BPA Responses to Financial Reserves Workshop Questions from July 16, 2019

1. **Western Montana G&T (7/17)** - How did "Net Position" change over time prior to the creation of the separate business units in the late 1990s and also from the time period following creation of the separate business units until use of the IEC memo to calculate business unit reserve amounts in FY03?

   BPA Response:

   The Separate Accounting Analysis (SAA) was developed at FERC's direction and served as an indicator of whether business unit revenues were recovering business unit costs. The analysis is of historical financial performance. Generally it does not include forecasts of future performance although some filings in the 1990's did include forecasts. The SAA is a supplement to the transmittal letter sent to FERC with the rate case record. The resulting "net position" is based on an income statement view of business unit revenues and costs. It was developed at a time when BPA did not have separate financial reporting for its two business units. It started with revenues, subtracted functionalized expenses, and then adjusted for non-cash expenses and revenues as well as for payments to the Treasury. This analysis was different from today's identification of financial reserves or cash, in that it did not analyze individual cash transactions or address timing differences.

2. **Western Montana G&T (7/17) –**

   A. How was the automated parallel process for Pay-Related Costs configured to identify the differences between the manual processes from FY03 to FY15?

   B. Were assumptions from FY16-18 used in this automated parallel process?

   C. Are the assumptions used in the process similar across the years or was the automated process updated to reflect unique circumstances associated with FY03-15 activity?

   BPA Response:

   A. As discussed, both the manual cash split process and automated processes were run in FY15, both producing cash split reports. We have found no documentation that discusses this issue when the BU Cash Split model was being automated. This issue was highlighted during our review of the BU Cash Split model when comparing the allocation of pay-related costs between the two reports and then confirming that the automated model was performing the split of pay-related costs correctly.

<u>Automated model</u>: To attribute and allocate pay-related costs to Power and Transmission, the automated model follows the process used in BPA's PeopleSoft Financial system. The BU Cash Split model performs a series of calculations to attribute agency pay data from the PeopleSoft HR system to the Corporate business unit, the Power business unit, and the Transmission business unit. The Corporate business unit amounts are then further allocated to Power and Transmission based on the allocation rates associated with the cost pools that were charged.

<u>Manual process</u>: The manual process used an incorrect methodology since FY03; the methodology appears to stem from the IEC memo, which stated to "distributed [payroll] to Power and Transmission based on the current month's salary allocation percentage from Corporate to the two Business Units." This guidance is very simplistic and does not sufficiently outline the steps necessary to attribute and allocate pay-related costs from the PeopleSoft HR system. It is difficult to understand if this guidance was interpreted incorrectly, implemented incorrectly, or simply a flawed assumption. Regardless, the method used to split pay was incorrect.

B. Parallel processes were not run in FY16 – 18. Starting in FY16, the automated model is the only process used to determine the cash split by business unit. The HR module of the BU Cash Split automated model was fully tested as part of the review. The model correctly attributes and allocates pay-related costs.*

C. One method was to attribute and allocate pay-related costs from FY03 – FY15; this method was consistently used and was incorrect. The automated model was in place in FY15, but the output was not used. The automated model did not look back to adjust for prior year activity. Pay-related costs have been properly split beginning with the adoption of the model in FY16.*

*Note: The exception is one issue identified in FY16 in the HR module which resulted in Power being overcharged $2.4m. This issue did not occur in FY17 or FY18. This issue occurs only when the timing of pay related accounting activity crosses the fiscal year, resulting in the accrual being recorded in the current fiscal year, but the cash being paid out in the next fiscal year. A control is being added to the cash split process to address this issue.

3. **Western Montana G&T (7/17) -** The materials provided state that: "The manual process used a rate that was not reflective of the overall weighted average Corp G&A rates." Please share the rates used in the manual process as well as the rates provided in the automated parallel process if these rates differ from those shown in the summary table of page 14.

BPA Response:

The rate used in the manual process to split pay varied month over month, but in general Power picked up about 20% of total pay-related costs and Transmission picked up 80% of total pay-related costs. Applying the proper attribution and allocation methods, Power should have picked up about 24% of total pay-related costs.

Power Perspective - Comparison of Power's % of Total Pay-Related Costs

	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
Incorrect Manual Cash Split Method	21%	21%	21%	20%	20%	19%	20%	20%	19%	19%	19%	19%	18%	17%
Correct Application Following PS Finanicals	25%	25%	24%	25%	26%	25%	25%	25%	25%	24%	24%	23%	23%	23%

4. **Western Montana G&T (7/17) -** Please also detail the errors associated with the Pay-Related Costs review that resulted in $242 million of misallocated costs from FY02-15. It is difficult to understand what happened here with a description that this module "was just wrong". The $242 million of misallocated Pay-Related Costs is new information and it would be helpful to understand why the prior cost allocations are being changed here. This appears to conflict with statements that prior cost allocations are not being reviewed or re-evaluated during this process.

BPA Response:

To clarify, prior cost allocations are not being changed in BPA's Financial Accounting system. This review compared the cash attributions and allocations being made in the BU Cash Split model (and prior manual processes) to the attributions and allocations in the PeopleSoft (PS) Financial system. Areas in which differences were found are noted as errors. Recall that the cash split happens outside of BPA's PS financial system and should reflect the attributions and allocations of the financial system.

The suggestion is to change the way pay-related costs were split for cash and reserves purposes *only*. The review showed that from a cash split perspective, pay-related costs were not properly split between Power and Transmission; that is, the allocation did not reflect the way pay-related costs were being treated in BPA's Financial Accounting system nor the way these costs were charged to Power and Transmission in their respective financial statements.

Slide 14 of the July 16th presentation shows the error amounts by fiscal year, for each error category, including the pay-related allocation error.

The manual cash split process did not follow Corporate G&A allocations for Corporate-employee related pay costs; and the attribution of Leave & Benefits costs to Power and Transmission did not align with the process used in PS Financials. From a cash and reserves perspective, this resulted in Power under contributing to pay-related costs and Transmission over contributing. The method used in the cash split process was not reflective of the way these costs were charged to Power and Transmission in their respective financial statements.

5. **Snohomish PUD (7/18) -** Did the error affect Debt Service Reassignment between Power and Transmission? If so and if material, could BPA show the impact and include the Federal Debt and Interest Expense/Income Module in the table on page 14.
(For reference: https://www.bpa.gov/Finance/FinancialPublicProcesses/Reserves-Review/Documents/Reserves%20Public%20Workshop%20July%2016.pdf)

BPA Response:

No. The misallocation of business unit reserves did not affect Debt Service Reassignment (DSR). As part of the review of the BU Cash Split model, DSR amounts were tested. Testing showed that DSR was properly attributed in the cash split model.

6. **Snohomish PUD (7/18) -** Did the error affect the calculation of the Minimum Required Net Revenue (MRNR) for Power during those years?

BPA Response:

No. The financial reserves balance is not a factor in determining MRNR. This calculation looks at the cash being generated by rates within a year and compares it to the amount of cash needed to repay debt that year. The actual or forecast financial reserves balance is not a factor.

7. **Snohomish PUD (7/18) -** In BP-18, Power Rates included a $20 million Planned Net Revenues for Risk (PNRR) per year as part of Financial Reserves Phase In Implementation, which could have been prevented if the error was discovered earlier. What is BPA's preliminary thinking on this?

BPA Response:

The prior discovery of the BU Cash Split error would not have affected BPA's policy decision to adopt the Financial Reserves Policy (FRP), the Financial Reserves Phase-In Policy (FRP Phase-In), or BPA's decision to include $20 million of PNRR in the BP-18 power rates. The FRP and FRP Phase-In policy decisions stem from BPA's strategic decision to shore up its financial health and establish policies that strengthen the agency's balance sheet for the long-term. Identifying and correcting the BU Cash Split error would not have obviated the need for these policies nor have changed BPA's decision to adopt these policies as the means of achieving the agency's long-term strategic goals. In addition, assuming BPA's initial reserves proposal (see July 30 reserves presentation), BPA's need to include PNRR of $20 million in Power rates would not have changed had the error been discovered earlier. Power Service's financial reserves were estimated to be approximately $28 million at the beginning of the BP-18 rate period (FY 2018). Thus, even if BPA had discovered the error and corrected it before the final proposal (thereby adding approximately $182 million to Power Services' financial reserves), Power Services' total financial reserves would still have been well below the FRP's required $300 million threshold.

8. **Snohomish PUD (7/18) -** Summary Table, p. 5 - What do the numbers mean when comparing the alternative approaches?
(For Reference: https://www.bpa.gov/Finance/FinancialPublicProcesses/Reserves-Review/Documents/July%2016%20Responses/3.%20Decision%20to%20Expand%20IEC%20to%20Reserves%20(2004)_Redacted.pdf)

Summary Table – E.1.a.

Decision Criteria	Alternative 1 Annual Approach	Alternative 2 Monthly Approach
Liquidity	2	2
Flexibility	N/A	N/A
Sustainable Capital	N/A	N/A
Rate Period Cost Shift	3	3
Customer Group Cost Shift	3	3
Cost Recovery	2	2
Rate Impact	2	2
Impact on Risk Profile	2	2
Administration Agreement	3	3
External Partner Agreement	3	3
Customer Support	3	3
Potential Imprudent Actions	3	3
Environmental Impact	3	3
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]

BPA Response:

The numbers reflect the rating / ranking methodology used at the time for decision making. BPA has not found a key or explanation describing the purpose of the numerical values.

9. **Western Public Agencies Group - WPAG (7/18) -** Please provide a monthly breakdown of the misallocated amounts for FY02-FY18 including all of the modules for which adjustments are proposed (e.g. IPAC, Pay-Related, Corp AP, etc).

BPA Response:

The review of the cash split model and manual process used data on an annual basis. We did not pull the data by month, nor was the analysis performed on a monthly basis; therefore this data is not available.

10. **Western Public Agencies Group - WPAG (7/18) –**

A. What were the rate case impacts of the Total Cash Impact amounts for each rate case, i.e. what items in each rate case (such as reserves for settlement, reserves for risk, or other probability-adjusted rate setting based on business line reserve levels that resulted in higher power rates) were over-stated for Power and hence led to higher collection from Power Customers over this time period?

B. What were the overcharge amounts to power customers from each rate case resulting from the misallocation?

C. If there was no impact, please explain why or why not?

BPA Response:

A. We have not analyzed the rate case by rate case impacts of the misallocation of business reserves. See the March 11 Financial Reserves Workshop handout, page 12. From a conceptual standpoint, only reserves data as of the end of the last complete historical year prior to a rate case would have affected that rate case. As the final proposal is prepared, staff typically use the Second Quarter forecast of the year in which the rate case is held. This forecast would be built on the actual business unit reserves split as of the end of the last fiscal year. For example, the BP-18 final proposal, which covered FYs 2018 2019, would have used the Second Quarter FY 2017 reserves forecast which would have been built on the reserves split at the end of FY 2016. Any misallocation in 2017, 2018, and 2019 would not have affected the rate case. As a result, the cumulative impact of a reserves misallocation can be delayed for several years. Actual results during the rate period would have affected the interest income earned on each business unit's share of BPA reserves. This would likely have had a very modest impact on business unit net revenues which then would very slightly increase or decrease the probability that a rate adjustment mechanism would trigger. The calculation of interest in the July 30th presentations shows a reasonable proxy of the actual impact on the interest income for each business unit.

B. Since we have not analyzed the rate case by rate case impacts, we are not able to identify any "overcharge" resulting from the misallocation. At the March 11th workshop we describe the general impact of the misallocation on rates. See the March 11 Financial Reserves Workshop handout, page 12 for additional details. BPA is not proposing to make any specific adjustments to rates to attempt to account for impacts of the error in prior rate proceedings. The calculation of interest in the July 30th presentations shows a reasonable proxy of the actual impact on the interest income for each business unit.

C. See response to A and B above.

11. **Alliance of Western Energy Consumers - WPAG (7/19) –**

A. Please Reference slide 16 of the July 16th Presentation. How were the initial reserve balances calculated in the 2002 Business Unit Split Report?

B. What were the initial reserve balances for the respective lines?

BPA Response:

A. Prior to the BU Cash Split method, BPA used the business line's statement of revenues and expense reports, along with adjustments for accrual to cash transaction and other information, to develop a "surrogate" business line reserve balance. Staff assumes this prior method was in place and used to determine the FY 2002 ending balance. Staff has been unable to recreate these balances or validate them from any data set.

B. Staff does not have any information that is responsive to this request. Staff has been unable to find any values by business line other than the end-of-year balance for FY 2002.

12. **Alliance of Western Energy Consumers - WPAG (7/19) –**

A. What information would BPA require to recalculate the reserve balances to confirm whether errors existed in the 2002 Business Unit Split Report?

B. How much of this information is/is not available to BPA?

BPA Response:

A & B. In FY03, it appears there was an attempt to back-cast the manual cash split process on FY02 data. The erroneous assumptions applied in FY03 were also applied to back cast FY02. As discussed at the July 16th workshop, those files can be found, i.e., the cash split activity for FY02, which appears to have been done after-the-fact in FY03. However, we have no FY02 beginning balance. To validate an ending cash split balance both components are needed -- beginning balance plus cash activity during the period. Since we do not know the beginning balance for FY02 or the methodology employed to split cash for reserves during that period, if there was one, we cannot assume that the errors are represented in the ending balance for FY02.

In FY03, our files show a beginning balance and cash activity for the FY03 period, using the manual cash split process. The beginning balance plus cash activity add up to the ending balance that is carried forward to FY04. This means we can confirm that the errors in the detailed cash activity split files are truly embedded in the FY03 reserves balances. And such is the case for all years going forward in which errors where discovered.

13. **Public Power Council - (PPC) (7/19) -** PPC would like to better understand the considerations regarding FY 2002 in BPA staff's analysis.

A. Was the BU Cash Split Model used to divide cash in FY 2002?

B. On Slide 16 of the 7/16/19 presentation, where did the figures in the "Business Units Cash Balances Analysis" section for "FY 02 Rates" and "FY 02 Reserves by BU" originate?

BPA Response:

A. No, we do not believe the cash split model/process was used to split cash in FY 2002. It appears that in FY 2003, there was an attempt to back-cast the cash split process onto FY 2002 data.

B. The data on slide 16 of the July 16th presentation is found in various excel files associated with cash and reserves.

14. **Public Power Council - (PPC) (7/19) -** PPC would like to obtain additional information regarding the development of the Internal Audit Report. Please describe the process by which this document was drafted, revised and approved internally.

BPA Response:

The Review of BPA's Business Unit Cash Split Allocation Validation report conforms with *The International Standards for the Professional Practice of Internal Auditing* and Internal Audit is an independent department at BPA that reports to the Audit Committee and the EVP of Compliance, Audit, and Risk which is not in the Finance reporting chain. Internal Audit followed its standard process for preparing and reviewing the draft report. This standard process included the Auditor drafting the report, and both the Supervisory Auditor and Chief Audit Executive reviewing the report and sending the draft report to the process owners for review. Internal Audit reviewed the comments received, made the necessary updates, and the final report was approved/signed by the Chief Audit Executive.

15. **Public Power Council - (PPC) (7/19) -** PPC would like to fully understand BPA's action plan for Process Improvements and Controls and how these proposed actions map to the findings of the Internal Audit Report and the Baker Tilly external review. This may be outside the scope of decision making for error correction of past issues, but it is of crucial importance for customer confidence going forward. We look forward to working collaboratively to find the best timing and format for this exchange of information.

BPA Response:

BPA's standard governance process for remediating issues will be followed for remediating the issues identified through this review.

- The BPA Finance organization, the owner of the BU Cash Split model, will have 30 days to develop an action plan that addresses all recommendations made by both Internal Audit and Baker Tilly.
- The action plan must include milestones and specific actions to remediate the issues noted, with actions completed within one year.
- The action plan will be reviewed by several groups to ensure adequacy, including BPA's Internal Audit and Compliance & Governance organizations. It will be logged and tracked by the Compliance and Governance organization.
- Finance will be required to report out periodically to the Audit, Compliance and Governance Committee (BPA's Audit committee) on the progress against the action plan.

In terms of the Action Plan itself, it will address all of the recommendations. Focus areas include:

- **Controls.** Specific controls have been developed for each module to be applied periodically (annually at SOY or EOY, semi-annually, quarterly or monthly). These controls are largely data validation in nature, and require validating the cash split amounts from each module to PS Financials.
- **Documentation.** Documenting at a more detailed level the methodology and assumptions employed in each module of the BU cash split model. This will be reviewed by senior management in Finance and formally approved.
- **Policy & Oversight.** A review process will be established to ensure manual entries made in the BU cash split model are logged, tracked and reviewed. Policy/procedures will be established to formalize variance thresholds that trigger additional review, analysis and signoff.
- **Records Management.** Development of a plan and process to better define naming conventions for files and storage of files to ensure final copies are clearly marked and centrally stored and managed.