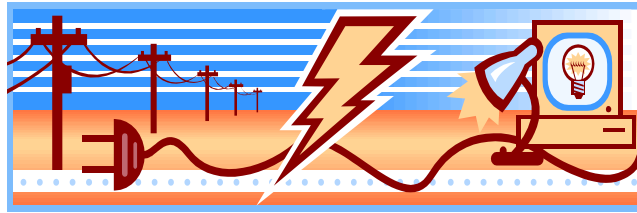


Public Utility District Audit Planning Guide



December 28, 2022

Table of Contents

WHAT'S NEW.....	2
REQUIRED RISKS TO ASSESS	2
GENERAL BACKGROUND	3
PLANNING & ADMINISTRATION	6
ACCOUNTABILITY	8
FINANCIAL STATEMENTS	15
SINGLE AUDIT.....	19
COMPLIANCE EXAMINATIONS	20
PERFORMANCE AND IT AUDIT CONSIDERATIONS	21
APPENDIX A: Regulatory Accounting	22
APPENDIX B: COVID-19 Impacts.....	25

Planning Guide Information

Supersedes previous planning guide dated March 3, 2021. Please direct questions or suggestions to a Public Utility District Subject Matter Expert.

Guidance is based on the extensive research, brainstorming and reviews conducted as part of the [planning guide update process](#). For this update, guidance was also informed by previous discussions with:

- Washington Public Utility Districts Association (WPUA)

Guidance is intended only for internal use to help auditors gain an understanding of public utility districts (PUD). The guide is intended to enhance planning and risk assessment procedures, not replace them. Information in the guide should therefore be considered along with other planning and risk assessment procedures. While guidance is designed to be as comprehensive as feasible, auditors must be alert for audit issues and situations not specifically addressed.

This guide is used by the State Auditor's Office staff as they plan audit engagements. Information presented in this document does not represent policy or legal guidance. State agencies and local governments should contact their legal counsel with specific questions.

WHAT'S NEW

Auditors should be aware of the following significant updates:

- [Clean Energy Transformation Act \(CETA\)](#) - Districts that distribute electricity to more than one retail customer are required to comply with CETA. No additional procedures are needed, Team Energy will perform these as compliance attestation examinations with a separately issued report.
- [Information for Compliance Engagements](#) - When performing a financial audit or reviewing an external CPA firm's financial audit of a PUD included in the list, auditors are requested to document specific information and place it in the FAWF for upcoming Energy Independence Act compliance engagements performed by Team Energy.
- [New GASBs Affecting Financial Reporting](#) – GASB 87 (Leases) is expected to have an impact on PUDs and require re-evaluation and changes to reporting. GASB 83 (Asset Retirement Obligations) is also expected to continue to have an impact on PUDs; additional information related to assets for PUDs that operate specific types of generating facilities has been added.

REQUIRED RISKS TO ASSESS

The following risks must be documented as red flags and discussed during brainstorming to ensure sufficient consideration. They should be prioritized for audit to the extent they are applicable and significant to the PUD.

Procurement - Transformers

Districts have expressed concern that competitive procurement of certain equipment, such as new electricity transformers to serve new construction in their respective service territories has become extremely difficult. Districts have stated orders are delayed up to 24-36 months and prices for the equipment are subject to change. To address this issue, Districts are looking for ways to secure orders. Auditors should be alert to non-compliance with procurement requirements.

We have advised Districts to document their rationale for the actions they take in procuring these hard to obtain items. We suggest if you identify these transactions for inclusion in your audit scope, ask the District for documentation of its efforts to follow applicable procurement laws (such as any legal analyses, pricing and vendor availability research, etc.) for auditor assessment.

Write Offs and Adjustments Related to COVID Restrictions

Districts have had questions as to whether these are allowable considering state prohibition against gifting of public funds, now that shut-offs are no longer prohibited under the Governor's Proclamation. Auditors should make sure Districts have a process for ensuring write offs and adjustments are reviewed, approved and adequately supported. **We expect a considerable increase in activity in this area.**

Financial Condition

Financial condition risk will be assessed as a baseline test for accountability audits and as part of our going concern analysis for financial audits. Governments have experienced a wide range of effects as a result of COVID-19; auditors should be alert for any risks to financial condition and review [FYI 2020-01](#) for expected disclosures.

The financial effects on residential and industrial/commercial customers brought on by COVID-19 are expected to have a financial impact to each PUD. For example, if a PUD's industrial or commercial customers are not using the amount of power or water expected when the district set its rates, this disparity could adversely impact the district's ability to recover its costs of services to those customers, and result in changes in how it will design its rates in the future. Note that analytics comparing retail utility revenues to volume of service provided may be skewed. In addition, an increase in accounts receivable aging could make it easier to conceal fraudulent activities. See also [COVID-19 Accounts Receivable Risks](#) in the Financial Statement section. It might take a PUD some time to adjust its rates to align with changes in demand and to compensate for the lost revenue.

In addition, we expect each utility to experience a significant increase in the number of commercial and residential accounts in arrears, which can adversely impact the PUD's financial position as well. PUDs have historically carried more funding in reserves than other government types; so, they may be in a better position

to absorb the financial impact of these types of issues without significantly increasing the billing rates the PUD charges its customers. Therefore, we expect to see reductions in PUD reserve fund balances in the short term.

Utilities, including PUDs, also have been impacted by the governor's proclamations on deferrals of late payments and prohibitions against shut-off of service, see [Appendix B – COVID 19 Impacts](#). Note that the proclamations expired on September 30, 2021. See also [Measurement of Financial Health](#).

EFT Controls

Payroll and vendor electronic file transfer (EFT) related cyber frauds continue to occur. Accordingly, controls over EFTs is a required risk to assess for all entities we audit. When assessing this area of risk, auditors should talk with the entity about its controls related to changing existing EFT contact information and associated bank account numbers. The approach perpetrators of these frauds use has evolved to include changing contact information for existing EFT transactions before requesting a change to the associated bank account numbers. Previously, entities were encouraged to follow up with the contact information known at the time of the request for changes to bank account information; however, a stronger control is to independently confirm any change to payroll or vendor profile contact information or banking account information. Individuals with the ability to change or add EFT accounts need to have clear guidance on the process to authorize these changes through a proper validation method. [A testing strategy is available in TeamMate at Accountability | Expenses | EFT Disbursements | Controls over EFTs](#). Contact Team IT Audit at SAOITAudit@sao.wa.gov for additional clarification or guidance.

BACKGROUND

Washington's 28 public utility districts (PUDs, or Districts) are considered "consumer-owned utilities" formed under Title 54 RCW for the purpose of conserving water and power resources and supplying various public utility services.¹

PUDs are proprietary in nature, governed by a three or five member board of commissioners who are responsible for regulating their respective District by setting rates and making business decisions that are carried out by a CEO / General Manager. District Commissioners' regulatory role over their respective consumer-owned utility is similar to the Washington Utility and Transportation Commission's regulatory role over the investor-owned utilities (Avista, Puget Sound Energy, and PacifiCorp).

Authority and Common Activities

PUDs are authorized to provide electric, water and sewer utility services, street lighting, wholesale telecommunications services, and are authorized to produce and distribute renewable resource fuels, such as biodiesel and ethanol. PUDs may sell renewable natural gas and, as of July 28, 2019, renewable hydrogen. PUDs may also operate power and water conservation programs. Telecommunication operations are limited to wholesale services that include development, licensing and operating telecommunications lines and facilities within the district. In general, PUDs can only provide wholesale or retail telecommunication services as a fee-for-service to internet service providers and other public utility districts, not to end-users.

PUDs have taxing authority but normally finance their activities exclusively through revenue bonds and sales of services. As is true with all forms of utilities, a PUD's rates are designed to recover all of its costs.

Formation of new entities:

Chapter 43.52 RCW gives PUDs authorization to form joint operating agencies (JOA). The current largest JOA is Energy Northwest. Its membership includes 19 Washington PUDs. It owns and operates the Columbia Generating Station, which is the state's only commercial nuclear power plant.

RCW 39.34.030(2) gives PUDs and other municipalities the authority to form LLCs, corporations, nonprofits and partnerships to facilitate cooperative action under an interlocal agreement. For PUDs, this structure has

¹ Title 80 RCW primarily relates to the State Utilities and Transportation Commission and its oversight of investor owned utilities and does not generally apply to public utility districts and municipal utilities.

been used for renewable energy projects, such as wind farms. These entities are expected to be subject to SAO audit.

Contact a PUD expert or program manager for assistance evaluating any newly formed entities or to evaluate any entities created by a PUD that are not currently being audited.

Purchasing and Selling Electricity

Although utilities are currently researching new technologies, electricity cannot be stored efficiently; so, power that is not used or sold represents lost revenue opportunities.

To meet their customers' power needs, a PUD may generate power from facilities it owns, purchase power from third-party power producers, such as the Bonneville Power Association (BPA), or purchase power on "the open market" from other utilities that generate excess power. BPA provides a large percentage of the electricity to meet the retail demand of the Pacific Northwest. BPA delivers electricity to its utility customers using transmission lines, owned and maintained by the U.S. Department of Energy.

In some cases, a district's customers may generate their own electricity and sell any excess power back to the district in the form of a credit to their electric bill. Referred to as net metering (Chapter 80.60 RCW), the district will install a bi-directional meter that measures how much energy a customer transfers to and from the District's grid from generation at the customer's premise. This generally applies to residential and commercial customers who have installed a wind generator or solar panels on their buildings. Similarly, a large industrial customer might operate a generator, such as a cogeneration facility installed at a lumber processing mill, using wood waste to heat a wood drying kiln. The waste heat emitted from that process is captured and used to heat water to create steam that is used to turn (or fuel) a turbine generator for energy production. The energy produced, or load, can be used by the facility, or can be sold to the PUD to supply its customers.

How power is measured

When reviewing amounts of electricity a PUD purchases or sells to its retail customers, the amounts are stated in units of MWhs (megawatt-hours) or kWhs (kilowatt-hours), where one MWh = 1,000 kWhs.

PUDs will enter into "Power Purchase Agreements", or "PPA's" where they purchase an amount of energy from a power seller as a one-time delivery, or over a period of time which can range from an hour using a short-term market sale, to several years using a long-term contract.

Output over the course of a period of time, such as a year, is expressed in MWhs or kWhs – the number of MW or kW produced over the total number of hours the generating unit operated during that year. For example, if a wind turbine generator with a nameplate capacity of 1.5 MW produced energy non-stop every hour of the year, the maximum amount of energy that wind turbine generator could produce in one year is 13,140 MWh (1.5 MW per hour, times 8,760 hours per year).

Electricity pricing and volatility risk management

The price of a unit of energy (spot price) can be highly volatile, depending on the demand for electricity at the time it is purchased – energy purchased at 5:00 pm when most people are home from work cooking dinner (on peak) is much more expensive than energy purchased at 3:00 am when most people are asleep (off peak).

A PUD can manage its cost volatility risk by using hedging strategies of varying complexity. For instance, a PUD can purchase "future" contracts to purchase energy ahead of the time it is needed to lock in a particular purchase price, in cases where the utility anticipates energy prices will increase. Conversely, a district could use the future contract to ensure it sells its excess energy at a particular price to cover its production costs in the event of future energy cost declines.

We would expect these hedging activities to be controlled by PUD risk management policies and disclosed in the financial statement notes (see derivatives in financial statement section). Managing the volatility of energy demand and prices requires highly specialized expertise and training. PUDs either hire staff with expertise in this area or outsource for the expertise. Specifically, PUDs can become a member of an organization comprised

of power purchasers who function like stock traders to purchase or sell power on behalf of the member utilities. The largest national public power energy trading and power management firm is "The Energy Authority" (TEA), which is wholly-owned and operated at the direction of its public power membership. The Attorney General's office has concluded it is allowable for Washington PUDs to be members of TEA.

Future Trends in the Utility Industry

Utilities are researching technologies to ensure reliable electricity is available to meet customer demand. Customer demand for electricity can vary during the day. Utilities deploy various strategies to ensure they have sufficient electricity available to respond to sudden increases in customer demand during the day. To offset the variability in customer electricity usage, utilities generally purchase electricity on the open market. They also invest in resources such as wind and solar, and utilities are developing technologies in the areas of thermodynamic, tidal energy generation, and battery storage as a means of obtaining additional electricity to supply customers during the day when usage is at its peak.

Utilities also are investing in demand management (demand response) measures such as smart meters that are designed to shift customer demand for electricity from a peak period during the day to an off-peak period. This helps reduce the Utility's need to purchase additional electricity on the open market.

Industry, Regulatory and Other External Factors

As a monopoly with rate-setting authority, PUDs are provided protection from many business risks because they can pass costs on to customers through their rates. Potential business risks for PUDs include: dependence on one or two large customers, weather, risk of damage or loss to infrastructure in a natural disaster, competition for the purchase of power, and changes in regulations.

Depending on the district, oversight agencies may include BPA and FERC:

- In 2008-2011, the medium to large PUDs signed new long-term power contracts with Bonneville Power Administration (BPA). These contracts cover the period 2011 – 2028 whereby BPA sells fixed and variable amounts of electricity to its utility customers, referred to as "block" and "slice" agreements, respectively. Under these agreements, the district will receive a block (pre-defined) amount of power, plus a percentage piece (slice) of the excess power generated, the amount of which can vary². **These contracts include a "slice-load ratio" compliance requirement that auditors should consider in identifying material contract compliance requirements during financial statement audit planning.** Specifically, utilities are required to maintain a slice-load ratio, or a measurement and verification to verify the PUD is delivering the less expensive BPA power to its retail customers (bringing the power it purchases from BPA to load), as opposed to selling the low-cost power at a higher price to power resellers. Through this slice agreement, BPA prohibits its PUD customers from selling the cheaper BPA power on the wholesale market for a large profit. **Noncompliance with this contract requirement can result in financial penalties to the PUD.**
- The Federal Energy Regulatory Commission (FERC) issues licenses/permits for hydroelectric facilities. These typically are long term (30-50 years) and are subject to renewal so long as the facility is operated in the parameters FERC requires. However, we expect financial penalties associated with non-compliance with these agreements to be rare because of the severe consequences of losing a license to operate a generating facility. PUDs place a high priority on complying with FERC's requests in a timely manner and have adequate funding sources to do so. FERC also coordinates the development and adoption of information technology systems (smart grid) guidelines and standards, and has authority to approve mandatory cybersecurity reliability standards.

There are other agencies, such as the US Department of Energy (DOE), North American Electric Reliability Corporation (NERC), and Western Electricity Coordinating Council (WECC), that are associated with the power industry and play a role in the regulatory environment, but are not normally considered oversight agencies of the PUDs.

² For example, the amount of power delivered to a utility under BPA's slice agreement can vary due to the amount of water available to create power at the dams that comprise the federal system.

Measurement of Financial Health

Historically, we have observed few financial health concerns because a PUD's board of commissioners can raise rates without restriction to generate additional revenues; however, utilities with infrastructure needs that are greater than the revenue it can raise through reasonable rate increases may be at risk. Also, there is increased risk of financial distress if a district's relationship with a major customer terminates, such as the shutdown of an industrial customer's facility.

The financial health of proprietary entities is often best measured by considering the change in net assets, after adding back depreciation and amortization costs.

PUDs often issue revenue bonds. Changes in current bond ratings (at www.emma.msrb.org) may also be a good source indicator of a PUDs financial health.

See also [Required Risks to Assess](#) for financial condition.

PLANNING & ADMINISTRATION

Training and Additional Resources

The following recorded self-study is available in the training system and may be helpful when auditing public utility districts:

- [Introduction to Public Utility Districts](#)
- [Know Before You Go: Public Utility Districts](#)

Additional resources related to public utility districts can be found on the intranet site under Audit | Information | Reference Guide | [PUD Resources](#).

Analytical Procedures

PUD specific items to inform analytical procedures:

- Increased investment in capital projects – Potential for increases in Clean Energy Transformation Projects under CETA, such as expenditures to construct vehicle charging stations.
- Late fees and shut offs – An increase in communications with customers, collections, and liens will more likely to be an issue affecting 2022, more so than 2021.
- Increase in receivable write-offs following Sept. 30, 2021 – Potential for issues with up to date policies and compliance with District policies following expiration of proclamations, plus additional risks with receivables management.
- Increase in spending for energy assistance - Likely to see an increase in spending on programs to provide energy assistance to (reduce the energy burden of) low-income households to comply with CETA requirements.

Clean Energy Transformation Act (CETA)

Districts that distribute electricity to more than one retail customer in the state of Washington are required to comply with the Clean Energy Transformation Act (RCW 19.405) and administrative rules (WAC 194-40). **We have placed memos in each District's FAWF file to inform auditors that no additional procedures are necessary. Team Energy will perform these as compliance attestation examinations with a separately issued report.**

CPA Firm Financial Statement Services

Many PUDs contract directly with external CPA firms for financial statement audits. In some cases, we audit PUDs on a 2 or 3 year cycle for accountability purposes, while a CPA firm performs the annual financial audit. The CPA Audit Report Review is to be performed annually (or as frequently as the external report is issued), regardless of the accountability audit frequency. See the [Review Work of Others](#) planning guide for additional information and contact the [CPA Audit Coordinator](#) for questions. The following guidelines summarize auditor responsibilities when all or part of a financial audit is performed by an external CPA firm or as part of another SAO audit.

- When **all** of the primary government audit is performed by an external auditor in lieu of an SAO audit, follow Audit Policy 3510, perform a "CPA Audit Report Review" in a separate TeamMate file ([available in the TeamStore under Special Engagements | CPA Audit Review](#)) and charge time to project code "CPAP". This TeamMate file must be completed prior to planning the Accountability Audit.
- When **part** of the audit is performed by an external auditor or as part of another SAO audit, follow Audit Policy 6240, use the appropriate "Rely on Work of Others" audit program ([available in TeamStore under Financial Statements | Rely on Work of Others](#)) and charge time to project code "CPAR". This work should be started as soon as possible during planning.
- When **part** of the audit is performed by an external auditor in lieu of an SAO audit and it is **significant** to the primary government, follow both Audit Policy 3510 and 6240, perform a "CPA Audit Review" coding time to "CPAP" and use the appropriate "Rely on Work of Others" audit program coding time to "CPAR".

Required – When performing a financial audit or reviewing an external CPA firm's financial audit of a PUD, auditors are requested to document the following information and place it in the FAWF for upcoming Energy Independence Act compliance engagements of these districts:

Benton Co PUD	Chelan Co PUD	Clallam Co PUD
Clark Co PUD	Cowlitz Co PUD	Franklin Co PUD
Grant Co PUD	Grays Harbor Co PUD	Lewis Co PUD
Mason Co PUD No. 3	Snohomish Co PUD	

Team Energy uses the following to inform its planning and analyses of the retail loads these districts use to calculate their respective renewable energy targets:

1. Was retail electricity sales revenue identified as a material balance?
2. If it was a material balance, did we or the CPA firm test/analyze the retail electricity sold as a function of the reported retail electricity revenues? If so, please summarize the procedures and results.
3. Were any misstatements, significant deficiencies or material weaknesses identified with the district's customer Billing System that had an effect on the reported retail electricity sold? If so, please describe condition, steps the utility took to resolve the issue, and document the impact the condition had on the retail electricity values reported.

NOTE: Audit testing of retail electricity is commonly performed as an analytical comparison of retail revenues to kWh or MWh sold, or sometimes a comparison of the amount of power purchased by the district compared to the amount of electricity the district sold to its retail customers and through wholesale market sales.

This information will help Team Energy avoid reperforming the same work in upcoming compliance examinations.

Key Operational Information

Key information the auditor should document in the permanent file includes:

- The types of services offered and major infrastructure related to each
- How the PUD buys its power, if it sells power, and its strategy to hedge power purchase and sale risks (long-term contracts, derivatives, etc.)
- Participation in joint ventures or other corporate entities

- Material compliance requirements
 - Bond covenants (see financial section)
 - For utilities with dams - existing relicensing agreements and expiration dates; any compliance requirements contained in the permit or license
 - For utilities who have agreed to maintain a slice-load ratio, if they do not they risk incurring a financial penalty from BPA (see discussion on BPA oversight agency)
- Any activities beyond basic utility services that have been evaluated for allowability
- Whether the PUD uses regulatory accounting, see [Appendix A](#)

Each electric utility will have an Integrated Resource Plan (IRP), or a more simplified resource plan, developed in accordance with state law that forecasts future supply, demand and infrastructure investments. The plan, which is generally posted on-line, is a good document for auditors to scan to understand the utility's business environment and resource acquisition strategies.

ACCOUNTABILITY

ALERT: The Public Records Act (RCW 42.56.330(2)) has a special exclusion of records or lists of a public utility from public disclosure if those documents include the following information about its customers:

- Addresses,
- Telephone numbers,
- Electronic contact information, and
- Customer-specific utility usage and billing information.

Records obtained from the utility that include this information must be handled by the auditor as **Category 3 confidential information** in accordance with SAO "[Security and Privacy Policy for Managing Data](#)". If auditors have questions on how to handle the data, contact the Team IT Audit Data Analysis manager, Tara Lindholm.

Revenues

Public Utility Districts may act as their own treasurer (RCW 54.24.010).

Strong internal controls over cash receipting is critical to a PUD due to the large amounts of monies receipted. Cash receipting fraud risks are particularly of concern at smaller PUDs where they might not segregate duties or have inadequate oversight over deposits and account adjustments.

The auditor should consider mitigating controls in the control risk assessment, such as an effective oversight process over transactions. If persons with access to the cash or the deposit (at any time) have the ability to perform adjustments to customer accounts, auditors should consider testing for validity, authorization, and support of adjustments made throughout the year. See also the Center's resource [Segregation of Duties: Essential Internal Controls](#) for additional control options for small entities.

Auditors should specifically consider risks over the following:

- 1) Are cashiers or any persons with access to the cash or the bank deposit able to adjust customer accounts (balances owed) and/or cash receipting transactions (i.e. void a receipt) in the billing system? In past PUD fraud investigations, we found that ineffective segregation of duties, lack of effective monitoring and inappropriate access to financial software to manipulate records were main factors in allowing misappropriations to occur:
 - Accounts that receive services (metered or unmetered usage) but were not billed.
 - Cash receipts that were skimmed, misappropriated and not applied to the account (i.e. lapping scheme) or are misappropriated and then concealed with an adjustment to the customer's account to reduce the balance due.

- Collections processes are at risk for unauthorized write offs or accounts that may go delinquent and unpaid due to lack of monitoring.
- 2) Are deposits independently reviewed and reconciled by someone who does not have access to cash receipting or to the deposit itself (this includes access to the safe and taking the deposit to the bank)? PUDs should try to minimize the transferring of the deposit between persons for purposes of recounting it as this practice increases the opportunity for misappropriation. When entities employ this practice, it makes it higher risk that there is not an independent review as numerous individuals have access to the deposit. The independent reviewer would be checking system receipting records to the bank validation receipt, including comparing cash/check composition.

Common revenue streams are as follows:

- **Fees for utility services provided** – This is generally the largest revenue category. Customer billing rates are generally established by resolution, although some large industrial customers may have negotiated power contracts for a reduced rate. Larger customers may also be subject to demand charges, or additional fees for peak power draw. For example, a baked goods manufacturer might use a high amount of power in the morning when all ovens are in use but a much lesser amount during the day. Due to the demand on the system at one point during the day, they will incur additional fees, or demand charges, from the PUD.

Customers may also incur late fees or be charged hookup fees for new services.

PUDs may provide their services at reduced rates for low-income senior citizens or other low-income citizens providing it's established in ordinance or resolution and uniformly applied to all service areas (RCW 74.38.070).

- **Collection Practices** – PUDs should have a collection policy that establishes how to handle past due accounts, when to shut off services, and when to send a customer's account to collections. Some PUD policies include a methodology for collecting on certain accounts such as focusing on the largest and longest past due because of the voluminous activity that can occur with late payments. For PUDs with high volumes of late payments and limited staffing, this may be a riskier area to consider for audit. See also [Appendix B – COVID-19 Impacts](#) for information on the governor's proclamations on deferrals of late payments and prohibitions against shut-off of service.
- **Conflict of Interest** - Entity staff and officials often have personal accounts at the PUD. Auditors may consider periodically testing those accounts to ensure charges are reasonable and adjustments are valid.
- **Third Party Receipting** - If the PUD contracts with a vendor to help it process payments such as to accept or process credit card payments or use a vendor receipting system online or otherwise, where the vendor helps with handling or processing payments, additional risks should be considered. [A TeamMate testing strategy is available at Accountability | Revenues | Third Party Cash Receipting.](#)
- **Voluntary Contributions** – A PUD may include as part of its regular customer billings a request for voluntary contributions to assist qualified low-income residential customers in paying their electricity, water or sewer bills (RCW 54.52.010). These funds may be managed by the PUD or a nonprofit as outlined in the statute and may only be used to assist the District's low-income customers with their bills, not for use to offset the District's costs to administer the program.
- **Sales of Excess Power** – PUDs with generation facilities or who purchase more power than they need to meet their retail demand can sell the excess power. BPA Tier I power purchases may not be resold without penalty, unless the District has made special arrangements with BPA to do so.

PUDs that sell power they generate from their own facilities, such as hydropower from dams they own, use the "Web Trader System" (WTS), third-party software, to record each sale and purchase. PUDs may

refer to the system by other name, such as "Deal Trader System" or the "Trade Capture System." PUDs use the WTS and its reports as the authoritative source for any reporting of trading activity that is needed.

- **Pole Attachment Revenue** – Rental income from microwave towers, used for cell phones and secure communications, built on substation property. These agreements may be made with cable companies and are typically for 20 years with the option to renew.
- **Special Property Tax Assessments** - RCW 54.16.120 allows PUDs to levy special property tax assessments to cover their capital and operating costs relating to street lighting. The PUDs should have a basis to demonstrate how its fees were calculated and how it relates to the actual cost of providing this service, demonstrating the benefit received. The PUD may contract with the County Treasurer to perform the actual billing and collection.
- *[Telecommunications only]* **Wholesale Telecommunications** – Utilities contract with and bill, at wholesale prices, retail telecommunication service providers for the right to use the District's telecommunication infrastructure. Some PUDs invest heavily in telecommunications infrastructure and are sometimes reluctant to address overdue accounts from retail telecommunication providers. Utilities may create financing arrangements with their telecommunication providers that are inconsistent with the PUDs collection policies.
- *[Telecommunications only]* **Retail Telecommunication Services** – RCW 54.16.330 offers guidance on who may provide service to end-users of telecommunication systems. Following the 2021 legislative session, PUDs **are authorized to** provide retail telecommunication services directly to underserved end-users, provided certain conditions are met. For example, a PUD is now authorized to provide retail broadband service to residential customers who are not able to acquire those services. Districts are required to work with the Governor's Broadband Office to gain the authorization to provide those services.

Please contact a PUD Subject Matter Expert should you have questions in this area.

Expenses

In addition to normal risks related to accounts payable, imprest and EFT systems, auditors should be aware of the following unique facts or risks:

- **Board Member Compensation** – RCW 54.12.080 governs Commissioner compensation and allows for a salary depending upon the size of the PUD, as well as a payment per meeting doing official business, and reimbursement of travel expenses. Commissioners may also participate in the entity group health insurance plan expressly authorized in this statute. There is a max limit on total salary.
- **General Manager Compensation** - RCW 54.16.100 requires the Board of Commissioners to set the General Manager's compensation by Board Resolution in an open public meeting.
- **Executive Compensation** - Executive employment contracts may provide additional compensation beyond that offered to other employees. Auditors should question the basis for additional compensation that is not defined in an employment contract. Examples could include car allowances, additional retirement funds or life insurance policies.
- **Incentive Plans, performance pay, bonuses or other forms of additional payments beyond standard salary** - PUDs have a need to hire employees in certain specialized positions that are in high demand, such as lineman. The market for employees to fill these positions can be quite competitive. To compete, PUDs are looking for ways to attract experienced staff and often use compensation incentives to achieve this objective. If awarded improperly though, these types of payments may represent extra compensation and a gifting of public funds, which are prohibited by the state Constitution. Management and other district staff may also be offered financial incentives, which are typically defined outside of employment contracts.

The Legislature has granted PUDs the authority to pay for the actual necessary travel and living expenses of certain interview candidates under certain circumstances (RCW 54.16.092). However, PUDs are not

expressly authorized to pay employees hiring bonuses or reimburse them for actual moving expenses, and should conduct their own legal analysis prior to setting up such programs. Here are some things to keep in mind:

- PUDs should have a legal analysis to support their legal authority to offer incentive programs
- The Governing body should formally adopt any incentive program by resolution
- Typically for incentive plans: goals should be established before the performance period begins; should be individually based and are above and beyond normal employment requirements for that position; outcomes should be measurable and evaluated at the end of the performance period before payment is made.

Auditors should consider large, one-time payments to employees, outside of regular, periodic payroll transactions. Hiring bonuses may be allowable but must be the result of a demonstrated public purpose and the employee meeting pre-defined criteria. For example, the entity pays the employee after the employee has worked for the entity for an agreed upon period of time, or the entity pays the employee after the entity has received some added consideration from the employee, i.e. paying hiring bonuses for staff development costs normally incurred by the entity. Auditors should request the PUD's policies and support showing these types of payments do not violate the state Constitution. Auditors should use the ["Bonus / Incentive Payments" step available in TeamMate at Accountability | Expenses | Payroll Disbursements](#) when reviewing incentive plans.

Recent fraud investigations have involved compensation for lineman (control deficiencies as it relates to detecting falsification of time sheets). Auditors should also consider the following risks:

- Whether the employee meets the criteria established by policy to qualify for the additional compensation, such as stipends.
- Controls over time tracking and timesheet preparation include controls in place to ensure the time reported is accurate. Some employees can earn significant amounts of overtime. The PUD should have controls to ensure overtime is authorized and reasonable including supervisory review, and periodic comparisons to support such as dispatch or on call logs, dispatch recordings, and/or gate access logs.
- Controls ensuring overtime and benefits are paid out in accordance with approved PUD policies.

It's likely PUDs have offered hiring bonuses for quite some time, so auditors might expect questions from the PUDs on this topic as we make recommendations. We've communicated with the PUD Association (WPUDA) and have provided alternatives for attracting positions, such as adding retention payments into employment contracts (where the PUD would pay a lump sum at the end of a period of time, such as after each year of employment). Auditors should contact a PUD Subject Matter Expert or the Program Manager with any questions. Additional guidance developed in consultation with the AAG, Director of Legal Affairs, Audit Management and PUD SMEs & PM can be found in external HelpDesk request [#90403](#) (1/11/21).

- **Retirement and Benefits** – If a PUD allows employees to "retire" but allows the use of vacation/sick leave before the employment effectively terminates, then this practice must be included in its board-approved policy. In 2014, SAO confirmed with Department of Retirement Services that the employee can continue to earn service credits for retirement plan purposes during this time.
- **Loaning of employees** – PUDs may loan an employee to another PUD or other agency by contract. The agreement should specify what benefit each entity is receiving and how the payments are made to the employee. PUDs may not subsidize private business ventures by providing employee assistance.
- **Advertising** – RCW 54.16.090 gives PUDs the authority to incur advertising costs. We generally see advertising to promote district energy conservation programs and to promote other district services.
- **Taxes** – PUD's are subject to state and possibly city B&O tax, public utility tax, and PUD privilege tax. The public utility tax is the only one charged to the customer, whereas the other two are borne by the PUD.

The PUD privilege tax is intended to be in lieu of property tax and allows the state, schools and other taxing districts to receive revenues from the large investment in PUD generating facilities.

- *[Electric only]* **Power Purchase Agreements (PPA)** – PUDs without generation facilities obtain electricity from BPA or from public or private power producers, such as other utilities with generation facilities. These purchases are by contract for longer period of commitment, such as a month, year or several years, are often referred to as a PPA, also referred to as "Term Sales" or "Forward Deals". PUDs are also allowed to prepay for power so long as a contract is in place (RCW 42.24.080).
- *[Electric only]* **Short-term market purchases** – PUDs need to meet customer demand for power every minute of every day, year-round. During times when customer demand exceeds the amount of power a PUD received from its PPA's, it must go to market for purchase of the additional power it needs to meet its short-term demand.
- *[Water only]* **Environmental Mitigation** – If drawing water from an aquifer, the PUD may be required as a provision of its Department of Ecology (DOE) permitting process to have a habitat management/restoration plan. This can result in programs such as stream steward and habitat restoration that would likely be allowable per this contractual arrangement with DOE.
- *[Telecommunications only]* **Gifts of Public Funds related to Wholesale Telecommunications** - Retail telecommunication service providers are often small enterprises with limited funding. PUDs should not use public resources to provide items such as equipment, office space or staff in an effort to ensure the success of the service provider. Additionally, the PUD must ensure that rates, terms, and conditions for such services are not discriminatory or preferential. Rates, terms and conditions for wholesale or retail telecommunications services should be offered at substantially similar rates, terms and conditions to all entities seeking substantially similar services (see RCW 54.16.330).

Assets

Common sources of assets at risk of misappropriation or misuse include:

- **Petty Cash Funds** – PUDs may have large "storm fund" petty cash accounts for emergency purchases during storms and power outages. In such cases, controls over such funds are vital since the funds are infrequently used.
- **Surplus Property** – RCW 54.16.180(2) gives PUDs the authority to surplus property with Board approval. Although it has flexibility on how it will dispose of assets, the PUD cannot donate property to private parties unless the assets are determined to have no value in which case the PUD can dispose of in the manner it determines best.
- **Small and Attractive Assets** - PUDs typically have decentralized shop locations where many assets are stored and safeguarded. A recent fraud investigation identified issues with lack of proper controls to ensure issued assets are returned when an employee leaves employment. Past audits have also identified issues related to not adequately monitoring tools & equipment, not maintaining adequate listings and/or not maintaining up to date policies/procedures over these assets. Evaluation of controls should also include consideration of the effectiveness of the District's work order system.
 - **Tools & Equipment** - PUDs use a number of specialty electronic items such as portable GPS equipment to work on transmission lines which can be costly. Some tools are assigned to vehicles and others may be located in a tool room. PUDs should have a tracking system for its tools, including a process to inventory them. There should also be monitoring controls over purchases of new tools or equipment (via a formal work order system); including evaluation of what happened to the item it replaced to ensure proper disposition. The tool room manager may have responsibility for all the internal controls so another risk is proper oversight and independent checks on this function. [A TeamMate testing strategy is available at Accountability | Assets | Small & Attractive Assets.](#)

- **Inventory** – PUDs often store large amounts of unused supplies and materials needed for building and maintaining infrastructure such as cables, wires and pipes. These items are susceptible to theft for scrap sales, especially copper wire, and should be adequately monitored and secured. Inventory should be tracked in an inventory tracking system, periodically inventoried, and any inventory adjustments monitored by someone independent of the inventory.

Compliance Requirements

Many compliance requirements that apply to other entity types also apply to PUDs, including: Open Public Meetings Act, expenditure audit and certification, conflict of interest, limitation on compensation of public officials (which includes salary and insurance based on size of the District under RCW 54.12.080), insurance / bonding requirements and authorized investments (since PUDs act as their own treasurer).

PUDs are not subject to budgeting requirements.

Other compliance requirements and risks to be aware of are as follows:

- **Authority** - Chapters 54.04 and 54.16 RCW detail the scope of PUD authority which is limited as a special purpose district. [If you encounter activities that are outside of providing basic utility services, contact a PUD expert or program manager.](#) Any activities that are evaluated should be documented in the perm file section, including our process for evaluating them.
- **Self-insurance Programs** – See the [Self-Insurance/Risk Pools Guide](#) for additional details. PUDs should have their self-insured programs approved by the State Risk Manager, specifically medical programs, RCW 48.62 and WAC 200-100 and -110.

In 2017, the State Legislature passed legislation creating Washington State’s **Paid Family and Medical Leave Program**. State law also allows employers—including local governments—to opt out of the state’s PFML Program for either the family benefit, the medical benefit, or both, and instead offer a Voluntary Plan. Employers with Voluntary Plans are required to offer benefits that are equal to or exceed the benefits offered by the state’s PFML Program. They must apply to Employment Security Department (ESD) and be approved to administer a Voluntary Plan.

Because employers with approved Voluntary Plans are responsible for paying benefit claims to eligible employees using, in part, resources that are required to be set-aside, the SAO considers them to be local government self-insurance plans in the context of RCW 43.09.260, therefore requiring examination at least once every two years.

A testing strategy for PFML voluntary programs is available at [Accountability | Compliance Requirement | Self-Insurance](#) that can be used starting with audits covering 2020, which is the first year that benefits were required to be offered.

- **Operating a Joint Utility** - PUDs may operate a joint/consolidated/combined utility that would allow profits to be shared amongst the utility functions and would negate the one fund benefitting another limitation between utilities. A PUD must have a resolution in place that covers the joint utility functions in order to do this. Otherwise, a PUD would be subject to requirements limiting one fund from benefitting another. See the TeamMate testing strategy for audit steps covering both joint utilities and stand-alone utilities at [Accountability | Entity Specific Areas | Public Utility Districts \(PUD\) | Utility Subsidization](#). Note this does not override GAAP reporting requirements which might require presenting major funds or segment information (see financial section).
- **Bid Law/Procurement** – See the [Bidding and Procurement Guide](#) for details and bid thresholds. See also [Required Risks to Assess](#) for procurement of transformers. Specific bidding information, issues and risks are as follows:
 - On-call, Time and Materials Contracting, or Unit Price Contracting – Effective July 2017, RCW 54.04.070 changed to expressly allow PUDs to enter into unit priced contracts. If testing is planned, please test to the requirements found within RCW 54.04.070(7).

- Limitations on Using In-house Labor for Public Works Projects - A PUD may use its own employees to perform public works, subject to limitations. RCW 54.04.070(2) limits in-house work to projects with materials of a value of less than \$150,000 (\$300,000, effective July 28, 2019). Effective July 28, 2019, the Legislature revised as the definition of "equipment" under this statute to include "conductor, cabling, wire, pipe, or lines used for electrical, water, fiber optic, or telecommunication."
- Purchases –
 - RCW 54.04.082 requires PUDs to follow procurement requirements for purchases over \$15,000 per calendar month (\$30,000 per calendar month, effective July 28, 2019), exclusive of sales tax, unless the PUD Commissioners approve the purchase contract process under RCW 39.04.190, in which case the limit is \$60,000 per calendar month (\$120,000 per calendar month, effective July 28, 2019), exclusive of sales tax.
 - RCW 54.04.070(1) allows the purchase of up to \$7,500 of the same kind of materials, equipment and supplies in any calendar month (\$12,000, effective July 28, 2019) without a contract. Any purchase in excess must be by contract and bid accordingly.
- Public Works – PUD's must publicly bid all work done by contract over \$25,000 (\$50,000, effective July 28, 2019) unless they have an approved small works roster process, then the threshold in state law is \$300,000 (\$350,000, effective July 28, 2019) (RCW 54.04.070(2)). PUDs may reject any bids that are more than 15% over the engineer's estimate. PUDs must include the cost of all materials in determining if a project must be competitively bid, regardless if the materials are on hand.
- Materials for public works projects – PUDs are unique in that they have the statutory authority to separately procure materials, including materials for public works projects, separately from labor (RCW 54.04.070(1)).
- [Electric only] Power facilities operated by others - If the PUD has a power generation facility that is operated or maintained by a third party per a contractual arrangement, there may be a risk for noncompliance with bid law. The contractor may not be aware of bid law requirements and may be paying directly for the improvements and seeking payment from the PUD via reimbursement for a contractually agreed price (as an example).
- Professional Service Contracts – Contracts for telecommunication and electronic software are not considered a professional services contract; these types of contracts must follow bid laws.
- Electrical facilities exception - RCW 54.04.080 and .085 allow PUDs to pre-qualify bidders for work on some electrical facilities.
- Sole source – We often see Districts incorrectly declare the sole source exemption to competitive bidding requirements for a brand name. While it is common for District's to purchase equipment produced by a specific manufacturer or a particular manufacturer's model (for example, water meters, conductive wire), Districts must base the sole source exemption on its assessment of the vendors available to sell the manufacturer's equipment.

Refer to the [Bidding and Procurement Guide](#) for details on conditions under which sole source exemption may be used.

We have commonly allowed sole source as a bid exception for work done on turbines, which are found in a generation facility. Often the turbine must be shut down to evaluate repair and maintenance needs (at a high cost per day) and the work is done in a compressed amount of time by highly skilled engineers and technicians that specialize in repairing that particular type of turbine, usually employed by the manufacturer itself.

- Under statute PUDs can only act as a general contractor for work eligible to be performed using in-house labor, within the limitations described under RCW 54.04.070(2). – see 'Limitations on Using In-house Labor for Public Works Projects' *section, above*.

- MOUs and Settlement Agreements - If a project is not bid and done under a memorandum of understanding (MOU) or a settlement agreement under some regulatory act, such as a FERC license, contact the PUD Program Manager in order to seek guidance from SAO's legal counsel on whether bid laws may apply.
- Telecommunications - Specific bid law for telecommunications purchases exists under RCW 39.04.270. This alternative to a sealed bid process allows competitive negotiation after the District publishes requests for proposals (RFPs).

IT Risks

The [Information Technology guide](#) describes various general information system-related topics and identifies key primary risks related to computer systems that auditors should consider. Some relevant to PUDs include:

- **User Access** – Appropriate user access can strengthen segregation of duties. Challenges the auditor should consider center on a utility's ability to maintain adequate controls over User Access and Authentication. Particularly, risks to be considered include segregation of duties, weak user authentication controls, and failure to remove former employee accounts. Auditors should refer to the TeamMate steps in Accountability | IT Controls | User Access.
- **Data Backup and Recovery** - With ransomware and other attacks focused on denial of access to confidential and critical data becoming increasingly common in addition to the regular risks to data such as equipment failure, it is vital that utilities maintain backups of all critical data. Typical weaknesses tend to be not retaining at least some of the backups "offline" so the backups do not fall victim to the attack. Additionally, it is not uncommon for offline backups to fail due to a configuration or storage issue. As such, it is important that backups be tested on a regular basis. Auditors should refer to the TeamMate steps in Accountability | IT Controls | Data Backup and Recovery.
- **Patch Management & Updates** – Water and electric utility providers, including PUDs, have been identified as strategically important, specifically in matters related to national security, and likely at a higher risk of cyber incidents. The services utilities provide are critical to the communities they serve. Customers depend on their utility's ability to maintain reliable water and electricity services. While some utilities rely on third-party service providers to store or manage collection and storage of generation data, others purchase systems they operate and manage themselves.

For systems a utility operates internally, such as facility operating systems and financial and customer information systems, patch management is a front-line defense to ensure those systems remain reliable and maintained effectively against known and potential vulnerabilities. [A testing strategy is available in TeamMate at Accountability | IT Controls | Patch Management.](#) Auditor's should focus their testing on key systems that house confidential customer data or operate infrastructure necessary to maintain the reliability of services they provide.

FINANCIAL STATEMENTS

The general fund of a PUD is considered an enterprise fund. Although districts have the option to report GAAP or Cash, we would expect all PUDs to report on a GAAP basis due to reporting requirements imposed by FERC to maintain records on an accrual basis. The following chart of accounts guidance may apply to the PUD:

Water and Wastewater PUD accounting

PUDs typically follow National Association of Regulatory Utility Commissioners (NARUC) chart of accounts. NARUC recommends its members adopt its chart of accounts, but it is not required.

Electric PUD accounting

Federal Regulatory Energy Commission (FERC) prescribes its own system of accounting. Electric PUDs are required to use FERC accounting by federal regulation ([18 CFR Section 101](#)).

Combined PUDs

PUDs with multiple business units may create a combined “in-house” chart of accounts that combines the FERC and NARUC account requirements.

Multi-Column Presentations

Enterprise-type entities, such as PUDs, may choose to or be required to under GASB 34 (par. 67) to present their financial statements using a multi-column presentation with different business units (Electric System, Generating System, Water System, etc.) as separate columns. In this case, we consider each column a separate opinion unit (major fund) for planning and reporting but PUDs refer to them as “business units”. See [FYI No. 2006-01](#) for details. **Our report should reference each major fund/opinion unit (business unit).**

In some cases, the revenues for the generation system are entirely the expense of the electric fund. While an argument might be made these funds could be combined, PUDs have bond covenant requirements that necessitate these funds being presented separately. However, interfund loans between these two funds would not necessarily need to comply with typical loan requirements as they can transfer funds with no restriction.

There has been some questions about whether telecommunications should be reported as its own fund or business unit. As with all other PUD utilities or activities, if the PUD meets criteria in GASB 34 par. 67 (requirements for enterprise funds) or par. 122 (requirements for segment reporting) then it would either have to report the activity as an enterprise fund or comply with segment reporting requirements.

For PUDs that meet the requirements in GASB 34, par. 122, an alternative presentation is a single column presentation with information by business unit presented as a segment information note disclosure (see GASB 34 par. 122).

Bond Covenants – Material Compliance Requirements

Districts typically issue revenue bonds, although they may levy taxes and issue general obligation bonds. In addition to restrictions on unspent bond proceeds (which should be presented as a restricted asset), outstanding revenue bonds generally include covenants for:

Reserve amounts – these are monies set aside that the PUD could draw on to make payments in the case of financial distress. They are shown as restricted cash or investments on the financial statements. Some entities obtain a surety bond in lieu of establishing reserves and should have a copy of this bond on hand to demonstrate compliance.

Debt service coverage ratios – this requires the PUD to charge fees to generate a certain proportion of operating revenue compared to expenses. It requires a detailed calculation that the PUD should be performing annually. Details about how this should be calculated would be in the official statement of the bonds although it is a fairly standard calculation. If the ratio is not met, this should be disclosed in the notes and the auditor should inquire about a waiver obtained from the lender and evaluate any potential impact to going concern.

If revenue debt or restricted assets are material to the financial statements, it is recommended that bond covenants are reviewed each financial statement audit. Noncompliance with bond covenants should be disclosed in the financial statements in accordance with GASB codification GASB 2300.106.h. and 1200.113.

*** If we are aware that a PUD is charging higher rates and collecting more revenue than it needs solely to have a buffer to meet debt coverage/bond covenant requirements, we should suggest it consider use of regulatory accounting, see [Appendix A - Regulatory Accounting](#).

Regulatory Accounting

PUDs may elect (optional but not required) to use regulatory accounting allowed by GASB 62. The result is a regulatory asset (deferral of expenses) or regulatory liability (deferral of revenues) on the balance sheet that will result in recognition on the operating statement at a later time. If the PUD uses regulatory accounting, auditors should ensure they are familiar with guidance in [Appendix A - Regulatory Accounting](#) about regulatory

accounting. There is a [workpaper in the Team Store for auditing this area at Financial Statements | GAAP called "Regulatory Accounting Testing Strategy"](#).

Accounts Receivable

Accounts receivable (valuation) are considered inherently risky due to the estimates involved in the calculation both in recording unbilled receivables and in determining an allowance for doubtful accounts.

PUDs record a fairly large managerial estimate affecting accounts receivable at the end of each year relating to utility services provided, but not yet invoiced.

- *Additional Risk to Consider with Accounts Receivable due to COVID-19* - We expect aged accounts receivable balances to increase due to prior COVID-19 exemptions and deferrals (see also [Appendix B – COVID-19 Impacts](#)). Consider reviewing the entity's controls for monitoring its aging of accounts receivable accounts and ensuring these are valid accounts. A growing receivable balance could make it easier to conceal fraudulent activity. If the entity does not have strong controls, consider testing receivable balances to ensure they are valid. See also [Required Risks to Assess](#) for write offs and adjustments related to COVID restrictions.

Other Post-Employment Benefits (OPEB)

PUDs frequently offer post-employment benefits to their employees and are subject to GASB 75; [see TeamMate testing strategy for reviewing OPEB](#).

Capital assets

- *Construction of Capital Assets* - PUDs often construct their own assets and must account for costs using a work order system. This subsidiary system tracks the allocation of the cost of inventory from the warehouse, payroll from those assigned to the job, and overhead allocations to a work order (or job). Open capital related work orders are reported in construction in progress on the financials. As work orders close, they are capitalized into plant in service. PUDs should have a process to ensure costs captured in the work order are accurate and reasonable.
- *FERC Guidance* – PUDs follow FERC guidance closely when accounting for capital assets and several practices may be employed that are unique to PUDs. Some capital asset accounting practices differ depending upon whether the utility is major or non-major per FERC (has to do with size of the PUD). Auditors should consult [the FERC manual](#) when questions arise in this area.
- *Depreciation – Group or Mass Depreciation* - PUDs typically use group depreciation where similar assets are depreciated as a group, see GASB codification 1400.177-.180 which allows for this practice. PUDs may refer to this as mass depreciation and it is done out of practicality due to the types of assets of a PUD. There are many capital assets of a PUD that are not separately identifiable and so are depreciated "en masse" such as poles, transformers, or switches. When items are disposed of, any gain or loss is charged to accumulated depreciation. Also, if there are costs to retire the asset, this also may be allocated using the depreciation function and then at retirement, the costs to retire are also charged to accumulated depreciation (this is supported by the FERC manual). Lastly, when it is impracticable to determine the book cost of each unit, retirements may be recorded based on an average cost of all units.
- *Depreciation Useful life* - As required by the FERC manual, estimated useful service lives of depreciable property, upon which depreciation is based, must be supported by engineering, economic, or other depreciation studies. However, this requirement goes beyond GAAP requirements which only require support for estimates.
- *Depreciation Expense, Presentation* – PUDs may allocate depreciation expense to other line items on the operating statement. Thus depreciation expense will not equal the increase in accumulated depreciation. If they do this, they just need a note disclosure detailing total depreciation expense and how it was allocated (GASB S34-117d, GAAFR 366).

Accounting for Joint Ventures

We would expect districts to have a GASB 14 analysis prepared to support reporting of joint ventures, joint operating agencies (such as those described in the background section), nonprofits, partnerships and LLCs in its statements. In particular, auditors should be alert for joint ventures with an equity interest (see GASB 14, par. 72-74), which may be applicable to participation in windmill projects or The Energy Authority (TEA). An optional [worksheet and flowchart, "Reporting Entity Determination"](#), is available in TeamMate to document evaluation of how an entity should be reported.

Derivatives

PUDs may use derivative instruments such as futures, forwards, options and swaps to hedge against interest rate, natural gas and energy price volatility. Based on Attorney General's office guidance, it is our understanding that PUDs have proprietary authority to use derivatives for hedging purposes (that is, to offset risk exposures). GASB 53 requires reporting of financially-settled derivatives at fair market value as well as extensive disclosures. However, forwards and options for physical delivery or sale of power will typically be considered "normal purchases and sales" not subject to GASB 53 treatment. *Note if electing to use the regulatory accounting option under GASB 62, Districts may defer any changes in fair value of derivatives that don't qualify for hedge accounting under GASB 53. Auditors should use the "Derivatives Testing Strategy" workpaper in TeamMate when reviewing this area.*

Customer Billings/Revenues

Customer usage is measured using a meter reading system. The data from the meter reads is uploaded to the billing subsidiary ledger to generate invoices for customers. PUDs monitor the accuracy of the meter reads and billing system using system generated exception reports that flag unusual trends for follow up by staff. For financial statement purposes, auditors should consider testing controls over this system ([consider "IT Control Testing – Electronic Interfaces" and "IT Control Testing – Exception Reports" TeamMate Testing Strategies in the Permanent File | IT Control Testing folder](#)); and then perform analytical procedures for substantive testing.

Unique Disclosures

PUDs may have a number of unique disclosures including:

- Power contracts – If the PUD has contractually committed to purchasing power over future years from another legal entity, this should be disclosed in the notes to the financial statements. For example, several PUDs have contracts to purchase power from Energy Northwest (introduced in the background section), which would require disclosure.
- Telecommunications - RCW 54.16.330 requires PUDs to account for telecommunication activities in accordance with SAO standards. The BARS Manual contains a sample note disclosure that PUDs need to follow, [Note X - Telecommunication Services \(updated in December 2022 to include retail telecommunications revenue amounts\)](#). Please verify the information is disclosed in the notes. The legislature and other parties are closely scrutinizing this activity.
- Northwest Open Access Network (NOANet) – many PUDs pledged future assets to NOANet to pay its debt. Verify the District has disclosed the debt contingencies in the Notes to the Financial Statements. Per SAO opinion letter dated 12/10/03; the investments in NOANet by PUDs constitute a joint venture with equity interest related to NOANet's net income or loss. NOANet's loss (or income in future years) should be treated as an adjustment to the investment account using the equity approach. In addition to the standard note disclosure outlining the terms of the District's agreement with NOANet, and debt information, the current year's loss in total for NOANet and the District's share of the loss should be included. We have included a copy of the NOANet opinion in all applicable FAWF files.
- Interfund activity - PUDs may also have interfund balances and transactions between different business units. The PUD should disclose its policy as to whether these are eliminated on the statements. Any material interfund transactions that are not eliminated must be disclosed.
- Significantly large customers – if the PUD has several large customers that comprise a substantial portion of its revenue, then this fact should be disclosed.

New GASBs Affecting Financial Reporting

All new GASBs are identified and evaluated by the Financial Audit Committee (FAC), as summarized on the [GASB Tracker](#) available on the FAC SharePoint page. When evaluating implementation of new GASBs for PUDs, the most significant impact will be the implementation of GASB Statement No. 83, Asset Retirement Obligations. PUDs will also have to implement Statement 84 for fiduciary activities, but due to having a 90 day exception, many fiduciary activities will not qualify for reporting so we are expecting minimal impact with this standard.

- Asset Retirement Obligations (GASB 83, original implementation effective FYE 2019, new implementation effective FYE 2020): An asset retirement obligation (ARO) is a legally enforceable liability associated with the retirement of a tangible capital asset. PUDs might have AROs associated with electric generation plants, underground fuel storage tanks, and water treatment plants (where applicable). For example, Energy Northwest reports an ARO for the future dismantling costs associated with its nuclear power plant. The Center published [Identifying Asset Retirement Obligations](#) resource to help entities evaluate potential obligations.

The Clean Energy Transformation Act (RCW 19.405) requires utilities that sell electricity to more than one retail customer in the state of Washington to:

- eliminate electricity from coal-fired resource electricity by December 31, 2025 (RCW 19.405.030); and,
- supply retail customers with non-greenhouse gas emitting electricity and electricity from renewable resources by January 1, 2045 (RCW 19.405.050).

For PUDs that operate these types of generating facilities (i.e.: coal, natural gas, or fossil fuels), auditors should inquire about the PUD's plans for these assets in relation to the Act. Auditors should compare these plans to the PUD's accounting for these assets and specifically consider the need for any impairments, asset retirement obligations or changes in estimated useful life.

- Leases (GASB 87, originally effective FYE 12/31/20, now effective FYE 6/30/22) is expected to have an impact on PUDs and require re-evaluation and changes to reporting for leases. Auditors should use the [TeamMate testing strategy workpaper available in Financial Statement | GAAP | Workpapers](#). In addition to common lease activity expected for local governments, like buildings and equipment, auditors should be especially alert for leases of fiber optic lines for PUDs. However, accounting for these contracts could fall under either [GASB 87 – Leases](#) or [GASB 94 – Public-Private and Public-Public Partnerships and Availability Payment Arrangements](#) (effective in FY2023), depending on the terms of the contract. We would expect that PUDs have evaluated these contracts to determine applicability of GASB 87 and can provide their analysis during audit.

GASB 95, issued May 8, 2020, delayed the implementation date of certain new standards. Entities have the option to decide whether or not to delay implementation. During planning, as part of [Understanding the Entity & Environment](#), auditors should inquire with the entity and confirm the entity's implementation decisions.

SINGLE AUDIT

Some PUDs receive federal grants infrequently and pre-COVID those that did receive federal grants did not usually receive \$750,000 or more in federal funding. However, many districts are receiving federal funding through Commerce from the state budget (grants to all utilities to offset arrearages due to COVID) and through other grants, such as the Coronavirus State and Local Fiscal Recover Funds (SLFRF, ALN 21.027) and the new Inflation Reduction Act (energy efficiency rebates). As a result, some may be subject to a single audit that normally were not subject to this requirement. Auditors should therefore be alert for indications of federal grants and be prepared to remind PUDs of Single Audit requirements and/or suggest trainings that may be helpful such as federal grant trainings through WFOA.

See [ALN Notes](#) for special SEFA reporting requirements for the following programs that districts may receive:

- FEMA Disaster Grants – Public Assistance (ALN 97.036)
- EPA Capitalization Grants for Clean Water State Revolving Funds (ALN 66.458)
- EPA Capitalization Grants for Drinking Water State Revolving Funds (ALN 66.468)

COMPLIANCE EXAMINATIONS

Energy Independence Act (2006) – RCW 19.285

Our office is required by state law to examine the following consumer-owned electric utilities with 25,000 customers or more (referred to as “qualifying utilities”) for compliance with the Energy Independence Act (EIA):

- | | |
|---|---|
| • Benton County Public Utility District | • Lewis Public Utility District |
| • Chelan Public Utility District | • Mason No. 3 Public Utility District |
| • Clallam Public Utility District | • City of Seattle – Seattle City Light |
| • Clark Public Utility District | • Snohomish Public Utility District |
| • Cowlitz Public Utility District | • Franklin County Public Utility District |
| • Grant Public Utility District | <i>(2020-2021 Energy Conservation; 2022 Renewable Energy)</i> |
| • City of Tacoma, Tacoma Public Utilities | • City of Richland |
| – Tacoma Power | <i>(2024-2025 Energy Conservation; 2026 Renewable Energy)</i> |
| • Grays Harbor Public Utility District | |

Renewable energy compliance:

These districts are required to meet **annual** renewable energy targets and meet those targets by acquiring MWh of electricity and/or Renewable Energy Credits from renewable resources identified as eligible under the EIA.

Renewable energy targets are generally calculated as a percentage of the average load the District sold to its retail customers over the two years prior to the target year. Because retail electricity sales are material to the financial statements, we use the internal control understanding and testing of retail revenues performed in our financial or accountability audit work to substantiate retail load values these Districts report to support our opinion on its compliance with this requirement.

The PUD Program Manager is responsible for identifying newly qualifying utilities and will notify teams as applicable. See the [Renewable Energy Compliance Examination](#) planning guide for details. Local teams should direct questions to the PUD Program Manager.

Energy conservation compliance:

These districts are also required to adopt **biennial** energy conservation targets and meet those targets with energy conservation it acquired during the period from participation of its electricity customers in the energy efficiency programs it offers.

Clean Energy Transformation Act (2019) – RCW 19.405

All utilities that sell electricity to more than one retail customer in the state of Washington, including the 13 qualifying utilities listed above, are required to comply with the Clean Energy Transformation Act (CETA). The State Auditor’s Office is required to audit all consumer-owned electric utilities for compliance with the Act.

Our Office will be auditing compliance with the following requirements in 2022:

- Energy assistance to low income households (RCW 19.405.120)
- Greenhouse gas content calculation requirements (RCW 19.405.070)
- Clean energy implementation plan development (RCW 19.405.060)

Please direct any questions you have or may receive to the PUD Program Manager.

PERFORMANCE AND IT AUDIT CONSIDERATIONS

Information on ongoing performance audits can be found on SAO website at: <https://www.sao.wa.gov/performance-audits/performance-audits-in-progress>. For all other inquiries please contact the Assistant Director for Performance Audit.

APPENDIX A: Regulatory Accounting

Regulatory accounting is allowed under GASB 62, paragraphs 476-500. This guidance comes almost verbatim from FASB standards 71, 90, and 101 which was incorporated into ASC 980. FASB has continued to make some adjustments to this guidance (not significant, just adding additional clarification for certain situations) that GASB has not adopted. GASB has this on their list of future projects to reevaluate regulatory accounting.

Regulatory accounting is for those with regulated operations who have to set rates to recover costs. GASB does not define which industries may use regulatory accounting, but rather has specific criteria that they have to meet in paragraph 476.

Criteria to meet (paragraph 476)

There are three criteria, the following is some additional information about each.

- a. The Governing board is responsible for setting rates – this should be straightforward. Ideally, the governing body should be actually involved in understanding the rate setting process and evaluating what costs are included. This is what typically occurs with investor owned counterparts but may not occur as rigorously in some local governments where the board relies more heavily on management.
- b. Rates are designed to recover the costs of providing services. This requires a cause and effect between costs and rates. Rates are developed based on incurred costs (actual or estimate). There can be practices that disqualify an entity if they are using something other than costs. For example, if they are basing rates on market or industry factors. Other actions might cause reason for concern that they are truly basing rates on costs such as engaging in rate freezes, discounting, performance or incentive rates, or price caps. If they are truly basing their rates on costs, they will be performing rate studies and updating rates on a regular basis. They will have a way to deal with significant unexpected costs that weren't previously included in rates but need to be incorporated once those costs are incurred. They will also be timely incorporating costs into their rates, such as for any regulatory assets they might recognize.
- c. Rates can be charged to and collected from customers – consider the demand for their product/service and level of competition they experience in their industry – this is about the future and whether there is adequate assurance that they will be able to charge rates for future costs to ensure their collection. If they operate in a monopolistic environment and have little to no competition for their services then that is helpful. Further considerations include the stability of the customer base, expectations about future demand and whether the PUD has excess capacity. If there are any foreseeable issues with charging and collecting rates then that could be a concern (for example, a utility who already has very high rates compared to neighboring utilities and might have trouble increasing its service territory any further).

Overview – Purpose and benefits

The purpose of the regulatory accounting is to allow matching of specified revenues and expenses to the period when they will be included in the PUD's rate structure. Matching will be approximate, not exact. The benefits include smoothing earnings, reducing rate volatility to customers, easier to comply with bond covenants (otherwise rates might need to be excessively high), and better comparison with investor owned utilities. It also allows for financial information to reflect the economic impact of rate decisions by the governing body, and in turn, provides the governing body with reliable financial information that they can use to make decisions about rates. However, accounting for regulatory accounting can result in extensive tracking and effort. The more complex the utility, the more likely regulatory accounting is used. For regulated operations, it is widely used.

Regulatory assets

Regulatory assets are in essence a contract between the utility and future rate payers. They are like a receivable. They are expenses or costs that under GAAP would have been recognized against earnings except that under regulatory accounting, they can be capitalized and then expensed/amortized over the time period they will be recovered (via increased rates). This allows PUDs to capitalize expenses that they normally wouldn't be able to capitalize.

To qualify as a regulatory asset, they have to meet the criteria in paragraphs 480. Also, they have to be approved by the governing body that those specific costs are to be recognized as a regulatory asset, their rationale for using GASB 62, that it will be included within future rates, and over what recovery period. The government must follow up and actually include them in rates at their next reasonable opportunity. The recovery period should be reasonable to management and the governing body. Documentation should include the cost or revenues to be deferred, details of the transaction, and the recovery period. Note disclosures should describe the nature of regulatory assets.

Entities should be reviewing their regulatory assets every year to ensure they still qualify. If at any point the regulatory asset is no longer probable of being recovered (i.e. they stop including it in their rate structure), then it should be written off to earnings immediately. Also, if at any point they no longer qualify to use regulatory accounting (see above) all assets might need to be written off.

Entities should also be evaluating new accounting standards that come out each year to identify the applicability of regulatory accounting. For example, GASB 89 requires interest costs for construction to be expensed but that might not work for a regulated utility who includes those costs within their rates.

Here are examples of regulatory assets:

- Extraordinary, non-routine maintenance costs such as during storm damage
- Debt issuance costs – GASB 65 typically requires expensing, but if rates will recover they can be capitalized as regulatory asset.
- Capitalized interest (GASB 89)
- Deferred Power costs
- Conservation expenses
- Premature losses on early asset retirements
- Decommissioning costs of generating units
- Unrealized derivative or investment losses
- Pension expense/GASB 68 pension liability recovery – the difference between what is required to be recognized in the financial statements with what must be paid out in contributions during the year. Later FASB guidance had concerns over this regulatory asset and put in stipulations that the costs must be recovered in rates over a 20 year period. If we see this, we will want to explore how and when they are going to recover in rates because it is possible the cash contributions will not keep up and fully fund the plan.
- Swap termination payments – fees incurred to terminate agreements that will be recovered over future years
- Pollution remediation
- Asset retirement obligations

PUDs should not use regulatory accounting to allocate depreciation expense over a longer period than useful life. These are referred to as phase in plans. GASB chose not to incorporate guidance for phase in plans when adopting GASB 62 because they thought those situations were rare. FASB maintains guidance in FASB 92 which is now codified into ASC 980.

PUD should also probably not slow down depreciation (such as capitalizing depreciation expense as a regulatory asset). If this occurs, contact the PUD subject matter expert and we might need to consult with GASB.

Regulatory liabilities (or deferred inflows)

The regulator can impose the following types of liabilities (paragraph 482)

- Refunds to customers - all refunds that are probable and estimable should be reported as a regulatory liability. Refunds could result from interactions with a third party such as during a FERC license renewal or a legal settlement. It is also possible that the board of directors might order a refund for costs that had previously been collected in rates for which the governing board (as the regulator) later denied, but this should be rare a public utility.
- Revenue collected for future costs - The governing body might authorize rates to include costs that may or may not be incurred in the future, such as for storm costs. If the governing body requires

that future rates should be reduced if those expenses are not incurred, then the entity should record a deferred inflow for the revenues as they are collected.

- Rate stabilization funds - A rate stabilization is a deferral of revenues that will be recognized in future periods (a deferred inflow). The entity has the option to set aside the cash but it is not required. Rate stabilization funds are often used to help an entity comply with the debt service coverage ratios. Essentially it allows them to set aside earnings in one period and recognize them in a later period. There should be a standalone policy to support the creation of the fund, the circumstances the fund is added to, and when the costs the fund should be used for. Alternatively the governing body can authorize for each transaction in or out of the fund as well via board resolution.

Regulatory accounting can be used for contributions in aid of construction and by doing so can better match the revenue associated with the donated asset and the related depreciation. A PUD would still capitalize the utility infrastructure, but instead of recognizing capital contribution revenue, it would recognize a deferred regulatory liability. This liability would stay on the balance sheet but would be reduced each year by the depreciation expense associated with the donated asset (debit deferred regulatory liability, credit depreciation expense). Therefore, no depreciation expense would be recognized for the donated assets, as well as no recognition of the capital contribution revenue.

Examples of regulatory liabilities:

- An ARO that the utility collected within rates, but it is not legally required. As revenue is collected, it could be a regulatory liability (deferred inflow) until the asset is retired.

Other requirements

- Regulatory assets and liabilities should be presented current and noncurrent classifications, as with other financial statement line items.
- The PUD should use regulatory accounting for all items that would qualify and apply the standard on a consistent basis.

Additional resources on regulatory accounting

Because the GASB guidance almost mirrors FASB guidance, private CPA firm guides for investor owned utilities contain helpful information about regulatory accounting.

- PriceWaterhouseCoopers – [Utilities and power companies guide](#)
- American Public Power Association - [Advanced Public Utility Accounting Manual](#)
- Baker Tilly – [Deciphering regulatory accounting and rate stabilization under GASB 62](#)
- Deloitte – [Regulated utilities manual](#)

APPENDIX B: COVID-19 Impacts

Policies for deferrals of late payments, prohibitions against shut-off of service due to COVID-19

Effective March 23, 2020, the Governor issued Proclamation 20-23 prohibiting “all energy, telecommunications, and water providers in Washington State from conducting the following activities:

- (1) Disconnecting any residential customers from energy, telecommunications, or water service due to nonpayment on an active account, except at the request of the customer.
- (2) Refusing to reconnect any residential customer who has been disconnected due to nonpayment;
- (3) Charging fees for late payment or reconnection of energy, telecommunications, or water service; and
- (4) Disconnecting service to any residential customer who has contacted the utility to request assistance from the utility’s COVID-19 Customer Support Program.

This proclamation expired on September 30, 2021.

In addition, under the Governor’s Proclamation 20-23 et al, utilities providing energy, telecommunications and water services in Washington State were required to develop COVID-19 Customer Support Programs. We would expect utilities covered by this guidance to have reviewed their existing policies concerning disconnection of service, reconnection of service, payment arrangements and suspension of other fees or charges and update those policies as appropriate and necessary.

To ensure that customers maintain access to essential services during the effective dates of the Governor’s Proclamation, utilities likely offered long-term payment arrangements for those directly affected by COVID-19, which could be six to 18 months or longer (as recommended by the Governor’s COVID Utility Customer Support Program Guidance).

We do not plan to audit an entity’s compliance with the Proclamations or Customer Support Program Guidance; rather, the audit focus should be on an entity’s compliance with their own policy and monitoring to ensure the controls over the customer repayment solutions it implemented are adequately monitored to protect public funds from fraud, loss or abuse.

Audit considerations in reviewing the PUD’s policy and controls over monitoring of accounts:

- How does the District verify and review to ensure only eligible customer accounts are adjusted, deferred or written off?
- How does the District ensure the adjustments, deferrals or write offs are allowable, correctly calculated, and are properly reviewed and approved?

Additional risks for auditor consideration:

- Cash receipting risk – fraudulent write off of cash receipts
- Accounts receivable risk - improper or fraudulent write off of balances owed
- Financial statement audit / Accountability audit analytics – expect an increase in aged accounts receivable and account write offs. A growing receivable balance could provide opportunity for someone to conceal fraudulent activity.

Districts should have controls that enable the District to ensure customer accounts selected for write off meet specific criteria established in policy. For example, district criteria entitling a customer for relief may be based on their eligibility as a member of a vulnerable population, highly-impacted community, or a low-income customer with a high energy burden consistent with those classifications identified in CETA (RCW 19.405 and WAC 194-40).