ALJ/MFG/sid **Mailed 10/25/2002**

Decision 02-10-054 October 24, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Sierra Pacific Power Company (U903 E) for an Accounting Order Authorizing the Establishment of a Regulatory Asset or Regulatory Liability Associated with the Implementation of Financial Accounting Standards Board Statement No. 133 and 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities.	Application 01-08-030 (Filed August 14, 2001)

OPINION ON ESTABLISHING REGULATORY ASSETS OR LIABILITIES ASSOCIATED WITH FINANCIAL ACCOUNTING STANDARDS 133 AND 138

I. Summary

In this opinion, we grant the request of Sierra Pacific Power Company (Sierra) for authority to establish regulatory assets or liabilities associated with implementation of Financial Accounting Statements (FAS) 133 and 138.[1] FAS 133 and 138 relate to accounting for certain derivatives and hedging activities. Applicant's rates will not be adversely affected. While we grant Sierra's request, our action does not constitute approval of any contract, or the regulatory treatment of any contract.

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[1] We granted similar authority to PacifiCorp by Decision (D.) 01-08-049, dated August 23, 2001.

II. Background

FAS 133 was issued by the Financial Accounting Standards Board (FASB) in June 1998 and amended by FAS 138 in June 2000. FAS 133 and 138 require that all derivatives and certain embedded derivatives be reported on the balance sheet at fair market value.

Sierra enters into certain contracts, defined as derivatives by FAS 133 and 138, in order to purchase power, generation and transmission capacity, etc. The fixed price components of these contracts can vary substantially from market prices at any one time. FAS 133 and 138 require that the difference between the contract and the market price be recognized as a gain or loss every quarter, even though there is no associated cash flow. When the contract is actually settled, the expense is recognized as the actual contract price. The net gain or loss previously recognized is reversed.

Implementation of FAS 133 and 138 could cause significant volatility in Sierra's retained earnings and significantly impact its ability to pay dividends. Thus, Sierra's financing arrangements could be adversely affected and it is reasonable to establish regulatory accounts to offset the entries required by FAS 133 and 138.

III. Applicant's Proposal

Sierra seeks authority to offset the balance sheet entries required by FAS 133 and 138 by regulatory assets or liabilities' accounts. Sierra proposes to record the fair market value of various resource acquisition contracts as assets in Federal Energy Regulatory Commission (FERC) Account 174, Miscellaneous Current and Accrued Assets, or as liabilities in FERC Account 242, Miscellaneous Current and Accrued Liabilities. These non-cash accounting entries would be offset by regulatory assets or liabilities' entries using the same accounts. The entries would be made simultaneously and would offset each other in Sierra's statements of income and comprehensive income. When the obligations under an affected contract are fulfilled, any gain or loss recognized under FAS 133 and 138 would be reversed and the offsetting regulatory asset or liability would also be reversed. The result would be no net loss or gain upon settlement of the contract.

Sierra's proposed accounting treatment, which results in equal and opposite entries in the balance sheet and income statement, would eliminate the earnings volatility caused by FAS 133 and 138. The adverse effect on reported earnings, dividends and financing arrangements would be eliminated. In addition, the ratemaking treatment of the contracts would be unaffected.

Sierra requests that its proposed accounting treatment become effective for its financial accounting entries beginning with its adoption of FAS 133 and 138 on January 1, 2001.

IV. Discussion

Under Sierra's proposed accounting treatment, the non-cash accounting entries (differences between the contract and market prices) would be simultaneously offset by regulatory assets or liabilities' accounts. When the contract is actually settled, the net gains or losses previously recognized as well as the net offsetting regulatory assets or liabilities would be reversed. The result would be no net gain or loss upon settlement of the contract.

The proposed accounting treatment would reduce the volatility in Sierra's balance sheet caused by FAS 133 and 138. As a result, potential adverse effects on its ability to pay dividends and to attract capital would be eliminated. In addition, Sierra's cost of service will not be affected due to its accounting proposal. Sierra's rates will not be adversely affected. Therefore, there is no reason that Sierra's proposed accounting treatment cannot be made effective for accounting entries effective January 1, 2001.

We will grant Sierra's request. However, our approval of Sierra's proposed accounting treatment does not constitute approval of any contract, or the regulatory treatment of any contract.

V. Procedural Matters

Notice of this application appeared in the Commission's Daily Calendar of August 28, 2001. In Resolution ALJ 176-3070 dated September 6, 2001, the Commission preliminarily categorized this application as ratesetting, and preliminarily determined that hearings were not necessary. With no filed protests, there is no reason to hold a public hearing and no reason to change the preliminary determinations made in Resolution ALJ 176-3070.

VI. Comments on Draft Decision

This is an uncontested matter, in which the decision grants the relief requested. Therefore, the applicable 30-day period for public review and comment is being waived pursuant to Section 311(g)(2) of the Public Utilities Code.

VII. Assignment of Proceeding

Carl Wood is the Assigned Commissioner and Michael Galvin is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. Sierra adopted FAS 133 and 138 on January 1, 2001.
2. FAS 133 and 138 require that all derivatives and certain embedded derivatives be reported on the balance sheet at fair market value.

3. Certain contracts, defined as derivatives by FAS 133 and 138, must be entered into by Sierra in order to purchase power, generation and transmission capacity, etc.

4. The fixed price components of these contracts can vary substantially from market prices at any one time.

5. FAS 133 and 138 require that the difference between the contract and the market price be recognized as a gain or loss every quarter, even though there is no associated cash flow.

6. Under Sierra's proposed accounting treatment, regulatory assets or liabilities using the same accounts would simultaneously offset the non-cash accounting entries.

7. When the contract is actually settled, the expense is recognized as the actual contract price, the net gains or losses previously recognized would be reversed, and the net offsetting regulatory assets or liabilities would be reversed resulting in no net gain or loss.

8. The proposed accounting treatment would reduce the volatility in Sierra's earnings caused by FAS 133 and 138.

9. Sierra's accounting proposal to offset differences between contract and market prices with regulatory assets or liabilities resulting from its adoption of FAS 133 and 138 will not affect its cost of service.

10. Under Sierra's proposal, potential adverse effects of earnings volatility caused by FAS 133 and 138 on the utility's ability to pay dividends and to attract capital would be eliminated and rates would not be affected.

Conclusions of Law

1. The application should be granted.

2. In order to avoid the potential adverse affects of FAS 133 and 138, the following order should be effective immediately.

O R D E R

IT IS ORDERED that:

1. The request of Sierra Pacific Power Company (Sierra) to establish regulatory assets or liabilities accounts to offset the entries required by Financial Accounting Statements (FAS) 133 and 138 is granted for financial accounting entries beginning January 1, 2001 to the extent rates are not affected.

2. Application 01-08-030 is closed.

This order is effective today.

Dated October 24, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
CARL W. WOOD
GEOFFREY F. BROWN
MICHAEL R. PEEVEY
Commissioners