



095755 71-0044-36
1-06-1

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548



CIVIL DIVISION

B-170816

OCT 23 1970

Dear Mr. Secretary: 37

The General Accounting Office, as part of its continuing reviews of the financial activities related to the Federal power program, has examined into the policies followed by the Bureau of Reclamation, Department of the Interior, regarding the capitalization of interest on construction costs during the period of construction of hydroelectric power projects of the Federal Columbia River Power System.

Our opinion letters to the audited financial statements of the System over the past several years have included comments on the Bureau's failure to capitalize interest during construction of certain Bureau power facilities included in the System and the need to resolve this matter for improved disclosure of the financial position and results of operations of the integrated power system. The System also includes the power-generating facilities of the Corps of Engineers and the transmission facilities of the Bonneville Power Administration (BPA). The cost of constructing and operating these power facilities is required, by law, to be repaid out of power revenues of the System. Both the Corps and BPA have capitalized interest costs during the construction of their power projects and have included such costs in the unrepaid investment in their facilities on which annual interest is payable to the Treasury from power revenues.

Prior to 1956 the Bureau did not, in all cases, capitalize, as a part of the Government's investment in power projects, the interest on the construction costs incurred during the period of construction, unless it was specifically required to do so by the legislation authorizing construction of a project. We found that, of the six Bureau hydroelectric projects in operation in the System at June 30, 1969, interest costs incurred during the construction period of four projects and one division of a fifth project--the Columbia Basin, Hungry Horse, Boise, and Minidoka Projects and the Kennewick Division of the Yakima Project--were not capitalized and were not scheduled for repayment from power revenues.

The Columbia Basin and Hungry Horse Projects constitute the major part of the Government's investment in the System upon which interest during construction has not been capitalized as part of the investment.

700435 095755

For these two projects, we estimate, on the basis of a 3-percent interest rate generally used by the Bureau in determining interest costs, that interest costs of about \$15 million during the period of construction were not capitalized as part of the Government's investment in the projects, and therefore are not being recovered through power revenues. Further, as a result of this understatement of the Government's investment, we estimate that the accumulated annual interest expense on the unrepaid portion of the Government's investment had been understated by about \$13 million as of June 30, 1969, and was not being recovered through power revenues.

Although the legislation under which BPA was created is similar to legislation relating to the Bureau in that BPA is not required to record or capitalize interest costs during construction, BPA has capitalized such costs as a matter of policy. As a result, BPA is recovering through power revenues its investment as well as the annual interest on the unrepaid portion of the investment. We also noted that the Corps, as a matter of policy, has capitalized interest on construction costs during the period of construction for each of its 18 projects in the System (in operation or under construction) at June 30, 1969.

In an earlier draft report on this subject, we proposed that you require that interest on construction costs incurred during the period of construction of those Bureau projects in the System which were constructed prior to 1956 be recovered and that annual interest expense be recovered on the Government's unrepaid investment in power facilities.

By letter dated December 23, 1969, the Acting Director of Survey and Review, commenting on our draft report for the Department, stated:

"Cash returns to the U.S. Treasury might be substantially increased if interest during construction was retroactively charged on all power facilities not presently subject to such a charge. However, such action would not be consonant with the reimbursability requirements of law under which the projects were authorized, funds appropriated for construction, or Congressional intent. Interest during construction has been recognized for those projects for which the Congress has specifically required it."

The Acting Director stated that the Department's position was in compliance with both legislative and administrative policies and that our proposal was inconsistent with congressional authorizations for the projects involved.

We cannot agree with the Department's position that recovery of interest charged retroactively on costs incurred during construction would be inconsistent with congressional authorization for the projects involved. Although the authorizing legislation for the projects constructed prior to 1956 did not specifically require the Bureau to recover interest during construction, we found no information in the authorizing legislation and related legislative history for any of the projects that precluded the Bureau from recovering interest on the costs incurred during construction.

Further, we noted several instances in which the Bureau had capitalized interest costs incurred during construction of power projects and had included such costs in the Government's unrepaid investment in power facilities even though the authorizing legislation did not require it. For example, the authorizing legislation for the Auburn-Folsom South Unit (Public Law 89-161, approved September 2, 1965) and for the Pacific Northwest-Pacific Southwest Intertie (Public Law 88-552, approved August 31, 1964) did not specifically require the Bureau to capitalize interest during construction of the projects or to include it in the Government's unrepaid investment in power facilities. The Bureau's budget justification for fiscal year 1971 shows, however, that such interest is to be recovered from power users.

In our opinion, interest costs incurred during the period the power projects were under construction are costs which, in accordance with sound business principles, should be recovered through power revenues. We believe that, when the Government is engaged in a revenue-producing activity such as the generation and sale of electric power, there is considerable merit in following the standard practice of private utility companies. The uniform system of accounts prescribed by the Federal Power Commission for the utility industry provides that "the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used" is properly includable in the plant accounts. Thus in the utility industry all interest on costs during the period of construction is capitalized.

Further, since BPA and the Corps have capitalized interest costs for their projects in the System, we believe that, in the interest of consistency in the presentation of financial information in annual reports for the System, the Bureau should adopt a similar policy for interest costs incurred during the construction of its projects prior to 1956.

In evaluating your position regarding this matter, we have reviewed the applicable legislation and conclude that (1) our proposal is not

B-170816

inconsistent with congressional authorizations and (2) you have the administrative authority to record and recover interest on the costs incurred during the period of construction for the projects constructed prior to 1956.

Therefore we recommend that you recover the Federal investment in power facilities by requiring that (1) interest costs during construction be capitalized as part of the Federal investment for all power projects constructed prior to 1956 and (2) accumulated annual interest expense be computed on the basis of such noncapitalized costs and be scheduled for repayment to the Treasury from power revenues.

- - - -

We believe that this matter is of such significance as to warrant reporting to the Congress at the earliest practicable date. Therefore we would appreciate receiving your comments within 60 days as to the action you plan to take in resolving this issue.

Copies of this report are being sent to the Director, Office of Management and Budget, and to your Assistant Secretaries for Water and Power Development and for Administration.

Sincerely yours,



Director, Civil Division

The Honorable
The Secretary of the Interior