



*January 17, 2006
Meeting Summary of the
Financial Affairs Committee*

Participants

Ara Azhderian – San Luis Delta Mendota Water Authority
Brice Bledsoe – Contra Costa WD
Charlotte Dahl – Westlands WD (telephone)
Mike Hagman – Friant Water Authority
Anthea Hansen – Del Puerto WD
Russ Harrington – CVP Water Association
Bill Harrison – Del Puerto WD
Lynn Hurley – Santa Clara Valley WD
Ron Jacobosma – Friant Water Authority
Kathy Kitchell – City of Roseville
Paul Olmstead – Sacramento MUD
John Pelley – Bureau of Reclamation
Jesus Reynoso – Bureau of Reclamation
Bob Stackhouse – CVP Water Association
Donna Tegelman – Bureau of Reclamation
Alan Thompson – East Bay MUD
Katherine Thompson – Bureau of Reclamation

1. Opening Business

The January 17th FAC meeting was held during the afternoon prior to the beginning of the Water Users Conference at the El Dorado Hotel in Reno. The meeting notes from the December FAC meeting were approved by those present without change; however, Barry Mortimeyer (Reclamation) had provided some requested adjustments. These adjustments are included at the end of this document.

There was a request to add an item to the Agenda regarding the Folsom Safety of Dams issues and the right-of-way that must be granted by Contractors. Bob Stackhouse noted that discussions still need to be held with key Congressional staffers before the CVPWA or the FAC takes action. This item was added to the agenda for a brief discussion prior to development of the 2006 FAC Issues Matrix. There was also a request to add an agenda item for Rescheduling Guidelines. Reclamation staff said that the Rescheduling Guidelines for the Friant Division and

San Luis Reservoir Contractors have been completed, but not signed. Jesus Reynoso will let Russ Harrington know when these Guidelines will be available to Contractors. This item was not discussed as an agenda item.

The next FAC meeting will be in Conference Room C-1001 at the Mid-Pacific Regional Office in Sacramento. This meeting will start at 9:30 on Friday, February 24th. A conference line will be available at 866-815-0941. The passcode is 4417510#.

2. 2005 FAC Issues Matrix

A. Budget Workshops – Refining Customer Participation. Russ Harrington will hold an introductory meeting with Reclamation staff on February 2nd at 8:30 regarding Budget Review Process participation by Contractors. Russ stated that the goals for this meeting are to determine (1) the output that Contractors would like to receive, (2) the budget data that Reclamation already has available, and (3) how to obtain any data that Contractors would like to have, but Reclamation doesn't currently have available. FAC members have been invited to attend this meeting.

B. BOR-WORKS Water Accounting Program Development. Reclamation staff announced that the modules for tiered water rates and transfer rates are still on track for completion by the end of January. Bonnie Hood is now Reclamation's team lead for the WORKS program. Reclamation will be identifying a project manager for WORKS itself. Reclamation is currently assembling a Change Management Board for WORKS. One of the first actions of this Board will be to develop a completion schedule for WORKS upgrades. The Power Accounting program is expected to be a major undertaking, and is required to be completed by the end of the Federal Fiscal Year. All payment recap forms are being entered manually again.

Friant Contractors commented that they have been having problems with determining whether specific water deliveries should be paid as Class 1, Class 2, Section 215, or Transfer water deliveries. This makes it much more difficult to determine if/when individual water users overuse their allocation. If overuse is to be enforced, then the appropriate tools need to be available to determine when overuse occurs.

Contractors asked Reclamation staff when the revisions to WORKS might be complete, and what major changes might still be necessary. Reclamation staff responded that the completion of WORKS is more event driven than time driven. Because of this, Reclamation does not have an established completion schedule for WORKS.

Reclamation staff indicated that the WORKS costs are 100% reimbursable, because the only purpose served by WORKS is to account for water deliveries and compute rates attributable to the water users. However, Reclamation staff also mentioned the requirement for WORKS to effectively interface with other Federal Government information systems. Reclamation staff was asked to identify the size of the 2006 WORKS Budget, and how WORKS has been and would be used to facilitate financial statement preparation and financial reporting requirements for both reimbursable and non-reimbursable costs. The comment was made that if Reclamation is using

WORKS for project-wide purposes, then the costs should be allocated as multi-purpose costs to all project purposes. The final comment regarding the costs for WORKS was that these systems upgrade and costs should be capitalized instead of treated as O&M.

Contractors also raised the question of whether WORKS could be more effectively and less expensively rebuilt from scratch. Reclamation staff estimated the cost to replace WORKS to range from \$18 to \$20 million to get the first 80% of the system. The remaining 20% would need to be customized. Also, the time estimate for a completely new system was estimated at 5 years, and Reclamation staff said that they would need to have an alternative to use in the meantime. Reclamation staff re-emphasized that they need to get the revenue reporting requirements resolved by the end of this year to maintain a “clean opinion” from the auditors. Failing to maintain a clean opinion could actually jeopardize operations. Reclamation believes that the system started by the JAVIS contractor is salvageable, and also provides something to use in the interim.

Contractors expressed two additional concerns/questions about WORKS:

- Will the CVP eventually get to 21st century financial accounting and reporting standards?
- Will the problem of the Area Offices and Regional Office having different revenue and delivery records arise again?

Contractors emphasized the importance of having delivery and revenue records that matched within different branches of the Mid-Pacific Region. The use of Excel spreadsheets that are not linked to WORKS to record revenue and delivery data was raised as a specific concern that has caused problems in the past. A problem with environmental documentation containing different delivery and revenue records from the MP Region, CVO, and Area Office was also cited as a serious problem. Ara Azhderian was requested to provide a sample of this conflicting data documentation to Katherine Thompson.

Action Items

- Reclamation to determine the amount of money spent on WORKS system, and how much of this total has been deemed reimbursable.
- Reclamation to determine how much of these upgrading costs have been capitalized and how much has been recorded as O&M.
- Reclamation to provide future spending plans for WORKS to the FAC.
- Reclamation to determine how much WORKS is used for CVP-wide activities (i.e., financial reporting and other non-water contractor specific activities).
- Ara Azhderian to provide example of conflicting revenue and delivery data from different MP-Region entities to Katherine Thompson.

C. Water Transfer Rate Policy Development. This agenda item was postponed until the end of the FAC meeting, when a meeting dedicated to the review of the Transfer Rate Policy Implementation Guide and Revenue Crediting Notification letter was conducted.

D. Historical Advance Payment Reconciliations. Reclamation announced that they now have a third independent contractor working on the Historical Advance Payment

Reconciliations. Reclamation's goal is to have all of the reconciliations completed by the end of this Federal Fiscal Year (the end of September).

E. Security Cost Reimbursability. Reclamation stated that the spreadsheet of prospective cost allocations that was distributed during the December FAC meeting was based on the capital cost allocation factors for the CVP. Since that time, the MP Region Office has been directed by Denver to use the O&M cost allocation factors for splitting the Post-9/11 Security Costs because the reimbursable security costs were O&M in nature. Contractors questioned the process through which a share of these costs would be allocated to Power, and whether it was advisable to incorporate the relatively high year-over-year variability of the O&M allocation into the allocation of the security costs. Reclamation added that the O&M allocations would only be based on the allocations for the facilities that are impacted: Folsom, Shasta, Keswick, Tracy, and San Luis. The increased security costs are allocated on a facility-by-facility basis for each of these facilities using that facility's O&M cost allocation for each year.

Reclamation staff reconfirmed that the hardening costs for these facilities would be treated as non-reimbursable costs. The goal of the Congressional Office of Management and Budget was to have all of these Post-9/11 Security costs declared reimbursable; however, Reclamation determined that this might not be consistent with Reclamation law. Reclamation staff wasn't aware of any additional hardening cost expenditures beyond the current year, but didn't know whether there would be additional hardening costs in the future.

The reimbursable Security Costs have been added to the final 2006 water rates although these costs were not included in the 2006 draft rates. Contractors asked whether they could make advance payments for the upcoming year based on the old rates on the basis that the final rates haven't been published. Reclamation staff who were present at this meeting said that this should be acceptable.

Contractors asked why the costs were determined to be reimbursable during 2006, when the Senate Report stated that costs should not be reimbursable pending the completion of a second Security Cost report in May 2007. Contractors stated that it was their understanding that the 2006 Security Costs would only be included in the final accountings if they were included at all due to the May 2007 timeframe for a reimbursability determination.

The 2007 Security Cost allocation to the MP Region has been estimated at \$6.3 million. This allocation was provided as a share of the cost allocation from the Denver Office. Of this \$6.3 million total, approximately \$5.5 million was estimated to be reimbursable.

Action Items

- Reclamation to review Congressional direction to determine whether Post-9/11 Security Costs were authorized for recovery through the 2006 water rates, and to provide Russ Harrington with the basis for including these costs in the 2006 water rates.
- Ara Azhderian to review the House Conference Committee Language for any language pertaining to reimbursability of the Post-9/11 Security Costs.

F. Draft 2006 Water Rates. Reclamation indicated that their responses to the Contractors' questions and comments on the 2006 draft rates have been assembled, reviewed, and may be returned during the week of January 23-27. The contractors requested that the responses indicate where Reclamation made a change to the rates as a result of a given comment.

Regarding the 2006 capital rate calculations, Reclamation stated that they made an adjustment to the Sacramento River settlement contractors' calculations such that the A-13 data in the denominator would never reflect an acre-foot total lower than 75%. Reclamation said that this is consistent with the settlement contracts. Regarding the discrepancy between the A-13 and A-14 data of most Contractors, which was due at least in part to Rescheduled water and Unused water, Reclamation said that adjustments have been made to reflect Rescheduled deliveries. Reclamation confirmed that in the final 2006 water rates, the A-13 data and the A-14 data will be consistent.

Action Items

- (per question raised during the discussion of Post-9/11 Security Costs) Reclamation to confirm that Contractors may base the advance payments at the beginning of the year on prior rates if the final 2006 rates are unavailable
- Reclamation to note in the responses to Contractor comments if changes were incorporated into the 2006 final rates based on different comments/questions.
- Contractors are advised to review the changes in the acre-foot data used in the A-13 and A-14 schedules from the Draft 2006 rates to the Final 2006 rates to confirm that the ratebook data accurately matches Contractors' records.

G. Direct Billings. Regarding the Safety of Dams costs, Reclamation indicated that there is nothing new to report. MP Region staff is working with the Denver Office to determine whether these costs can be included in the ratesetting policy, and that this is still under review within Reclamation as a work in progress.

Regarding the Post-9/11 Security Costs, Reclamation has determined that these costs should be recovered through the ratesetting policy and should not be Direct Billed.

Regarding the Trinity PUD costs, Reclamation staff stated that they would be reviewing this matter in the near future. The issue is based on a settlement agreement which states that the payments are to be collected directly from Contractors. This core issue is whether the payments should come from Contractors or whether payments could be made from Congressional appropriations and reimbursed by Contractors. Reclamation stated that they were concerned about the impacts of this issue on their budget as well as the legislation, and that payments from appropriations removed approximately \$600 thousand from their annual budget.

Contractors said that this issue has already been reviewed once, and the determination was made that these costs may be paid through the ratesetting process.

Contractors listed several concerns with the possibility of Direct Billing the Trinity PUD costs:

- How will Reclamation enforce these billing collections if some Contractors fail to pay?

- How can this problem be resolved in a manner consistent with Article 7 of the water service contracts?
- Is this Direct Billing consistent with State Law allowing the Contractors to collect these costs from their users and paying them outside of the provisions of their water service contracts? (Note that Reclamation staff stated that their understanding is that Federal Law supercedes State Law)

Contractors also asked about the possibility of including these costs in the Final Accountings without including any of these costs in the water rates. Contractors stated that so long as interest is charged on any outstanding O&M deficits, there shouldn't be an issue with the Treasury. Reclamation stated that all billings under \$50 will actually be handled in this manner. Reclamation staff asked how these costs should be allocated, and suggested Contract Entitlement as one alternative.

Contractors indicated that they would like to work with Reclamation to resolve this issue, and the implications of potential solutions pertaining to taxation and state law issues.

Reclamation suggested that this matter be discussed further as an additional topic during the February 2nd Budget Review Process meeting as they need to make a final decision soon on this issue. Reclamation identified Ratesetting, Accounting, Solicitors, and Contracts as groups that would need to have representatives in attendance at the meeting. Contractors responded that a preferred solution would resolve current and future Direct Billings problems before they arise. Contractors want to see the Direct Billings concept abandoned as an unnecessary circumvention of the ratesetting policy.

Reclamation said that resolving the Direct Billings problem would require that the underlying problems that led to consideration of the Direct Billings be addressed. In each of the current instances, the cause of the Direct Billings is a different source outside the direct control of the MP Regional Office. In the case of the Safety of Dams, the source is a Washington DC Solicitor. In the case of the Trinity PUD, the source is legislative interpretation. In the case of the PUE costs, the source is the IGO Auditors for WAPA. Reclamation would prefer not to be required to conduct the extra work required for a Direct Billing as opposed to inserting these costs into the water rate base for recovery.

Reclamation indicated that the same decision-makers for the Post-9/11 Security Cost issue would be involved in any decisions regarding Direct Billings, and specifically cited the Denver Office was cited as a source of input regarding the final decision. Russ Harrington will work with Reclamation staff to determine the root causes of each Direct Billings issue.

Regarding the Direct Billings issue as it pertains to Project Use Energy, the Non-Appropriated Transfers reimburse WAPA for Reclamation expenses on the cost side. However, the IGO Auditors for WAPA said that the problem is that there is no corresponding revenue transfer to cover these costs. As a result, Reclamation stated that transmission revenues need to be segregated from generation revenues, and that revenues and costs need to be resolved separately. Note that generation costs are incurred by Reclamation, while transmission costs are incurred by

WAPA. The IGO auditors informed Reclamation that their clean opinion for their financial statements would be contingent upon fixing this revenue reporting issue in the current year.

Contractors asked Reclamation whether this issue pertains to revenues and payments accounting. Contractors asked whether an accounting methodology could be developed to resolve this problem. Reclamation staff said that they have not concluded that Direct Billing is an appropriate solution, and would like to develop an alternative. Contractors asked whether all of the interested parties could get together to resolve this issue, and stated that the benefits of an accounting change must outweigh the costs. It was suggested that Contractor representatives meet with Laura Close separately to discuss this specific issue. Reclamation reiterated that they're still working to a decision on how to resolve this issue, and that they've still got a ways to go before they are finished.

Contractors mentioned that the issue of the Direct Billings needs to be resolved imminently unless Reclamation agrees to recover costs not paid through Direct Billings or water rates through adjusting the final accountings to incorporate these costs. The status of the Trinity Direct Billing was raised, and the comment was made by Reclamation staff that the payment to the Trinity PUD has not yet been made for the current year. Reclamation staff noted that WAPA has paid its share of the Trinity PUD costs. Contractors stated that they would not oppose the application of costs not included in the water rates through the Final Accountings.

Action Items – Russ Harrington to work with Reclamation staff to determine the causes of each Direct Billings Issue: regarding the SOD, speaking with Dick Stevenson; regarding the PUE, more information from Laura Close; regarding the Trinity PUD, co-ordinating with Katherine Thompson. Payment source needs to be determined for the Trinity PUD costs, because the required payment for the current year has not yet been paid.

Added Agenda Item: Safety of Dams. This item was added to the agenda at the beginning of this FAC meeting. Contractors have prepared a letter to the Corps of Engineers advising the Corps that Contractors have several issues and questions that need to be resolved and answered before Contractors would be willing to grant the necessary right-of-way for the Folsom Bridge. However, lobbyists who represent Contractors have advised that this letter not be sent until Contractor representatives speak with Jason Larrabee of Congressman Doolittle's staff. From the Contractors' perspective, promised legislation to solve the cost allocation problems have not been delivered. The Power Contractors may be sending a separate letter to Reclamation regarding this issue and other issues.

Action Items – CVPWA staff to hold discussion with Jason Larrabee regarding the Folsom Safety of Dams cost allocation. CVPWA staff to co-ordinate with Power Contractors regarding ancillary issues pertaining to Folsom Dam Modifications and their financial impacts. [Bob – do we want to ask SMUD about the switchyard issue as it pertains to the Folsom Bridge?]

3. 2006 Issues Matrix.

The draft 2006 Issues Matrix is attached. Note that this Matrix will not be finalized until approved by the CVPWA Board of Directors. Subcommittees will be developed for each active

item on the Issues Matrix. Volunteers for each Subcommittee need to inform Russ Harrington of their interest to participate in each Subcommittee. The following changes have been made to the 2006 Issues Matrix from the 2005 Issues Matrix:

Active Issues from 2005:

1. Budget Review Process and Administrative Accountability: Remains an Active Issue
2. CalFed Cost Recovery Strategies: Becomes a Tracking Issue
3. BOR WORKS Enhancements: Remains an Active Issue (because Contractors may want to engage in an active dialogue regarding costs and reimbursability)
4. Folsom Safety of Dams Modifications and Costs: Remains an Active Issue
5. Capital/Deficit Rate Development: Removed from the Issues Matrix altogether
6. Water Transfer Policy Development: Remains an Active Issue
7. PUE Cost Issues: Remains an Active Issue (and may include several sub-issues)

Tracking Issues from 2005:

1. CVPIA Accounting and Program Accomplishments Reporting / Accountability: This issue will be segregated into two parts. The Program Accomplishments Reporting / Accountability aspect will be a tracking issue, while the CVPIA Accounting and cost authority development will become an active issue
2. SWRCB Fees: Remains a Tracking Issue
3. Security Costs: Becomes an Active Issue at this time, but may be a Tracking Issue within a few weeks
4. Historical Advance Payment Accountings: Remains a Tracking Issue
5. CVP Water Service Contract Assignments: May be removed from Issues Matrix altogether, pending review of resolution by Jesus Reynoso and Russ Harrington
6. CVP Cost Allocation (SCRB or some other method): Remains a Tracking Issue
7. Interagency Ecological Program Implementation: Removed from the Issues Matrix altogether

New Issues Matrix Items for 2006:

1. Direct Billings Issues: Added to Active Issues
2. Power Accounting and Statement Recording: Added to Active Issues

Requested Adjustment to December FAC Meeting Notes by Barry Mortimeyer

Review of PUE Issues. At the request of Reclamation Power and Western staff, the PUE Issues were moved to the front of the Agenda.

A. **2207A Status.** Regarding PG&E's attempt to pass through the Scheduling Coordination costs to Contractors, Barry said that there could be an advantage to this, but that there are also some risks. The advantage is that the New Melones pseudo-tie could be incorporated into the WAPA Control Area, but that the downside risk is that the canal-side pumps served by this contract could be converted to wholesale distribution costs if WAPA and

Reclamation are found to be in breach of Contract 2207A. Monthly data for the spinning reserves credit that might be realized from the New Melones pseudo-tie is attached, along with two documents titled "Background New Melones Pseudo-Tie Issue"; the first document was prepared by Barry Mortimeyer, and the second is an edit of Barry's document by Ed Roman from SMUD. The statement was made that the change will occur in 2016 regardless of the Pseudo-Tie issue, because this is when Contract 2207A will expire. When this occurs, the Power Cost for the canal-side loads is expected to increase five-fold. Barry said that the deviation costs must be closely controlled, because this is expected to be the predominant source of this five-fold cost increase. Conveyance Pumping deviation costs are very controllable, while the Direct Pumping costs may be more problematic. Barry said that there are positive deviations at this time, and that these deviations need to be brought to zero by the end of the calendar year. Barry said that if under-scheduling exceeds 3% of the total, then severe financial penalties are assessed. Regarding the attachment for the monthly spinning reserves, Bob Cheskey said that he looked at the three cost categories and confirmed that each categories is currently running a credit balance. At this time, PG&E is holding these credits pending the litigation regarding the ability to pass-through the Scheduling Coordinator costs; however, PG&E has acknowledged that they don't believe that they should keep this credit for themselves. The comment was made that 2207A is a prepaid contract; however, PG&E is claiming that the Scheduling Coordination wasn't included in the prepaid costs. FERC has initially sided with PG&E, although this case is still being heard. The Department of Justice doesn't have a lot of interest in pursuing this matter with PG&E. The risk is that PG&E may claim breach of Contract if Contractors don't pay the Scheduling Coordinator costs. Regarding the New Melones Pseudo-Tie and the credit for the spinning reserves, Barry Mortimeyer said that Reclamation is not yet in position to get the benefits from this credit. He added that 8 months would be necessary to implement the change to the Pseudo-Tie. Barry said that the strategy at this time is to handle the New Melones Pseudo-Tie and Scheduling Coordinator issue first, then deal with the issue of post-2207A when this contract expires in 2016. He said that there is a possibility that Reclamation and WAPA may move to acquire the lines serving San Luis facilities. CVPWA staff has asked Barry to provide a cost estimate of installing Reclamation-owned lines to serve canal side pumping, such that Contractors will no longer be subject to duress from PG&E.