

- Principal considerations: period over which to apply correction on misallocated amounts:
  - FY 2002 – 2018 = $306 million
  - FY 2004 – 2018 = $277 million ✓
- Interest considerations: All funds in the Bonneville Fund earn interest. Interest income on misallocated funds was attributed to Transmission rather than Power.
  - Methods considered for calculating interest income:
    - No interest.
    - Simple interest calculated on misallocated amounts by fiscal year, with no compounding
    - Simple monthly interest on cumulative misallocated amounts, with no compounding ✓
    - Full monthly compounding on interest and cumulative misallocated amounts
  - Interest <u>rate</u> options considered:
    - Interest rate applied in rate cases ✓
    - Actual effective rate earned on the Bonneville Fund

✓ Refers to BPA's initial leaning.

INITIAL LEANING FOR CORRECTION

- Transfer reserves from Transmission to Power in the amount of $330 million (principal of $277 million plus interest of $54 million).

- Key points of consideration
  - Action most aligns with making Power whole.
  - Balances rate case methodology and actual results in financial statements.
  - Auditable and traceable.

Table 2: Interest Calculation Options Based on Initial Proposal Reserves Forecast

	A	B	C	D	E	F	G
	2004 - 2018						
		P & I Compounded (in $mil)	Days Cash	P Compounded (in $mil)	Days Cash	Simple (in $mil)	Days Cash
1	Power Initial Proposal*	$ 48	9	$ 48	9	$ 48	9
2	Principal	$ 277	54	$ 277	54	$ 277	54
3	Interest	$ 64	12	$ 54	10	$ 10	2
4	Total P & I	$ 340	66	$ 330	64	$ 287	56
5	Total after Adjustment	$ 388	76	$ 378	74	$ 335	65
	TRANSMISSION						
6	Transmission Initial Proposal*	$ 539	319	$ 539	319	$ 539	319
7	Total after Adjustment	$ 199	118	$ 209	124	$ 253	149

* Initial Proposal EOY FY19 forecast Reserves for Risk produced at SOY FY19

FINANCIAL RESERVES POLICY

- The Financial Reserves Policy (FRP) established lower financial reserve thresholds for Power Services and Transmission Services of 60 days cash on hand.
  - For Power Services, 60 days cash is approximately $300 million.
  - For Transmission Services, 60 days cash is approximately $100 million.
- The FRP is implemented through the FRP surcharge. As proposed, the FRP surcharge is calculated in November and triggers based on each business unit's ending financial reserves (as measured with accumulated calibrated net revenue) for the prior fiscal year. Thus, whether the FRP surcharge will trigger for FY 2020 depends on the business unit's ending FY 2019 financial reserves (as measured with ACNR).
- FRP surcharge is dynamic; it only collects the amount needed to build financial reserves up to the business unit's 60-day lower threshold.
  - For example, if Power Services ended FY 2019 with $290 million in financial reserves, then the FRP surcharge would trigger in December 2019 for $10 million, and power rates would increase for the remainder of FY 2020.
- The FRP surcharge has a *de minimis* threshold of $5 million.

IMPACT OF ERROR ON RATES

- Interest income in both power and transmission rates has been affected by the error. The amounts are relatively small compared to overall power and transmission revenue requirements.

- Assessing other potential impacts is more speculative because many factors may have affected previous rate case decisions.
  - Power rates – cost recovery adjustment clause in 2006; planned net revenues for risk in 2007, 2008, 2018 and 2019.
  - Transmission rates have been settled several times during the impacted period and it is difficult to know how this error would or would not have impacted the decisions to settle in those proceedings.

- Given the relatively small impact of changes in interest income, and the speculation associated with assessing other potential rate impacts, BPA is not proposing to make any specific adjustments to rates to attempt to account for impacts of the error in prior rate proceedings.

NEXT STEPS ON CORRECTION

- Public comment period on the initial leaning for the IPAC error correction closes Tuesday, April 9. BPA is looking for comments on:
  - How far the error should be corrected (2002 v. 2004).
  - If and how interest should be applied to the error (options on slide 9).
- BPA believes this presentation covers those questions submitted in advance. However, if customers still have questions, please submit to communications@bpa.gov by Friday, March 15. BPA intends to post responses to the Financial Reserves Review webpage no later than Friday, March 29.
- BPA will review and consider public comments on the IPAC error correction. The decision will be incorporated into the second quarter reserves forecast.
- BPA will publish the forecast on Friday, April 26, in the Quarterly Financial Package and it will be addressed in the April 30 Quarterly Business Review.

NEXT STEPS FOR REVIEW PROCESS

- Historic reserves review
  - Complete review of remaining business unit split modules.
  - Secondary review by BPA internal audit and external third-party.
  - Anticipate phase one completion prior to second public meeting in May.
- End-of-year reserves forecast review
  - Scope will include process and control recommendations.
  - End-of-year FY 2019 reserves forecast will be presented at Q2 Quarterly Business Review.
  - Forecast will incorporate the administrator's final decision on the retroactive correction for the IPAC allocation error.

FINANCIAL DISCLOSURE

This information was made publicly available on March 7, 2019, and contains information not sourced directly from BPA financial statements.

APPENDIX A

Table 1 on slide 5 contains data directly from BPA's financial system, showing the IPAC amounts that were reflected in Transmission's Income Statement and the agency's balance sheet.

Because of the IPAC allocation error in the Business Unit Split model, on a cash/reserves basis, these amounts were erroneously deducted from Power's financial reserves. Table components:

- Column A: The Transmission portion of Corporate IPAC payments; Transmission portion is based on the Corporate G&A allocation rates.
  - FY09 - FY18: To determine Transmission's portion of Corporate IPAC costs, for each transaction, applied the applicable allocation rates in place for the fiscal year and allocation pool. While the overall rate varied by year, in total, the average allocation rate was 60%.
  - FY02 – FY08: BPA records retention policy for G&A allocation rates documentation is 10 years. Because the usual published G&A allocation documentation was not available, applied the overall average 60% allocation rate from FY09- FY18 to Corporate IPAC charges in the FY02-FY08 period to derive Transmission's portion. Continuing to pursue other methods to obtain the actual rates; if obtained, numbers will be updated.
- Column B: Worker's Compensation is a Transmission-related cost and flows through Transmission's income statement.
- Column C: IPAC payments costed directly to Transmission in financial statements. Examples goods/services purchased: fuel purchases, rights of way payments, NEPA services, and vegetation management.
- Column D: GSA Fleet-related Transmission costs attributed to Transmission in financial statements. GSA Fleet costs are attributed to Power and Transmission based on usage. Due to its large geographic territory, Transmission is the predominate user of fleet vehicles.
- Column E: Shows Transmission costs that were correctly assigned in the Business Unit Split model. As shown, only in one year were any Transmission-related costs correctly assigned in the cash model. In FY2010, one large Transmission transaction for $16.2M, paid via IPAC, was charged to Transmission in financials and in the BU Split model. The transaction was for the purchase of land by Transmission from the Department of Interior, Bureau of Indian Affairs.

APPENDIX B – CORRECTION FIGURES FY 2002-2018

Table 3 below shows the interest income results under the three methods considered based on misallocated principal amounts from FY02 – FY18.

Table 3: Interest Calculation Options Based on Initial Proposal Reserves Forecast

	A	B	C	D	E	F	G
	2002 - 2018						
		P & I Compounded (in $mil)	Days Cash	P Compounded (in $mil)	Days Cash	Simple (in $mil)	Days Cash
1	Power Initial Proposal*	$ 48	9	$ 48	9	$ 48	9
2	Principal	$ 306	60	$ 306	60	$ 306	60
3	Interest	$ 91	18	$ 73	14	$ 12	2
4	Total P & I	$ 397	77	$ 379	74	$ 318	62
5	Total after Adjustment	$ 445	87	$ 427	83	$ 366	72
	TRANSMISSION						
6	Transmission Initial Proposal*	$ 539	319	$ 539	319	$ 539	319
7	Total after Adjustment	$ 143	84	$ 161	95	$ 221	131

* Initial Proposal EOY FY19 forecast Reserves for Risk produced at SOY FY19