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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF IDAHO POWER COMPANY FOR AN ACCOUNTING ORDER CLARIFYING THE ACCOUNTING FOR FUTURE PENSION OBLIGATIONS	**CASE NO. IPC-E-07-7** **COMMENTS OF THE COMMISSION STAFF**

The Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Donovan E. Walker, Deputy Attorney General, in response to Order No. 30287, the Notice of Application and Notice of Modified Procedure issued on March 29, 2007, respectfully submits the following comments.

BACKGROUND

On March 20, 2007, Idaho Power Company filed an Application seeking an accounting order to clarify the accounting for future pension obligations.

Idaho Power is seeking an Order authorizing it to: (1) change from accrual to cash accounting to determine future contributions to defined benefit pension plans; and (2) defer future defined benefit pension plan contributions and record them as regulatory assets with ratemaking treatment of such regulatory assets to be determined in subsequent revenue requirement

requirement proceedings. The Company states that it is not requesting current approval of future ratemaking treatment of deferred expenses associated with the Company's defined benefit pension plans, but is only requesting authority to implement regulatory accounting practices.

Idaho Power accounts for defined benefit pension expense in accordance with Statement of Financial Accounting Standards 87 (SFAS/FAS 87). The Company states that in its 2003 general rate case, IPC-E-03-13, the Commission did not allow the accrued SFAS 87 amount to be included in the Company's revenue requirement; however, the Commission did not direct the Company to change to a cash method to account for defined benefit pension expense. Additionally, the Company refers to Case No. UWI-W-04-04 where United Water utilized the SFAS 87 accrual methodology, and the Commission determined that using actual cash contributions, not accrued obligations, was the appropriate way to determine the amount to recover in rates for the defined benefit pension expense.

STAFF ANALYSIS

Staff has reviewed the Company's Application and accompanying testimony of Lori Smith, along with the records of Case No. IPC-E-03-13 resulting in Order No. 29505 and Case No. UWI-W-04-4 resulting in Order No. 29838 as both were referenced by the Company. Staff's comments are intended to provide the Commission with additional background regarding the Company's treatment of pension expense, the purpose and effects of the Company's Application as well as additional concerns regarding the Company's Application. Ultimately Staff will recommend that the Commission approve the Company's request to capitalize SFAS 87 amounts as a regulatory asset, thus removing it from the income statement, but deny the Company's second request to defer future cash contributions.

Statement of Financial Accounting Standards No. 87 (SFAS 87) was issued by the Financial Accounting Standards Board in 1987 to, among other things, provide a consistent basis for which publicly traded companies accounted for pension expenses. Prior to 1987, companies had a variety of options when recording pension expense making it difficult for users of financial statements to adequately compare the expenses, and thus earnings, of one company to another. The Company implemented the statement by accruing the Net Periodic Pension Cost, as calculated under SFAS 87 and synonymous with SFAS 87 Expense, as an expense on the income statement, while contributing the minimum required cash contributions as calculated under the

Employee Retirement Income Security Act of 1978 (ERISA). The difference between those two calculations is significant.

Following the 1994 general rate case, the Company's first general rate case since the implementation of SFAS 87, the Company began recovering from customers $2,036,000 annually for pension expense. The Company's 1994 SFAS 87 was actuarially calculated at $3,040,000, however only $2,036,000 was expensed. The remaining $1,003,200 was capitalized as overhead labor, allowing the Company to receive an annual return on the remaining amount plus the annual depreciation expense associated with the pension expense included in capitalized overhead. The Company's treatment of pension expense was not contested in that case and Staff was silent on the issue.

In Idaho Power's next general rate case (Case No. IPC-E-03-13, in 2003) increasing pension expense, among other reasons, was cited as the main driver for the need to raise rates. Though Idaho Power states in its current Application that it included accrued SFAS 87 pension expenses in the IPC-E-03-13 case, it was actually Idaho Power that initially proposed to abandon SFAS 87 for rate recovery, requesting an additional $2,170,160 in pension expense by suggesting that Service Cost is a more appropriate measure of expense to be recovered by customers. This was despite the Company not being permitted to contribute any cash to the plan for the previous eight years due to a significant over-funding originating from better than anticipated market returns over the prior decade. It wasn't until after Staff pre-filed direct testimony arguing against Idaho Power's proposal that the Company retracted the proposal. Staff's testimony in that case detailed the differences between Net Periodic Pension Cost as calculated under SFAS 87, Service Cost, and the cash contribution range between the Required Minimum Contribution and Maximum Deductible Contribution. *See,* Tr. at 1496-1509. The Commission agreed with Staff's recommendation in the case and ordered that the Company be allowed to recover only the amount it had actually contributed to the pension plan during the test year, which was $0.00.

The Company's Application requests that the Commission allow it to account for pension expense on a cash basis. Application at 4. For financial reporting purposes, the Company is required to account for pension expense by the standards that are set forth by the Financial Account Standards Board, and thus the Company is required to calculate the SFAS 87 pension expense. Though not explicitly stated as such, the impact of this proposal would remove the SFAS 87 pension expense from its income statement resulting in improved earnings and capitalization ratios. The method in which the Company proposes to remove the SFAS 87 pension expense from its income statement is to defer the expense and report it as a regulatory asset on its balance sheet. The regulatory asset would accumulate each year as the SFAS 87 expense is calculated and debited to the regulatory asset account.

Statement of Financial Accounting Standards No. 71 (SFAS 71) is the accounting standard that would allow the Commission to approve any deviations from generally accepted accounting principals (GAAP). SFAS 71 was intended to apply to the general purpose external financial statements issued by enterprises which have regulated operations. It does not apply to the financial statements submitted to the regulatory authorities. The pronouncement recognizes that regulatory agencies will require deviations from GAAP for ratemaking purposes; however, it emphasizes that regulatory accounting procedures not related to the economic effects of ratemaking are not appropriate and GAAP must be followed.

SFAS 71 provides that before costs which would otherwise be expensed can be capitalized or deferred, it must be probable that the regulating entity will allow recovery of prudently incurred amount in future rates. In other words, if the Company's Application were approved, they would be deferring the SFAS 87 pension expense for future recovery, which is inconsistent with the Commission's intent in Order No. 29505 that only allowed the Company to recover the actual amount contributed to the plan during the test year, $0.00. The paradox created by Idaho Power in its Application is that while claiming to be consistent with prior Commission orders and accounting for pensions on a cash basis, the Company is seeking to defer an expense that has already been explicitly denied by the Commission for recovery on a current basis. Thus it could actually be construed as inconsistent with the Commission's recent orders regarding pension expense to allow Idaho Power to create a regulatory asset to defer the SFAS 87 pension expense. However, Staff will propose a solution that addresses the concerns created by SFAS 71 in the Staff Recommendation portion of these comments.

Company witness Smith states in her direct testimony, filed as Attachment A to the Company's Application, that there will be no near-term impact on rates if the Application were approved. Staff disagrees with this assertion. Although it is true that the Company is not seeking recovery of the amounts at this time, and will not do so until a contribution is required, customer rates would still be affected by the deferral. Pension expense is one factor in determining the Company's percentage of labor-related expenses to capitalize as overhead. The switch to cash accounting would require the Company to use the cash contribution instead of the currently used SFAS 87 expense to determine the operating percentage. If the overhead percentage decreased, the Company would be expensing a larger percentage of its labor-related costs. At the same time, the capitalized portion of labor-related expenses earns the Company a return on its investment, and the Company is currently recovering depreciation expense associated with the capitalized overhead. In order to account for the full elimination of SFAS 87 pension expense from rates, the Company would need to recalculate its operating percentage, which would lead to a decrease in rate base and depreciation expense going forward.

Furthermore, the regulatory asset account would improve the Company's capitalization by increasing the equity portion in the Company's cost of capital. Because the Company's return on equity is greater than the interest it pays on debt, approval of the Application will cause upward pressure on rates. Though the amounts may be minimal, approval of the Application reverses the impact of SFAS 87 on the capital structure and customer rates, so it should not be ignored.

Staff is opposed to the second portion of the Company's Application seeking authority to defer future cash contributions to the defined benefit pension plan and to account for such contributions as a regulatory asset. Application at 5. The Company has ample opportunity to recover the actual cash contribution in future rate cases as it has indicated that there will be at least three, and possibly five, rate cases sought by the Company before any cash contributions will be required. Idaho Power has also indicated that contributions will not need to be made to the defined benefit pension plan until approximately 2010, depending on market performance, turnover and the amount of annual salary increases given to employees. Staff recommends that the Commission deny the request to defer cash contributions to the pension plan as a regulatory asset.

Deferred accounting treatment is a method in which the Commission may allow a company to record on its books as a regulatory asset for future recovery a current expense that is extraordinary and unusual in nature, mandated by regulatory authority and provides benefits to customers. Contributing to a pension plan is neither extraordinary nor unusual, and under normal regulatory practices, pension expenses are recoverable when they occur during a test year that is used to set customer rates. It is premature for the Company to seek deferral of an expense of an unknown amount, especially when it is also unknown when that cost will eventually be incurred. Given the Company's recent statements that it intends to file annual rate cases in each of the next four, possibly five years, the Company will not experience any regulatory lag and will be able to recover the appropriate costs of the pension plan at the time funding resumes, thus eliminating the need for deferral.

STAFF RECOMMENDATION

Staff proposes a compromise position that allows Idaho Power to remove the SFAS 87 pension expense from its income statements and thus improve its earnings and capitalization ratios while simultaneously addressing Staff's previously expressed concerns. It is uncontested that removal of the SFAS 87 pension expense from the income statement will improve the Company's capitalization ratios, improve the Company's standing with rating agencies and ultimately benefit customers, presumably through lower borrowing costs. The amount of the benefit received by customers is impossible to quantify. However, approving a regulatory asset for the Company's SFAS 87 pension expense will reaffirm the Company's financial position to rating agencies and may assist, along with many other factors, the Company receiving an improved bond rating.

Over the life of a pension plan, the amount of SFAS 87 pension expense and the amount of cash contributions are theoretically equivalent and without interference, the SFAS 87 expense and the cash contributions over time will be comparable. Therefore, to address Staff's concerns about SFAS 71, Staff believes it would be permittable to allow the deferral of SFAS 87 pension expense as a regulatory asset if the cash contributions when made are credited as an offsetting entry to that regulatory asset. Given the presumption that the two expenses will ultimately be equivalent and the regulatory asset account will zero out on its own, then the SFAS 71 requirements will be satisfied.

However, this scenario also presents concerns to Staff. First, under this scenario the Company receives the benefit of timing. The SFAS 87 expense will be debited to the regulatory asset account for several years before an offsetting entry from cash contributions will be made, thus allowing the regulatory asset to become uncontrollably large. Secondly, the scenario only works without interference and therefore the Company should not seek to recover an amortization of the regulatory asset because the two offsetting expenses will balance each other out in due time.

Staff also believes that the Company should not accrue a carrying charge on the regulatory asset or include it in rate base. It would not be prudent to receive a return on an artificially created asset implemented to improve the Company's financial status without incurring an actual expense. Furthermore, the regulatory asset account will presumably fluctuate between a positive amount and a negative amount, and if a carry charge were granted to the Company when the asset was positive, the Company would then be obligated to credit customers with the same interest when the account becomes a liability. Staff believes the absence of carrying charges or interest payments to customers is just and reasonable and is an equitable solution for both the Company and customers, and would also appease Staff's concern regarding the large regulatory asset that would be built up by the Company.

To summarize, Staff recommends that the Commission accept Staff's proposal to allow the Company to capitalize the annual SFAS 87 pension expense by creating a regulatory asset, with the cash contributions used to offset that regulatory asset. Staff recommends denial of the Company's request to defer future cash contributions. The accounting treatment of this recommendation is illustrated in Attachment A. By accepting Staff's proposal, the regulatory asset should not be amortized to customers; instead it would balance over time through journal entries. Staff also recommends that the Commission deny carrying charges on the regulatory asset, and that the ratemaking treatment and recovery of actual pension expense be determined at a later date, presumably when the Company is required to contribute to the plan again.

Respectfully submitted this 19th day of April 2007.

Donovan E. Walker
Deputy Attorney General

Technical Staff: Donn English

i:umisc/comments/ipce07.7dwde

12/31/2007

1823XX	Other RA - Deferred Pension Expense	6,950,435	
	253321 Other Def. Cr. - Accrued Pension Costs		6,950,435
	(To record 2007 estimated SFAS 87 expense to reg asset - similar entry each year)		

12/31/20XX

253321	Other Def. Cr. - Accrued Pension Costs	10,000,000	
	131XXX Cash		10,000,000
	(To record cash contribution* to the pension plan)		
926200	Opr A&G Pen & Ben - Pension**	10,000,000	
	1823XX Other RA - Deferred Pension Expense		10,000,000
	(To record the cash contribution* regulatory asset)		

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* The contribution amount used is not an actual amount; it is being used for demonstration only.

** This entry only effects the operating portion of the pension expense and entries will also need to be made for the capitalized portion.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 19TH DAY OF APRIL 2007, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NO. IPC-E-07-07, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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