ORDER NO. 04-212

ENTERED APR 15 2004

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1135

In the Matter of	)	
	)	ORDER
CASCADE NATURAL GAS CORPORATION	)	
	)	
Application Requesting Order Authorizing Accounting Change for Treatment of Contracts under Financial Accounting Standards 133 and 138.	)	

DISPOSITION: APPLICATION APPROVED WITH CONDITIONS

On February 27, 2004, Cascade Natural Gas Corporation (Cascade) filed an application with the Public Utility Commission of Oregon (Commission) requesting an accounting order authorizing the establishment of a regulatory asset or regulatory liability associated with the implementation of Financial Accounting Standards (FAS) 133 and 138, Accounting for Derivative Instruments and Hedging Activities. Cascade further requested that the accounting treatment become effective beginning on March 31, 2004.

At its regular public meeting on April 8, 2004, the Commission adopted Staff's recommendation to approve the application, with conditions. Staff's recommendation is attached as Appendix A and is incorporated by reference.

ORDER

IT IS ORDERED that Cascade Natural Gas Corporation's application for an accounting order is approved, effective March 31, 2004, with the following conditions:

1. At the close of each quarter, Cascade Natural Gas Corporation will provide Staff with all journal entries made under the requirements of FAS 133/138 and all journal entries made under this accounting application.

2. Any time Cascade Natural Gas Corporation files for a rate change, including, but not limited to, general rate filing and Power Cost Adjustment filing, the company must provide Staff with all journal entries made under the requirements of FAS 133/138, all journal

entries made under this accounting application, and any adjustments necessary to remove rate impacts of the accounting treatment. This condition does not apply to proposed rate changes that are not affected by the requirements for FAS 133/138, such as DSM filings.

Made, entered and effective ___________________________________.

BY THE COMMISSION:

____

Becky L. Beier
Commission Secretary

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A party may appeal this order to a court pursuant to ORS 756.580.

ITEM NO. CA10

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: April 8, 2004

REGULAR ____ CONSENT __X__ EFFECTIVE DATE _____March 31, 2004_____

DATE: March 2, 2004

TO: Lee Sparling through Ed Busch and Judy Johnson

FROM: Ed Durrenberger

SUBJECT: CASCADE NATURAL GAS: (Docket No. UM 1135) Request for accounting change by Cascade Natural Gas for treatment of contracts under Financial Accounting Standards 133 and 138.

STAFF RECOMMENDATION:

I recommend that the Commission approve Cascade Natural Gas's application for an accounting order, with conditions, and that the accounting treatment become effective March 31, 2004.

DISCUSSION:

On February 25, 2004, Cascade Natural Gas filed an application requesting an accounting order authorizing the establishment of a regulatory asset or regulatory liability associated with the implementation of Financial Accounting Standards 133 and 138 (FAS 133/138), Accounting for Derivative Instruments and Hedging Activities. The company further requested that the accounting treatment become effective for the financial accounting entries beginning on March 31, 2004. Cascade Natural Gas states, in their application, that its proposed accounting treatment will not affect the review and determination of prudence regarding the company's resource acquisitions. It further states that under the proposed accounting, the ratemaking treatment of contracts will be unchanged from the current practices.

Description
FAS 133, Accounting for Derivative Investments and Hedging Activities, was issued by the Financial Accounting Standards Board (FASB) in June 1998 and was amended by FAS 138 in June 2000.

"FASB Statement 133 is based on four fundamental premises:

1. …Derivative instruments are assets or liabilities and, thus, should be reported in balance sheet.

2. … Fair value is the relevant measure for financial instruments and the only relevant measure of derivative instruments. Thus derivative instruments will be measured at fair value. The FASB, therefore, requires that mark-to-market accounting be used in measuring derivatives in the balance sheet as of each balance sheet date.
3. …Only assets and liabilities should be reported in these balance sheet categories.
4. …Special "hedge" accounting should be used on qualifying items. A key aspect in determining whether a derivative qualifies as a hedge should be an assessment of the hedge's expected effectiveness."[1]

"In today's environment, it is not uncommon for entities to enter into contracts for the purchase and sale of energy commodities. Such activities have historically been settled by physical delivery in the entity's primary operating environment (that is, that area in which an operation typically delivers energy or could physically deliver such energy in a cost-effective manner in order to earn its revenues). However, more and more frequently, these energy contracts are being entered into for speculation. Additionally, some entities enter into these energy contracts for trading using both over-the counter contracts and exchange-traded contracts and settling them on a net cash basis or by entering into offsetting positions."[2]

"Based on FASB Statement No. 133, energy trading contracts that can be effectively net settled would be considered derivatives. Energy trading contracts should be marked to market with the gains and losses included in earnings and separately disclosed in the financial statements or related notes…"[3]

The Standards require all derivatives and certain embedded derivatives to be reported on the balance sheet at fair value. Changes in the fair value of derivatives, as defined by FAS 133/138, are to be recorded through earnings. Cascade Natural Gas states that this will expose its earnings to significant volatility not experienced previously.
The volatility is related to timing differences between when a contract is entered into and when the contract is settled. The company states that the accounting associated with FAS 133/138 will not be part of the company's regulated pricing.

Proposed Accounting
The Company will record the fair value of various resource acquisition contracts according to FAS 133, as assets in FERC Account 186, Miscellaneous Deferred Debts, or as liabilities in FERC

[1] Paul Munter and Thomas A. Ratcliffe, *Applying GAAP and GAAS* (New York: Lexis Publishing, September 2000), p.9.39
[2] Ibid, p. 9.53
[3] Ibid, p. 9.54

Account 253, Other Deferred Credits. These non-cash accounting entries will be offset by regulatory assets or liabilities using the same accounts. These entries will be made simultaneously and will offset in the company's income statement. Under the proposed accounting, when the obligations under an affected contract are fulfilled, any gain or loss recognized under the standard would be reversed, and the offsetting regulatory asset or liability would be reversed, resulting in no net gain or loss upon settlement of the contract.

Staff and Cascade Natural Gas both acknowledge that there should be no rate change, now or in the future, associated with the application of the requested accounting change.

PROPOSED COMMISSION MOTION:

The application made by Cascade Natural Gas for an accounting order be approved and that the accounting treatment become effective March 31, 2004, subject to the following conditions:

1. At the close of each quarter, Cascade Natural Gas Corporation will provide Staff with all journal entries made under the requirements of FAS 133/138 and all journal entries made under this accounting application.
2. Any time Cascade Natural Gas Corporation files for a rate change, including, but not limited to, general rate filing and Power Cost Adjustment filing, the company must provide Staff with all journal entries made under the requirements of FAS 133/138 all journal entries made under this accounting application and any adjustments necessary to remove rate impacts of this accounting treatment. This condition does not apply to proposed rate changes that are not affected by the requirements for FAS 133/138, such as DSM filings.