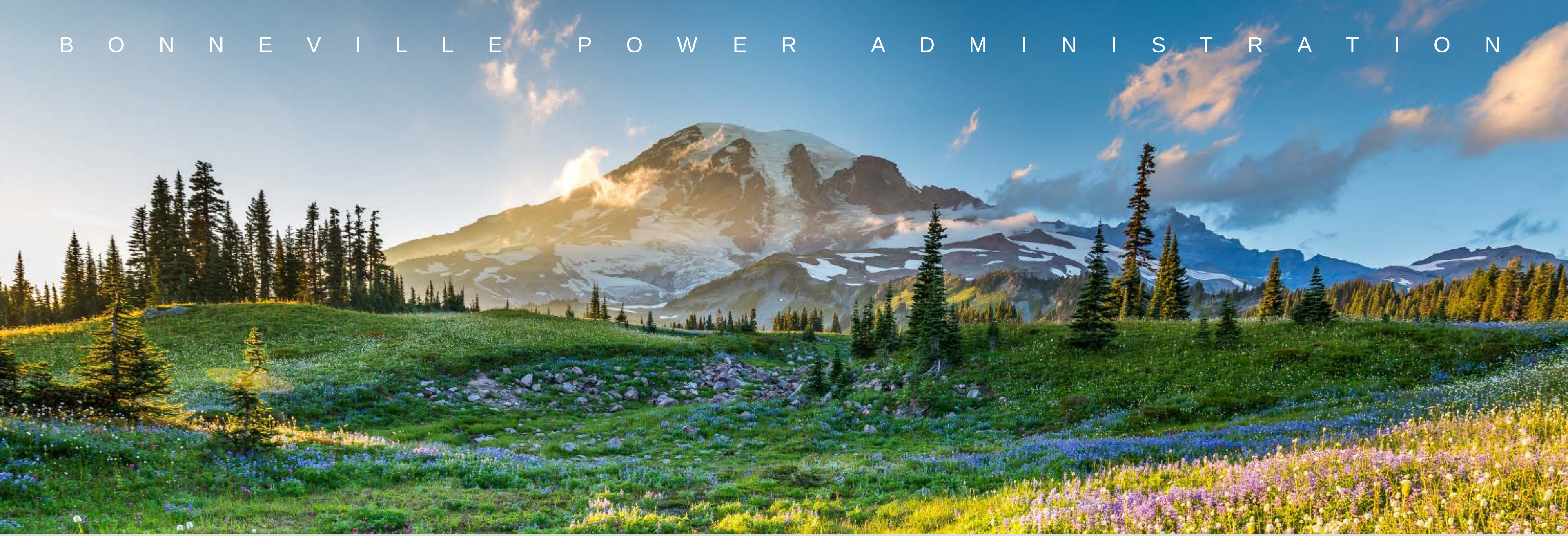

Public Workshop
Reserves Review Update

July 16, 2019

Rates Hearing Room

Bridge: 1-415-527-5035

1:00pm-4:00pm

WebEx: https://doe.webex.com/doe/j.php?MTID=m9ae4e16e2aa7d7e3d81dead4ec9b61a1
Meeting ID: 901 027 674
Password: kKx88YKa

Business Unit Cash Split Review – Progress Update

- **Overall Objective:** Determine whether the BU cash split model allocation of cash between Power and Transmission is consistent with how transactions are recorded in the financial statements.
- **Approach:** Review the data from FY15 – FY18 (post automation) in each module. If errors are discovered, review prior fiscal years to determine extent of error.
- **Status:** All modules have been reviewed by Finance, following a risk-based scoping approach. Internal Audit and Baker Tilly review complete.

Major Process Deadlines

July 16

- Update of Additional Findings.
- 3 Day Window to Submit Questions Begins.

July 19

- All Questions from July 16 Workshop Due.

July 30

- Present BPA Recommended Solution.
- Respond to Questions to the Best of BPA's Ability.
- 21 Day Comment Period Begins.

August 21

- Comment Period Ends.

October

- Bonneville Issues Final ROD.

Business Unit (BU) Cash Split Model

- The Business Unit Cash Split Model (BU Cash Split Model) is an internal automated model that administratively attributes cash held in the Bonneville Fund between Power and Transmission.
  - The BU Cash Split Model consists of ten “modules,” each of which reflects different types of transaction data that affect cash.

- Purpose of the BU Cash Split Model:
  - Used to assign the actual interest income from the Bonneville Fund between the business lines.
  - Used to calculate financial reserves on a monthly basis, which is used to calculate both end-of-year projections and end-of-year actual financial reserves. (These financial reserves are used for various rate case purposes including calculating forecast interest credit over the rate period.)

HISTORICAL CONTEXT

History of BU Cash Split Process

- Bonneville is required to separately track Power and Transmission-related costs and revenues.
  - FERC requires Bonneville to file a "separate accounting analysis" with rate filings.
  - Separate accounting analysis ensures, on a projected basis, that Power revenues will pay for Power costs, and Transmission revenues will pay for Transmission costs.
  - Since the 1980s, Bonneville has identified business line level cash in a separate accounting analysis, based on an accumulative "net position," to allocate projected interest earnings on cash in the Bonneville Fund between Power and Transmission in rates.
  - Actual interest earnings were not split between business lines. Instead, actual interest was used to pay interest expense amortization of the Federal investment, payment of bond premiums, and payment of Corps and Bureau O&M.

History of BU Cash Split Process

- The BU Cash Split process originated from a methodology developed in 2003 that was intended to split **actual earned interest income** in the BPA Fund between the business lines on a monthly basis.

- The methodology was described in a memorandum (Interest Earned Credit (IEC) Memo) issued in December 2003 from BPA's Accounting Officer.

- The IEC Memo included several "adjustments" to cash transactions which were not consistent with the allocations in BPA's financial system. Two of the "adjustments" are related to Corporate receipts/disbursements and Payroll allocations.
  - The Corp receipts/disbursements adjustment directed a 50/50 split, which does not align with the Corp G&A allocations process and would result in overpayment by Power.
  - The Payroll adjustment directive was vague. It is difficult to understand if it was interpreted incorrectly, implemented incorrectly, or simply a very flawed assumption; regardless the result was a significant underpayment by Power.

- A third assumption error, not addressed in the IEC Memo, relates to IPAC payments. BPA erroneously assumed all payments made through the IPAC system were synonymous with payments made to the Corps and Bureau.

- Why the discrepancies?
  - The IEC Memo was intended to allocate actual interest from the BPA Fund between Power and Transmission. It had a very limited application, so not thoroughly vetted.
  - It was **not** intended to replace the then-existing methodology for calculating financial reserves by business line or be used for rate-setting purposes.

History of BU Cash Split Methodology

- BPA expands the use of the process described in the IEC Memo.
  - In March 2004, BPA decided to use the methodology in the IEC Memo to calculate financial reserves by business line. The assumptions from the IEC Memo thus became the assumptions used in the BU Cash Split process.
- Why expand use of the cash split process outlined in the IEC Memo?
  - The process was thought to be a more accurate way of calculating annual financial reserves by business line because it relied on “actual” financial data and was approved by Finance.
  - BPA did not revisit the IEC Memo’s assumptions when deciding to expand its use for calculating business line financial reserves.
  - Using the IEC Memo assumptions in the BU Cash Split process was not expected to result in cost shifts or have any rate impacts. IEC Memo assumptions were expected to provide overall greater accuracy in the allocation of cash between the business lines.

History of BU Cash Split Methodology

- Over time, Staff changed various inputs and assumptions in the BU Cash Split process to align it with allocations in BPA's Financial System.
  - In December FY 2010, an IPAC transaction of $16 million for a purchase of land by Transmission from BIA was allocated to Transmission in the BU Cash Split process.
  - In FY 2013, the cash split process assumption that Corporate should be split 50-50 was changed.
    - The split was changed to 35% to Power and 65% to Transmission. This was made retroactive to FY 2012. The 35-65 split was not consistent with the allocations used in BPA's financial system, but closer than the original 50-50 assumption.
    - In FY 2014, an attempt was made to pick up the actual Corp G&A allocation rates used to split Corporate costs, but it appears the F&W portion was not included.
  - In FY 2015, BPA automated the business line cash split process.
    - The automation process correctly tied the allocation of Payroll and Corporate costs to BPA's financial system allocations. It did not correct the misallocation of IPAC cost.
    - Parallel processes were run for the entire year. The results of the manual cash split process were used to report reserves.
- Since FY 2016, except for IPAC, the BU Cash Split process has been following the allocations BPA uses in its financial system.

Discovering the Errors

- In FY 2018, BPA encountered some forecasting errors and had difficulties tying out the end-of-year reserves actuals to the Reserves forecast.

- In response, BPA conducted a multi-phased review of its financial systems.
  - The review identified the BU Cash Split Model as a critical element in determining financial reserves.
  - Staff tested the allocations in the BU Cash Split Model (and its predecessor process, the BU Cash Split process) for consistency with the financial system allocations, which are used in rate setting.

- Staff found discrepancies in three areas:
  - IPAC transactions: **BU Cash Split Process** allocated all to Power. **BPA financial system** allocates IPAC costs to both Power and Transmission based on purpose of the cost.
  - Payroll costs: **BU Cash Split Process** used a very simplified approach to allocate pay, resulting in an average allocation of total pay to Power of about 20%. **BPA financial system**, after allocations of all pay-related costs are calculated, Power generally picks up about 25% of total pay-related costs.
  - Corporate receipts/disbursements: **BU Cash Split Process** allocated these 50/50 until FY 2013, and then moved closer to the Corp G&A rates. **BPA's financial system** allocates these costs based on Corp G&A pool rates, on average about 40% to Power and 60% to Transmission.

Historical Timeline

FY 03 — Origins

Developed to split ***actual earned interest income*** in BPA fund between Power & Transmission. Not intended for splitting financial reserves. Some assumptions outlined in an internal memo from finance. IPAC was not mentioned; assumes IPAC and COE/BOR costs are synonymous.

Memo outlines Corporate AP and Pay-related allocation methods.

- Payroll allocated by Corporate allocation
- Corporate receipts & disbursements split 50-50

FY 04 — Intent Shift

Decision made to use interest income methodology to calculate financial reserves. Assumptions of methodology not revisited. Staff believed the method would result in NO cost shifts, NO rate impacts, and was more accurate.

FY 10 — IPAC

A December 2009 land purchase for $16m was assigned to Transmission. The first known IPAC transaction applied to Transmission.

FY 13 — Corp AP

Per 2003 memo, Corporate AP transactions were split 50/50 between Power & Transmission until FY13. A retroactive change was made to Corporate AP for FY 12/13 to a 35/65 split. Method is tweaked further in FY14/15.

FY 15 — Automation

BU Cash Spilt Process is automated; parallel processes are run. Allocation of pay-related costs differs by $20m between two methods. IPAC is automated to allocate 100% to Power.

FY 19 — Reserves Review

FY 18 forecasting errors lead to Reserves Review. BU Cash Split model was identified as a critical model to review. Identified IPAC allocation issue and allocation issues in prior manual process.

Business Unit Cash Split Review – Error Summary

Cash split errors that may result in cash moving to Power

- Errors found in the manual and automated cash split process
- Power was overcharged a total of $422 million (not including interest)

Module or Area	Error	Impact
Intergovernmental Payments & Collections (IPAC)	$306m misallocated, dating back to FY02 ($277m dating back to FY04).	Power was overcharged from a cash perspective.
Corporate Accounts Payable (AP)	$100m for Corp AP amounts misallocated. • The manual cash split process split Corp AP at 50/50 from FY02 - FY11, rather than at Corp G&A rates. • In FY12, staff attempted to apply the Corp G&A rates going forward, however, the allocation rates applied to Power were slightly too low. • P-Card GL should have been allocated based on BU spend percentages. • Net result Power was mostly overcharged, but undercharged in FY14.	Power was both over- and undercharged from a cash perspective, net overcharged.
Other Errors:	• Federal Debt - $5m: Federal bond issuance, FY18 only. Not a model error; bond was miscoded in PS Financials. Power cash did not reflect the cash inflow from this borrowing. • HR Module - $2m: Payroll cash carryover to next fiscal year. Allocation should be at the overall Power & Transmission % of total payroll, rather than at the weighted average Corporate G&A rate. • IPAC - $3m: Charges to Corporate GSA Fleet assets not included in the original IPAC error totals. • AP - $6m: FY15 delta between the manual process and the automated process for total disbursements made through Accounts Payable.	Power cash from borrowing was under reported; Power was overcharged from a cash perspective.

Business Unit Cash Split Review – Error Summary (cont'd)

Cash split errors that may result in cash moving to Transmission

- Errors found in the manual cash split process
- Power was undercharged a total of $251 million (not including interest)

Module or Area	Error	Impact
Pay-related Costs	Approximately $242m for misallocated pay-related costs from FY02 – FY15. • Issue was highlighted by a $21m difference between the manual cash split allocation of pay and the automated cash split allocation of pay in FY15, when parallel processes were run. • The manual process used a rate that was not reflective of the overall weighted average Corp G&A rates.	Power was undercharged from a cash perspective.
Other Errors: Post-Retirement Benefits (PRB)	$9m misallocated for the PRB payment in FY04. • In FY04, the $31m PRB payment was split using the same allocation rate applied to the pay split for Power, 21%. It should have been a 50% allocation rate.	Power was undercharged from a cash perspective.

Business Unit Cash Split Review – Error Summary (cont'd)

- The table below is from a ***Power perspective*** and summarizes the estimated over- and under-payments by Power from a cash split perspective. Amounts are principal only; no interest.
  - A negative number means that Power was undercharged from a cash perspective.
  - A positive number means that Power was overcharged from a cash perspective.
- Previously, with only the IPAC error, the estimated cash transfer from Transmission to Power was:
  - Principal = $277m (FY04 – FY18) and Interest = $53m (rate case rates)
  - Total principal and interest: $330m
- The current ***total potential*** net transfer of cash from Transmission to Power, with all the errors known to date, is:
  - Principal = $171.5m (Note – this includes the estimated errors of $12.8m from FY02, for which insufficient documentation exists to validate these amounts).
  - Interest = $30.9m (effective interest rate) OR $38.6m (rate case rates).

$ in Millions

	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY02 - FY18
Pay-Related	($11.9)	($11.2)	($10.4)	($15.5)	($16.0)	($19.9)	($20.1)	($20.6)	($20.6)	($18.5)	($19.0)	($18.6)	($17.7)	($21.7)	$0.0	$0.0	$0.0	**($241.7)**
Corp AP	$9.8	$10.4	$7.6	$7.0	$8.6	$8.2	$9.4	$10.1	$10.7	$15.3	$0.6	$2.4	($0.3)	$0.0	$0.0	$0.0	$0.0	**$99.7**
IPAC	$14.8	$14.5	$15.0	$14.9	$14.3	$16.8	$16.0	$18.1	$18.8	$21.4	$19.2	$21.0	$21.6	$20.0	$19.9	$20.1	$19.5	**$305.9**
Other	$0.2	$0.2	($8.8)	$0.2	$0.2	$0.2	$0.2	$0.2	$0.2	$0.2	$0.2	$0.2	$0.2	$6.1	$2.6	$0.2	$5.2	**$7.7**
Total Cash Impact	**$12.8**	**$13.9**	**$3.5**	**$6.5**	**$7.0**	**$5.3**	**$5.5**	**$7.8**	**$9.1**	**$18.4**	**$0.9**	**$5.0**	**$3.9**	**$4.4**	**$22.5**	**$20.3**	**$24.7**	**$171.5**
Annual Weighted Ave. Corp G&A Rates to Power	41.5%	35.9%	38.0%	42.7%	41.4%	41.7%	41.8%	41.4%	41.2%	37.6%	38.5%	36.4%	35.5%	36.9%	36.5%	35.2%	34.9%	

FY 2003 Considerations

- Staff has verified that errors in BU Cash Split process were included FY 2003 ending balances.

FY 03 Cash Flows (in GL as cash)	Totals
PBL	
Receipts	2,216,841,484.20
Disbursements	(1,093,433,309.16)
Payroll Alloc	(63,183,027.29)
IPAC	(322,894,994.38)
Bonds Borrowing	225,062,000.00
	(97,622,000.00)
	(8,060,268.75)
e Reassign	(315,200,000.00)
Enron Interest Payment	(252,745.64)
Treasury Payment	(114,952,051.20)
Total	426,941,924.79

See BU Cash spreadsheet (GL Cash)

Business Units Cash Balances Analysis	Power	Trans
FY 03		
Beg Bal	(15.9)	164.5
GL Cash	426.9	(167.3)
Subtotal	411.0	(2.8)
ENW	(56.0)	56.0
BBL	(26.4)	26.4
End Bal	328.6	79.6
FY 04		
Beg Bal	328.6	79.6
End Bal	389.7	197.2
Avg Ending Bal in Sept	491.1	196.4

FY 2002 Considerations

- Staff have been unable to confirm the errors existed in the ending balance for FY 2002.

FY 02 Cash Flows		
(in GL as cash)		
		Totals
PBL		
Receipts		2,123,717,549.17
Disbursements		(1,678,468,362.40)
Payroll Alloc		(57,926,410.21)
IPAC		(292,774,969.98)
Bonds Borrowing		90,000,000.00
Bonds Repay		-
Bond Interest net credits		(15,966,936.50)
ENW Debt Service Reassign		-
Treasury Payment		(432,926,938.17)
	Total	(264,346,068.09)

Where is this balance? Not in BU Cash

Business Units Cash Balances Analysis			(in millions)	
	Power	Trans	Corpt	Cash Bal
FY 02				
FY 02 Rates	(15.9)	164.5		148.6
FY 02 Reserves by BU	**13.7**	**174.4**		**188.1**
FY 03				
Beg Bal	(15.9)	164.5	0.0	148.6
End Bal	328.6	79.6	0.0	408.2

BU Cash Split Review - Status Update

Finance review of modules is complete. The secondary reviews by both Internal Audit and Baker Tilly are complete and the final reports are pending.

Module	Transaction Type	$ Value (FY18)
ARC	Customer receipts	$3.7B
AR	Miscellaneous AR	$0.7M
AP	Disbursements processed in Accounts Payable	$2.4B
HR	Pay-related cash transactions	$419M
HRJE	Miscellaneous pay-related cash transactions	$0.5M
DM	Borrowings, repayments and interest expense on Federal bonds	$362M
DMI	Interest income on Federal MBS investments	$4.5M
IPAC	Transactions in the Intergovernmental Payments & Collections Payments system	$708M
ADJ	Adjustments/transactions for: Interest Offset Credit (IOC), beginning balance, EN Adjustments, between business line amounts	$210M
JE	Journal entries for: Year-end US Treasury payment, adjustments to IOC, Radio Spectrum, miscellaneous cash receipts/disbursements	$322M

BU Cash Split Review – Process Improvement & Controls

- BPA has an established program and process that governs the remediation of issues uncovered from internal and external reviews. The remediation of the issues highlighted from the review of the BU Cash Split model will follow this process.
  - The BPA Finance organization, the owner of the BU Cash Split model, will have 30 days to develop an action plan that addresses all of the findings from the Finance review and the review 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 is reviewed by several groups to ensure adequacy, including BPA's Internal Audit and Compliance & Governance organizations. It is 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.
- To date, approximately 30 controls have been developed, to ensure the completeness and accuracy of the cash split attribution and allocations to Power and Transmission. These controls will be included in the overall action plan.
- Additional improvements will be included in the action plan and implemented to address the full set of observations noted by both Internal Audit and Baker Tilly.

Next Steps

- By **COB Friday, July 19th**, please submit questions regarding the information presented today to Communications@bpa.gov with a subject line “Financial Reserves.”
- Bonneville will address questions at the July 30th workshop to the best of our ability.

Financial Disclosures

- **This information has been made publicly available by BPA on July 12, 2019 and does not contain Agency-approved Financial Information.**