

# Delivering on our Promises



Annual Report 2002

Continue

## DELIVERING ON OUR PROMISES

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Promises are easy to make, but hard to keep.

Yet when we verbalize our promises, our words make us more accountable, knowing others expect to see results. Living up to those expectations is what the President's Management Agenda is all about. While the agenda calls for sweeping reform of how government does business, President George W. Bush wants to know how each government agency—including Western—will deliver on those promises.

"What matters in the end is completion. Performance. Results. Not just making promises, but making good on promises. In my Administration, that will be the standard from the farthest regional office of government to the highest office in the land," said President Bush in the opening remarks of his Agenda, which he launched in August 2001. "In the long term, there are few items more urgent than ensuring that the Federal government is well run and results-oriented."

The Agenda focuses on 14 initiatives—or areas of improvements that agencies will be evaluated on using an Executive Branch Management Scorecard. Western's FY 2002 Annual Report highlights five of those initiatives, which are designed to improve processes, services and products governmentwide. These are:

- Strategic Management of Human Capital
- Competitive Sourcing
- Improved Financial Performance
- Expanded Electronic Government
- Budget and Performance Integration

Because Western faces competition daily from across the electric utility industry, as well as rapid technological advances and shifting demographics, these initiatives already guide our daily work. Yet we continually look for opportunities to further improve how we do business.

We measure our performance not only by how well we address the President's Management Agenda, but also by how well we deliver on the promises we make to you, our customers.

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# WESTERN AT A GLANCE

## Customer profile

	Number	Sales (billion kWh)
Municipalities	295	9.7
Cooperatives	54	7.0
Public utility districts	18	3.7
Federal agencies	39	1.3
State agencies	52	9.9
Irrigation districts	48	0.8
Native American tribes	33	0.8
Investor-owned utilities	30	1.5
Power marketers	33	1.2
Project use (Reclamation)	81	1.7
Interproject	5	0.3
<b>Total</b>	<b>688</b>	<b>37.9</b>
Firm customers	603 <sup>1</sup>	34.0
Nonfirm customers	153 <sup>1</sup>	3.9

<sup>1</sup>Includes 73 customers who purchase both firm and nonfirm power.

## Integrated Resource Planning profile

Individual IRPs submitted	76
IRPs from cooperatives	49
Minimum investment reports	34
Small customer plans submitted	112
Customers and members represented	725

## Repayment profile

Principal repaid in FY 2002	\$28 million*
Federal	\$19.7 million
Non-federal	\$4.0 million
Federally-financed non-power	\$4.0 million
Total investment	\$8.97 billion
Federal	\$8.79 billion
Non-federal	\$0.20 billion
Total repaid	\$2.83 billion
Federal	\$2.78 billion
Non-federal	\$.05 billion

\*This figure does not include the impact of prior-year adjustments (see page 27, Status of Repayment and the Management Discussion and Performance Measures.)

## Resource profile

Hydro powerplants	55
Thermal powerplants	1
Total powerplants	56
Actual operating capability-July 1, 2002	9,348 MW
Total units	179
Net generation	28,986 GWh
Purchased power	11,083 GWh

## Financial profile (in thousands)

Assets	\$4,083,849
Liabilities	\$449,350
Gross operating revenues	\$944,625
Other operating income	\$275,571
Total operating expenses	\$760,615
Operation and maintenance expense	\$276,903
Administration and general expense	\$47,627
Depreciation	\$99,073
Net interest expense	\$166,197

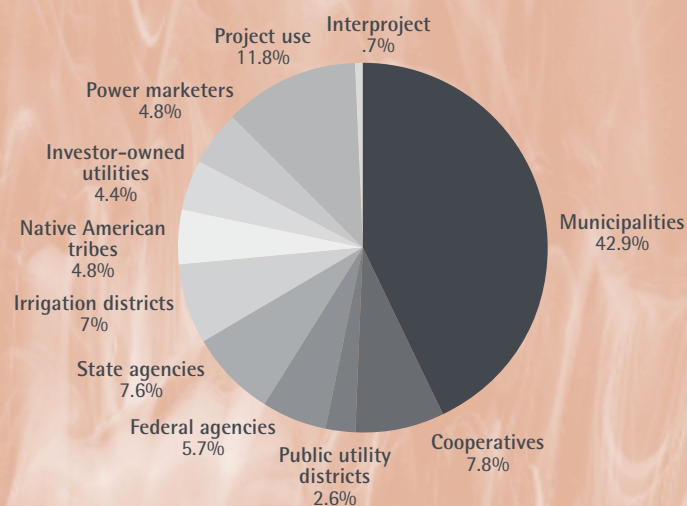
## Transmission system profile

Communication sites	430
Substations	266
Transmission lines	17,474 miles
Transformer capacity	26,898,000 kVA

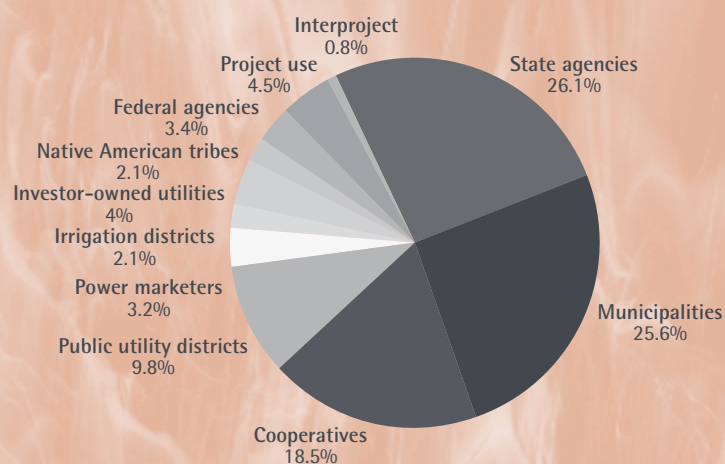
## Employee profile

Federal full-time equivalent usage	1,297
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## Customer mix



## Where our energy goes (kWh)





## ADMINISTRATOR'S LETTER

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The Honorable Spencer Abraham  
Secretary of Energy  
Washington, D.C. 20585



### **Dear Secretary Abraham:**

I am pleased to submit to you Western's FY 2002 Annual Report, highlighting our priority to deliver on our promises. Whether it's working within budget, keeping accountable outages down or repaying the Federal investment in power facilities, our commitments to our customers, industry groups and the public is at the forefront of our daily operations.

When we promise to market and deliver reliable, cost-based hydroelectric power and related services, we know it's not the promise that matters but the result. To help us stay focused on those expectations, we are closely adhering to the President's Management Agenda and are measuring our progress with performance plans and incentive programs.

For example, our annual Performance Plan holds us accountable to the promises we made in our Strategic Plan. Prepared under the guidelines of the Government Performance and Results Act, the Performance Plan gives us an opportunity to critically examine our goals and objectives, define strategies to achieve those goals and report on those goals and results to the public. We track such things as how well we meet rate targets, repay the Federal investment, secure adequate funding to accomplish our mission, work safely, retain a talented workforce and support industry reliability.

We also strive to link these long-term goals with day-to-day activities. Our Bonus Goal Program provides just such a link by tying three of Western's critical performance goals—safety, operations and cost control—to everyday tasks. This program helps motivate employees to reduce recordable injuries, lost work days and recordable motor vehicle accidents; keep program costs down; and to reduce accountable outages. My performance agreements with each senior manager also help us to focus daily on our future plans. These agreements specify the results each senior manager is accountable for each year. In turn, senior managers have performance agreements with their direct reports. This process cascades through all levels of management in Western.

Through our focus on performance, we have been able to accomplish much in FY 2002. For example, we:

- Secured sufficient resources to finance Western's purchase power and wheeling program.
- Increased the usability of our business systems.
- Completed trust-funded construction and rehabilitation projects costing more than \$500,000 on average 6 percent under budget.
- Kept rates at or below the five-year target for four of six Western projects identified for performance review.
- Increased security of mission-critical systems using internal and peer reviews.
- Reduced lost or restricted work days and motor vehicle accidents.
- Improved the effectiveness of our hiring/selection process.
- Exceeded national and regional control area operating criteria.

In some cases, we set the bar very high for ourselves. We set targets that require us to work harder and initiate improvements. We must also occasionally re-evaluate our goals to ensure they will produce the results that will move us forward in a competitive utility industry.

Our work under the President's Management Agenda is helping us to do just that—produce results. Using the five governmentwide initiatives as a guide, we are planning for our future workforce, improving the accuracy and timeliness of our financial reporting, looking for more efficient ways to accomplish work, increasing our online communication tools and more closely integrating budget decisions with performance. The results that you expect from these initiatives are the same that we expect—lower costs, improved services to customers and the public and innovative, efficient programs.

I look forward to the outcomes of these initiatives; when we say we will do something, Western can be counted on to deliver.



Michael S. HacsKaylo  
Administrator

## WESTERN PROFILE

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As we celebrated our quarter century mark in December, we recognized the many ways Western has evolved in a rapidly changing, sometimes turbulent utility industry.

An aging transmission infrastructure, unpredictable weather patterns and industry restructuring are all challenges Western has faced since its inception as a power marketing agency on Dec. 21, 1977. No matter what challenges the next 25 years bring, Western will stay focused on its mission of marketing and transmitting reliable, cost-based hydroelectric power.

That mission involves marketing generation that helps meet the nation's growing appetite for energy. Since Western's inception, customers increased from 457 in FY 1978 to 688 in FY 2002. Power sales increased from 34.9 billion kWh in our first year to almost 38 billion kWh last year.

The 25-year anniversary also allowed us to reflect on the increase in generation. While total installed capability of the generating units from which Western markets power was 7,704 MW in FY 1978, today Western markets and transmits about 10,000 megawatts of power from 55 hydropower plants. Western also markets the



United States' 547-MW entitlement from the coal-fired Navajo Generating Station near Page, Ariz.

Western sells about 40 percent of regional hydroelectric generation in a service area that covers 1.3 million square miles in 15 states. Our customers include municipalities, cooperatives, public utility and irrigation districts, Federal and state agencies, investor-owned utilities (only one of which purchases firm power from Western), marketers

and Native American tribes. They, in turn, provide retail electric service to millions of consumers in Arizona, California, Colorado, Iowa, Kansas, Minnesota, Montana, Nebraska, Nevada, New Mexico, North Dakota, South Dakota, Texas, Utah and Wyoming.

Providing this diverse customer base with transmission system reliability is as central to Western's mission today as it was 25 years ago. Using an integrated 17,000-plus circuit mile, high-voltage Federal transmission system, Western delivers reliable electric power to



most of the western half of the United States. Since FY 1978, Western has added more than 1,000 miles of lines to its system and has managed hundreds of requests for interconnection. Yet the endless stream of developments in the industry—regional transmission organization formation, changes in control areas and the emergence of new Federal Energy Regulatory Commission regulations and policies—have further increased Western's challenge to maintain system reliability.

Western's role in delivering power also includes managing 11 different rate-setting systems (not including the Central Arizona Project's Navajo generation). These rate systems are made up of 14 multipurpose water resource projects and one transmission project. The systems include Western's transmission facilities, along with power generation facilities owned and operated primarily by the U.S. Bureau of Reclamation, the U.S. Army Corps of Engineers and the International Boundary and Water Commission.

While Western's role in the industry has evolved over the years, the dedication of employees at Western's 52 duty stations has not wavered. Employees scattered throughout Western's vast territory work around the clock to provide power sales, transmission operations and maintenance and engineering services. These duty locations include Western's Corporate Services Office in Lakewood, Colo., and four Customer Service Regions with offices in Billings, Mont.; Loveland, Colo.; Phoenix, Ariz.; and Folsom, Calif. We also market power from our Management Center in Salt Lake City, Utah, and manage system operations and maintenance from offices in Bismarck, N.D.; Fort Peck, Mont.; Huron, S.D. and Watertown, S.D.

## **Legislative authority**

Congress established Western on Dec. 21, 1977 under Section 302 of the Department of Energy Organization Act. Under this statute, power marketing responsibilities and the transmission system assets previously managed by Reclamation were transferred to Western.

## **Financing methods**

Our power marketing program includes three principal activities: operation and maintenance; purchase power and wheeling; and construction and rehabilitation.

Each year, Congress appropriates funds to finance the operation and maintenance and construction and rehabilitation activities for many of our power systems, including the Pick-Sloan Missouri Basin Program, Central Valley Project, Parker-Davis Project, Fryingpan-Arkansas Project and the Pacific Northwest-Pacific Southwest Intertie Project.

Our appropriations also include an annual contribution to the Utah Reclamation Mitigation and Conservation Account as specified in the Reclamation Projects Authorization and Adjustment Act of 1992.

Existing legislation allows for the Colorado River Storage, Central Arizona, Seedska-dee, Dolores and Fort Peck projects to operate with power receipts through a revolving fund. Boulder Canyon Project is financed through permanent appropriations of receipts from the Colorado River Dam Fund. In accordance with the Foreign Relations Authorization Act for FY 1994 and FY 1995, a separate appropriation provides funding to operate and maintain Falcon and Amistad project facilities for the International Boundary and Water Commission.

Because legislation requires that the U.S. Treasury be repaid by those who benefit from Federal investments in the projects, power sales must produce enough reve-

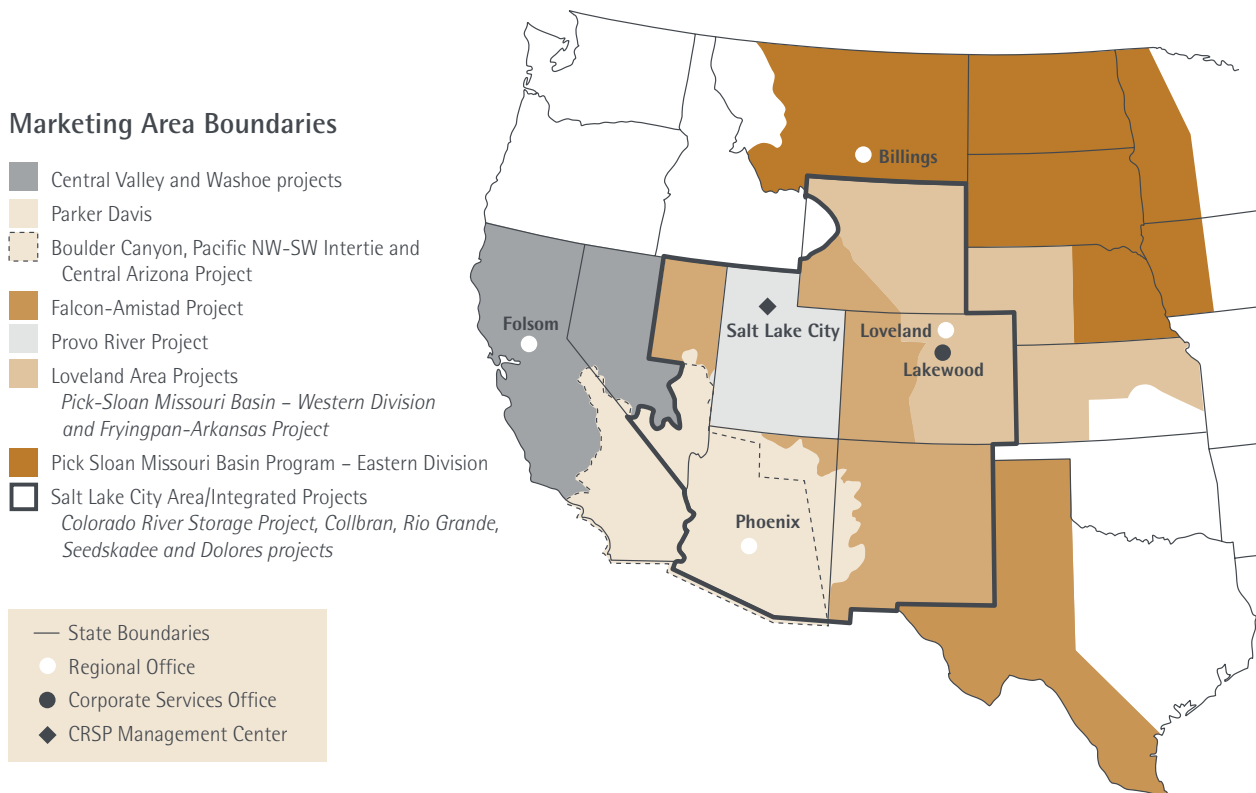
nues to cover power users' share of annual operation and maintenance project costs. Therefore, we set power rates to recover all costs associated with our activities and the power activities of the generating agencies, as well as the Federal investment in the power and transmission facilities (with interest) and certain costs assigned to power for repayment, such as aid to irrigation development.

Power revenue is also used to fund portions of Western's purchase power and wheeling activities. Drought conditions—like those we experienced in FY 2002—and other factors sometimes require us to purchase power from other suppliers to meet long-term firm power contract commitments. In FY 2001, Western obtained new authority to fund these activities from power

receipts. The new receipt funding authority, combined with alternative financing methods, such as net billing, bill crediting and customer advanced funding, eliminated the need for an annual appropriation to meet planned Purchase Power and Wheeling program needs. Western's continuing fund authorities also provide emergency funding under below normal generating conditions to finance unplanned purchase power expenses.

Customers provide advance funding to finance other power system expenses and capital improvements. We also do work for other Federal and non-Federal organizations under authority of the Economy Act, the Contributed Funds Acts and the Interior Department Appropriations Act of 1928. ▼

## PROJECT MARKETING AREAS



## DELIVERING ON OUR PROMISES

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# Look of our future workforce a government priority

**H**iring and retaining qualified, talented employees is at the top of the President's list of Management Initiatives. That he listed Strategic Management of Human Capital first among five governmentwide initiatives points to the pressing need to address the future Federal workforce. For Western, the need is even more urgent given continued utility industry restructuring.

In February 2001, the Government Accounting Office added human capital management to the governmentwide "high risk list" of serious management challenges to come. Downsizing in the early 1990s, the lack of younger employees entering government and an aging workforce have all contributed to this pending workforce crisis.

While downsizing efforts reduced the Federal workforce by 324,580 full-time equivalent employees since 1993, reducing the number of employees created a new problem: a reduced influx of people with new knowledge, energy and ideas.

The need to recruit innovative, talented employees is even more important since the average age of the Federal workforce is 46 years—or almost 48, in Western's case. Over the next decade, almost half of Western's current workforce will be eligible to retire. Changes in work-

force demographics—in the education and skills required in the future—and an increasingly competitive job market will require flexible and responsive tools to attract and retain talented employees.

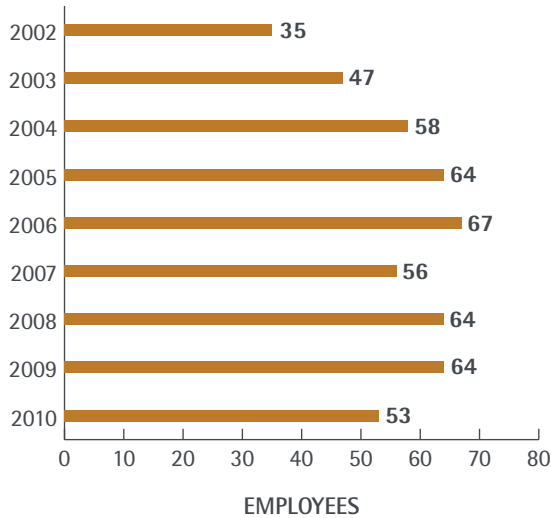
"Replacing highly skilled employees in a restructured electric industry where competition for talent is keen will be challenging," said Human Capital Initiatives Manager **Mike Watkins**. "It will be particularly acute in fields such as engineering, project management, information technology and the crafts—electricians and meter and relay mechanics.

"In the next decade, we will need to attract significant numbers of talented employees to replace the large number of baby boomer employees who will be retiring. At the same time, the U.S. workforce will begin to shrink as the next generation of workers is significantly smaller in number," he added.

Western is more prepared to face these workforce issues with a new Human Capital Plan. This strategic plan identifies workforce planning, succession planning, retention, recruitment, training and performance incentives as the most important actions Western must take in the next seven years to ensure we have the right mix of technical and supervisory skills.

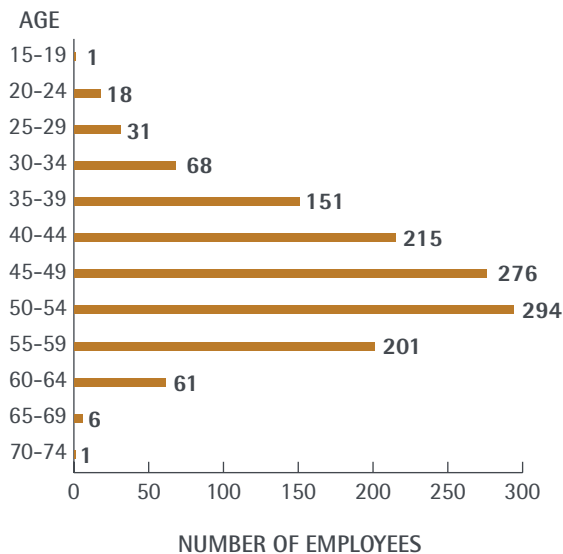
For example, this plan addresses how Western

## PROJECTED RETIREMENTS



Western's Human Capital Plan was developed to address expected retirements at Western, which will likely be evenly distributed during the next decade.  
 (Note: This graph projects that about the same percentage of eligible employees who retired in 2002 would retire in subsequent years.)

## EMPLOYEE AGE



This illustration shows Western's aging workforce. In FY 2002, the average age of employees at Western was 47.

will establish a performance culture that more closely links performance with the organization's mission, a key element of the President's Human Capital Initiative. As a result, all General Schedule managers and supervisors now incorporate the expectations from Senior Executive Service managers' performance plans into their plans as well. In addition, managers and supervisors are guiding their employees in how to link their performance plans to organizational goals and objectives.

Western is also strengthening project management as a career path. Position descriptions for project managers are now standardized across the agency and include progressive levels of experience and education of project management responsibilities. In addition, we held informational sessions agencywide on Western's project management methods, developed a project management manual and initiated a mentoring program. Contract managers also receive ongoing training, development and certification, which is tracked through DOE's Acquisition Career Development program.

Long-term expected results are that agencies will build, sustain and effectively deploy a skilled, diverse and high-performing workforce to meet current and emerging needs; the workforce will adapt quickly in size, composition and competencies; employee satisfaction will increase; citizens will recognize improved service and performance; and high performance will become a way of life that defines the Federal culture.

"We must have a government that thinks differently, so we need to recruit talented and imaginative people to public service," said President Bush. "With a system of rewards and accountability, we can promote a culture of achievement throughout the Federal government."

# Competitive Sourcing initiative

In seeking the most economical methods to accomplish work, President Bush wants Western and other agencies to ensure the Federal government maximizes the value from services provided by contractors. Under the guidance of President Bush's Competitive Sourcing Initiative and DOE policy, Western has changed how we structure our contracts to ensure we get the best quality of work.

## It's all about performance

Western has for some time contracted for services when it was a sound economic alternative. We use commercial sources when it makes good business sense and represents the most value to taxpayers and our customers. And we also re-evaluate how to get the most value from contracted services. In part, that's why Western moved from the traditional statement-of-work type contracting to performance-based contracting for contracts larger than \$100,000. This structures a contract around the purpose of the work, instead of defining how the work should be performed.

"Performance-based service contracting emphasizes that all aspects of an acquisition (contract) be structured around the purpose of the work to be performed—as opposed to how the work is to be performed or broad, imprecise statements of work that preclude an objective assessment of contractor performance," said UGP Contract Specialist **Cheryl Jones**.

"(This type of contracting) is designed to allow contractors the freedom to determine how to best meet government performance objectives, that appropriate performance quality levels are achieved and that pay-

ment is made only for services that meet those levels," she said.

**Ann Nikolas**, contracting officer's representative on the CSO administrative support contract, explained how this new type of contracting differs from the old ways of doing business.

"We used to specify the work and the numbers and kinds of people required to do it," she said. "Basically, we were buying labor hours to do a number of jobs. Under performance-based contracting, we define the work to be done and specify how we will evaluate performance—generally using timelines, quality and cost-control kinds of measures. The contractor selected to perform the work decides how many and what kinds of employees to hire," she explained.

**“We used to specify the work and the numbers and kinds of people required to do it.”**

Western's CSO, and Rocky Mountain, Desert Southwest and Upper Great Plains regional offices have all selected new support services contractors using the performance-based processes.

CSO Acquisition Manager **Jon Olsen** summed up the benefits of Western's new approach: "Performance-based contracting is designed to save money while ensuring the work performed meets our technical and quality requirements," he said. "Another benefit is that we can motivate contractors to perform favorably by including incentives in the contract and Quality Assurance Plans," he said.

# Improving financial performance starts with daily decisions

**A**ccurate and timely financial information—the American public expects nothing less from Federal agencies, including Western. But just how do we go about ensuring that we can deliver on that promise? In the Improved Financial Management initiative, President Bush says the answer lies in integrating daily financial management decisions with performance and results.

For example, Western's participation on DOE's Accelerated Reporting Team is guiding us to move up our reporting deadlines to meet the Office of Management and Budget's expeditious new reporting schedule. OMB

**“The earlier dates will require agencies to fundamentally rethink the systems they now rely on to produce financial information.”**

challenged all Federal agencies to accelerate their annual financial performance reporting so that by FY 2004 they will submit audited financial statements by Nov. 15.

We're on the right path to meeting the new schedule—Western accountants are now working diligently to submit quarterly reports one month after the quarter ends and to submit the FY 2003 Annual Report on an accelerated schedule.

## Corrective actions

But submitting reports on time won't matter if they aren't accurate. To improve the accuracy of Western's financial reports, Chief Financial Officer **Harry**

**Pease** has guided his staff in strengthening review processes for manual journal entries made in our financial system, providing additional training for both CSO and regional staff and researching and clearing prior-year cash and accounts receivable differences with the U.S. Treasury.

In addition, Western's financial community is aiming for timely, clean audits—a key component of the President's Management Agenda. To ensure that we have applied the findings of previous audits to current financial data, accountants have begun thoroughly reviewing, validating and documenting completed corrective actions on prior-year financial audit findings. Western will provide information on these corrective actions to external auditors for their review and testing. Finance staff also began identifying other program areas to further improve internal controls and performance.

## Western 'BIDSS' on future improvements

Integral to all of this work is Western's Business Information Decision Support System—our consolidated financial and business software. The President directed agencies to ensure their financial systems combine financial and performance management to support day-to-day operations and unqualified timely audits.

“The earlier dates will require agencies to fundamentally rethink the systems they now rely on to produce financial information,” said Paul Everson, controller of OMB's Finance Office.

Western's problems with switching to the new system and upgrading components within the system—the Oracle Federal Financial suite version—made addressing



this initiative a challenge, said Pease.

"However, Western is now making good progress," Pease said. "Since November 2001, we've completed financial statement audits for FY 1999, 2000, 2001, 2002 and received unqualified opinions on each. We've also significantly improved the accuracy and timeliness of our financial reporting. In addition, we have an outstanding record of making accurate and timely payments."

Western expects to complete all known corrective actions on its financial management system by December 2003.

When work on this financial performance initiative is completed, the President expects improved accountability to the American people through audited financial reports. He also expects us to have a financial system that routinely produces timely, useful and reliable information to ensure consistent and comparable trend analysis over time and to facilitate better performance measurement and decision making. Finally, he expects that Western and other Federal agencies will make changes to the budget process that will allow us to better measure the real cost and performance of programs.

## E-government initiative aims to reduce redundancy, improve responsiveness

**W**hen President Bush considered how to increase employee performance and simplify access to government information and services, he couldn't overlook the Internet and e-mail—two tools that Federal agencies depend on to communicate and conduct business. His e-government initiative aims to expand the government's use of these electronic communication tools to improve responsiveness and reduce costs.

Western has steadily increased its Internet use to convey information and provide services to customers and the public. Almost every Western organization has applied on-line communication methods to daily tasks.

### Conveniences for customers

For example, the Internet has transformed how we communicate with customers. Our Open Access Same-Time Transmission System gives utilities and power marketers equal access to information about available transmission on Western's system. Considering deregula-

tion and Federal Energy Regulatory Commission requirements, Western is studying the implications of Standard Market Design Business Practices and our role or future relationships with regional transmission organizations.

Additionally, Western tested the use of electronic signatures for tariff documents in the Desert Southwest Region. Using electronic signatures reduces processing time and associated costs by streamlining the approval process and replacing manual steps with on-line transactions.

### Web-based benefits

Internet technology is also helping us improve our government-to-business, government-to-government, government-to-citizens and internal efficiency and effectiveness. Now that Western posts all solicitations with a value over \$25,000 on a centralized Federal Web site, contracting opportunities are available to all businesses at the same time. These e-commerce methods increase

competition among vendors that provide goods and services to Western and reduce postage and copying costs.

In addition, we've used our external Web site as a one-stop site for information about Western. By clicking on the News Desk on our Web site, the public can find out the latest news about Western projects, read the *Closed Circuit* online, or search for detailed information on our system. We also use the Internet for on-line supply ordering and to accept online payment and registration for Electric Power Training Center classes.

Many tools are now available on-line, giving employee electronic access to information such as software applications, forms, telephone books and directories. Western has also offered online services, such as renewable energy services and interactive maps, to other government agencies. Several business systems and infrastructure tools have been structured for the Web, greatly reducing labor and hardware costs. For example:

- Transmission network monitoring and management tools to see which lines are overloaded and redirect traffic.
- Storage management and load balancing tools within the IT Operations Center
- Configuration management tools to reduce the number of software licenses required

## Technology blueprints

Many other opportunities exist to automate processes and services, but it's critical that we first examine and design our underlying IT structure. Western is developing its Enterprise Architecture based on a common analytical framework with associated business processes, which encompass all of the technology, tools, applications and business processes that assist our business operations. The goal is to integrate systems within the agency to enhance communication and eliminate redundancy.

"Enterprise Architecture benefits Western's business process model in many ways. EA helps to process

Western posts solicitations over \$25,000 to the FedBizOpps Web site, which provides one-stop shopping for those interested in contracting opportunities with the Federal government.



structure, automates manual processes, shortens business cycle times, builds consistency across business lines, provides commonality/standardization (when applicable) and ultimately improves how Western responds to industry changes," said **Eun Moredock**, chief information officer.

For example, Western's Sierra Nevada Region is integrating its existing power business systems and automating manual processes to keep bulk power moving through the transmission system.

Several information technology projects will benefit from the Enterprise Architecture foundation, such as increased cyber security, automated software and virus protection updates, consolidated IT purchases, standardized hardware and software and preparation for telecommuting.

Western plans more enhancements, but will complete them only with effective strategies and evaluation.

For example, we evaluate all major IT investments against Office of Management and Budget criteria to determine if the potential benefit is worth the cost.

### "3 clicks" to better service

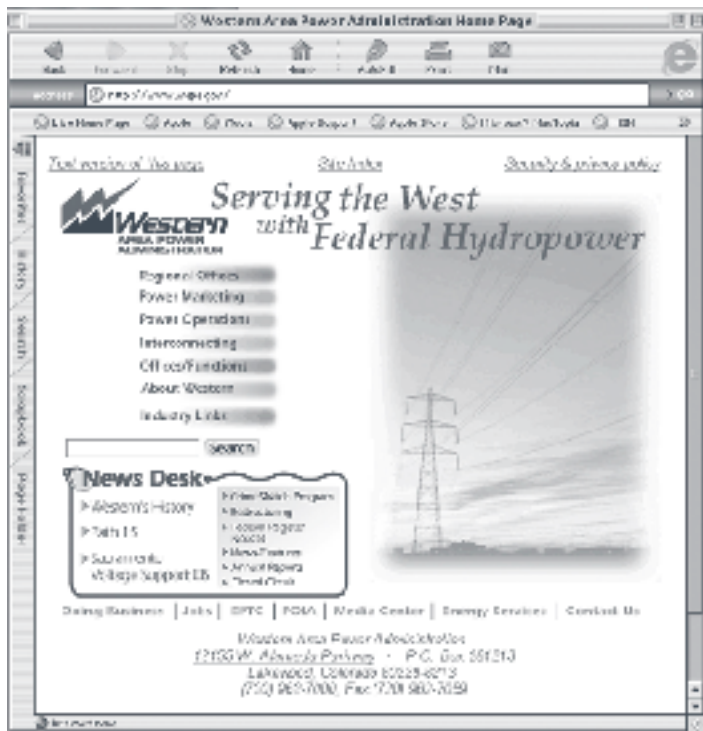
The President envisions an IT architecture that provides services and information no more than "three clicks away."

Other expected results from the e-government initiative include reducing the expense and difficulty of doing business with the government; cutting government operating costs; making government more transparent and accountable; and providing high-quality customer service regardless of whether someone contacts the agency by phone, in person or on the Web.

"I will expand the use of the Internet to empower citizens, allowing them to request customized information from Washington when they need it, not just when Washington wants to give it to them.

"True reform involves not just giving people information, but giving citizens the freedom to act upon it," said Bush before taking office.

This is the homepage for Western's external Web site at [www.wapa.gov](http://www.wapa.gov).



# Linking budget with performance will help us achieve all initiatives

The best way to ensure we adequately plan our future workforce, accomplish work at the lowest cost, improve financial performance or expand electronic government is to link budget decisions with performance reviews, said President Bush in his Budget and Performance Initiative.

"Government should be results oriented—guided not by process but by performance. There comes a time when every program must be judged either a success or a failure. Where we find success, we should repeat it, share it and make it the standard. And where we find failure, we must call it by its name. Government action that fails in its purpose must be reformed or ended," he said.

**“Each performance indicator is also matched with a specific measure(s) or output target.”**

This initiative, which builds on the 1993 Government Performance Results Act, aims to better manage dwindling Federal resources. The Bush Administration has now defined objectives for Federal programs and is measuring program costs against expected results. The Administration will set performance targets for selected programs, along with funding levels.

"The President's Budget for 2003 takes the first step toward reporting to taxpayers on the relative effectiveness of the thousands of programs on which their money is spent. It commences the overdue process of seriously linking program performance to future spending levels. It asks not merely 'How much?' it endeavors to explain

'How well?' said Paul Everson, controller of Office of Management and Budget's Finance Office.

As part of this oversight process, Western participates in DOE's newly established five-year planning, programming, budgeting and evaluation process.

The Program Information Reporting System links Western's program activities, funding, staffing, strategic planning and performance with DOE's.

Western's budget staff works with program and senior managers to identify measurable goals in the budget process.

For example, Western's FY 2003 budget request included three major performance indicators:

- Maintain reliability in the evolving electric utility industry.
- Establish and meet planned annual repayment for each Federal power system.
- Ensure all employees are aware of, committed to and equipped to work safely.

"Each performance indicator is also matched with a specific measure(s) or output target," said **C. J. McNichols**, a budget analyst at CSO. "We use these objectives and targets to measure how well we are performing compared to our goals, which, in turn helps us determine how well we are meeting the President's Management Initiatives."

In FY 2002, we met the target for the transmission reliability by passing monthly control compliance ratings on Control Performance standards, which measure unscheduled power flows or frequency errors. We met our safety target by achieving a recordable accident frequency rate of 1.7, well below the 5.0 standard

industry recordable accident frequency rate per 200,000 hours worked in 2001. Also, despite drought conditions, we repaid \$19.7 million in Federal principal to the U.S. Treasury.

Western's FY 2004 budget request added two more specific targets to the existing three performance indicators:

- Limit accountable customer and/or transmission outages to the average number of outages for the past five years.
- Repay required principal on Federal power investment.

In FY 2002, Federal employees were awarded a payout through our Bonus Goal Program for limiting accountable outages to 17, which was less than the five-year average of 52.6.

Electrical Engineer **Mark Meyer** said, "Western works hard to provide reliable transmission. Through better operating and maintenance practices, improved station commissioning and improved substation and transmission line design, Western will continue to reduce the number of accountable outages on our system."

As for our repayment performance, by the end of FY 2002, Western had repaid \$2.83 billion (in Federally and non-Federally financed power and Federally financed and non-Federally financed non-power investments) out of a total \$8.9 billion in investment. Western will continue to establish cost-based rates to recover all costs of providing power service, including principal and interest owed to the U.S. Treasury.

## Measuring the benefits

The President expects that once all agencies are focused on these types of results, his Budget and Performance Initiative will have been a success.

The results he expects are:

- Performance measured against goals.
- Better control and accountability over resources used.
- Better service; standard, integrated budgeting and accounting information systems that provide timely feedback.
- And integration of existing segregated and burdensome paperwork to measure the government's performance and competitive practices.

Western Administrator **Mike Hacskaylo** believes Western has made significant progress and is well on its way to fully implementing all five initiatives.

"Western was engaged in making improvements in the initiative areas even before President Bush made them mandatory because they make good business sense for us and our customers," he said.

"We expect to refine our goals and targets each year as we continue to focus on the key aspects of what drives our business and better ways to serve our customers. ▼"

# 2002 ACCOMPLISHMENTS



## **BIDSS/Maximo Upgrade Project**

Western initiated the BIDSS-MAXIMO upgrade—known as the BMX Initiatives Project—to move Western to Oracle Federal Financials release 11i and MAXIMO release 4.1.1. Functional analysis activities began in late FY 2002 and will continue next year, followed by design, development, testing, training and implementation. The upgraded versions will “go live” in October 2003.

## **Big Horn Basin Upgrades**

The Rocky Mountain Region completed the Big Horn Project to increase the total transmission capability of the Big Horn Basin area of Wyoming. The project included converting the Big George-Carter 69-kV line to 115-kV, rebuilding an existing substation and replacing structures on the Lovell-Thermopolis 115-kV line. RM maintenance staff performed a significant portion of the construction work. As a result of these outstanding efforts, Western will save \$1.5 million per year in wheeling costs, have additional transmission capacity to sell and provide a more reliable system.

## **Bird Collision Study**

Western is involved in a bird collision prevention project through the Electric Power Research Institute and the Avian Power Line Interaction Committee. Bird monitoring studies in North Dakota found 150 dead birds in power line rights of way in 2002. That number includes birds that collided with power lines and those struck by

motor vehicles. It also includes a single piping plover, which is a threatened species.

## **Bismarck Maintenance Facility**

Construction on a new maintenance warehouse and maintenance facility was completed in Bismarck. The facility features a safe loading dock, improved project drainage and better insulation. The facility replaces two obsolete 50-year-old buildings, which didn't meet today's building, electrical or fire codes and had sustained flood damage.

## **Bonus Goals**

Employees achieved three of five Bonus Goals in FY 2002: reducing the number of lost and restricted work days, reducing recordable motor vehicle accidents and reducing accountable outages.

## **Collaboration with Western States Power Corporation**

Through a six-year collaborative program among Western, the U.S. Bureau of Reclamation and Western States Power Corporation, Western States has advanced to Western and Reclamation about \$20 million for funding purchased power expenses and many operation and maintenance expenses for Estes, Yellowtail and Mt. Elbert powerplants. Western States is a non-profit corporation established by Western customers that provides advance customer funding to several projects.



## **Crime Watch Program**

Western launched its Crime Watch Program, which allows the public to report theft, vandalism or malicious mischief to Western's facilities. The program includes a toll-free number and Web site to anonymously report these crimes. Witnesses can receive up to \$1,000 for information leading to the arrest and prosecution of a suspect. Western sent program information to local media, landowners and law enforcement agencies across its service area.

## **Electric Service to Albuquerque Operations Office**

Western executed a letter agreement with the Department of Energy's Albuquerque Operations Office and Public Service Company of New Mexico, which makes Western the sole power supplier for Kirtland Air Force Base and Sandia National Laboratories in New Mexico. In addition to providing lower cost power to the facility, the agreement will help DOE more effectively use a special 15-MW capacity allocation under an interchange agreement.

## **Experimental Flow at Glen Canyon Dam**

The Colorado River Storage Project Management Center developed a proposal for an experimental flow at Glen Canyon Dam that conserves resources within the Grand Canyon and calls for minimal change in operation or electric power production. Western negotiated with other Adaptive Management Program members—the Arizona Game and Fish Department, several Indian tribes, seven Colorado River Basin states, environmental groups, recreation interests and Glen Canyon Dam power customers—to include this proposal in the second year of the experimental flows. The Adaptive Management Program

experiment is to remove non-native predators from the Little Colorado River and mainstem Colorado River in the Grand Canyon.

## **FEMA Assistance**

A Western employee helped the Federal Emergency Management Agency assess technical damage and analyze repairs and restoration needed to rebuild the electrical grid on Guam, Chuuk and Tonoas Islands, which were devastated by a typhoon.

## **Green Tags**

Western facilitated an agreement between the U.S. Air Force and Basin Electric Power Cooperative that will allow the Air Force to buy green tags, which represent the environmental attributes associated with energy produced from renewable resources. The Air Force will buy green tags associated with up to 4,320 Mwh of wind turbine generation each fiscal year through 2006. The green tags are for Ellsworth Air Force Base in Rapid City, S.D., and F.W. Warren Air Force Base in Cheyenne, Wyo. Western also negotiated a contract for renewable energy on behalf of Edwards AFB. The new arrangement replaces a contract that Edwards had with Enron. The quantity of renewable power to be provided varies by time of day, but ranges from 7 to 23 MW. This five-year contract starts with a minimum of 25 percent renewable power and steps up to 100 percent renewables in 2004.

## **Human Capital Plan**

Western unveiled a Human Capital Plan to address the challenges of attracting and retaining talented employees to replace our aging workforce. This Plan includes seven initiatives for implementation, including:

- 1) developing a human capital plan linked to Western's

strategic goals; 2) developing a Westernwide workforce planning program; 3) establishing a succession planning program; 4) fostering a workplace environment to attract and retain talented employees; 5) establishing a Westernwide coordinated recruitment program; 6) developing a training program on human capital management; and 7) developing pay options to improve the link between pay and performance.

### **Interconnections, Merchant Plants**

In FY 2002, Western managed proposed interconnections for eight merchant plants with 5,376 MW of generating capacity, which will be sold directly into the market. Work included a supplemental draft EIS for the Big Sandy plant that would interconnect with Western's Mead-Phoenix 500-kV line; construction of two Liberty-Sundance and Coolidge-Sundance 230-kV transmission lines for the Sundance Powerplant interconnection and commissioning of the Sundance generators; systems impact and facilities studies for the Mohawk Generation facility, Valley Electric Association interconnection, Centennial transmission line interconnection into Mead Substation, and the LV Cogen, Mirant, Duke, Reliant Big Horn and Pinnacle West Silver Hawk generators; a system impact study consultation for the San Luis generator; interconnection of transmission lines at Galivan Peak, Raceway and Flagstaff Substations for Arizona Public Service; and commissioning of the Blythe generator. FY 2002 we also developed a solution to transmission line sagging to lines built before 1975 and implemented net billing procedures and appropriate BIDSS development for Griffith, a merchant plant in Kingman, Ariz.

### **LAP Post 2004 Resource Pool**

Final Loveland Area Projects Resource Pool allocations were published in the *Federal Register* on Jan. 10, 2002. Western allocated power to 26 new customers that include six Native American tribes, five cooperatives, 12 municipalities and 3 government agencies. Western allocated power to Colorado's Regional Transportation District and to Yellowstone National Park. Power deliveries start Oct. 1, 2004. The resource pool—about 28 MW and 80,000 MWhs—represents 4 percent of the RM's current marketable capacity.

### **Montana-Dakotas Transmission Study**

To focus on expanding transmission to deliver energy from various types of generation to new markets in the Midwest, Western completed the Montana-Dakotas Regional Transmission Study. Authorized by Congress and commissioned by Western, the study specifically targets transmission system reinforcements and upgrades needed to support an additional 1,000 megawatts of new wind and lignite coal energy generation in North Dakota, South Dakota and Montana. The study consists of three volumes.

### **NERC Electronic Tagging**

Western energy schedulers successfully upgraded the North American Electric Reliability Council E-tagging system, an Internet-based protocol. E-tags document the scheduling of energy from an energy supplier and the reservation to transmit that energy. The switch to the new version on April 10 was critical because every energy scheduling entity in the United States, Canada and Mexico had to launch the new software simultaneously at midnight Central Daylight Time and the system had to work correctly and accurately from the start.

## **New Substations**

The newest substation in the Rocky Mountain Region—Cañon West—was energized and put into service two months ahead of schedule. The new 230-kV ring bus substation bisects the CRSP Midway-Poncha 230-kV transmission line. Western will own and operate the 230-kV part of the new substation. Western also completed the design and construction on two new Western substations in the Upper Great Plains Region. The Virgil Fodness Substation near Tea, S.D., was added to serve load for East River Electric Power Cooperative. The Elk Creek Substation near Rapid City, S.D., was added to serve load for Rushmore Electric Power Cooperative. Additionally, the Sundance Substation near Coolidge, Ariz., was acquired from Sundance Energy PPL as part of interconnection agreements allowing East River and Sundance to interconnect with Western's transmission system. In addition, Western added one other substation—the Buck Boulevard switchyard in California—to bring the total number of substations to 266.

## **Non-Hydro Renewable Resource Program**

The NHRRP secured more than \$263,500 from outside organizations to advance renewable resource use. The program also provided grants to the American Public Power Association, Nevada State Energy Office, Northern Arizona University, Northwest Seed and the University of Nevada at Reno for wind anemometers, regional wind resource maps, state wind and geothermal industry working groups and public power and cooperative utility technical outreach programs. The NHRRP manager also developed a publication called, "Green Pricing at Public Utilities: A How-to Guide Based on Lessons Learned to Date." Western is also continuing its partnership with the Public Renewables Partnership to foster demand for renewable resources.

## **Parker-Davis Project Marketing Plan Proposal**

Western began the Parker-Davis Project remarketing process with a *Federal Register Notice* announcing a proposal to apply the Energy Planning and Management Program Power Marketing Initiative to the project. The Initiative calls for extending a major portion of the existing contracts for 20 years beyond their Sept. 30, 2008 expiration date. The remaining portion would form a resource pool available to new customers, including Native American tribes. Western is consulting with current and potential customers and interested publics on its proposal.

## **Path 15 Project**

The Federal Energy Regulatory Commission approved a Letter Agreement for the Path 15 Upgrade Project, setting out cost recovery and incentive proposals for a \$306 million upgrade to California's constrained Path 15 transmission line. In addition, the California Independent System Operator's Board of Directors voted to accept a Path 15 upgrade as part of the ISO-controlled grid. The upgrade project is being carried out by Western, Trans-Elect Inc., and PG&E. The new 500-kV transmission line is scheduled to come online in late 2004. The Project will be operated as a transmission facility within the ISO.

## **PG&E Gives Refunds to Western Customers**

Western customers will receive refunds from Pacific Gas and Electric Company of about \$9.0 million, excluding interest. The refunds stem from a Federal Energy Regulatory Commission ruling that affirmed the initial Administrative Law Judge's ruling preventing PG&E from passing through reliability service costs under its integration contract with Western. The initial ruling found that the reliability service was not a new service and that

PG&E had not met the contractual requirements nor provided sufficient cost of service information to make a filing under section 205 of the Federal Power Act to increase its rates. Due to the company's bankruptcy filing, FERC granted PG&E an extension on paying reliability service refunds. Western is working with PG&E to determine the amount and timing of the refunds and accrued interest. The charges have been accruing since June 2000.

### **Pick-Sloan Resource Pool**

Western held four public meetings across the upper Midwest to determine how to allocate up to 1 percent of the power generated by eight hydroelectric powerplants from the Pick-Sloan Missouri Basin Program's Eastern Division. Staff from the Upper Great Plains Region also began gathering letters of interest as part of its public process to allocate up to about 20 megawatts of power for deliveries that could begin in January 2006.

### **Post-2004 SLCA/IP Energy Allocations**

Final allocations of power and energy from the Salt Lake City Area/Integrated Projects Post 2004 Resource Pool to Native American tribes were published in the Federal Register. Western made allocations to 53 tribes in Arizona, Colorado, Nevada, Utah and Wyoming and began negotiating firm electric service contracts. Power deliveries will begin Oct. 1, 2004.

### **Pre-Scheduling Changes**

The Montrose Energy Management and Marketing Office assumed the pre-scheduling duties for Basin Electric/Rocky Mountain Generation Cooperative. While EMMO staff was already scheduling in real-time for these entities, Basin Electric was also interested in pre-scheduling. The pre-scheduler works on the trading floor with

the Montrose EMMO real-time marketers for enhanced coordination between both parties. The real-time marketers work directly with the pre-scheduler and Laramie River Station powerplant operators.

### **PV Modules Replaced**

BP Solar is replacing 144 existing photovoltaic modules on the roof of Western's Folsom, Calif., office with more efficient modules. The installation will continue Western and BP Solar's partnership that began in 2000 with the installation of a 10-kW beta test site to obtain field measurements from BP Solar's cadmium telluride modules, a new technology. BP Solar receives valuable performance data and Western benefits from the generated electricity and system ownership.

### **Rapid City DC Tie**

Western partnered with Basin Electric Power Cooperative and Black Hills Power and Light on the construction and operation of a back-to-back DC Converter Station project in Rapid City, S.D. When completed, the station will be able to transfer up to 200 MW of power between the Western Electricity Coordinating Council in the western interconnection and the Mid-Continent Area Power Pool in the eastern interconnection. The converter station will be operated by the Rocky Mountain Region's Western Area-Colorado Missouri control area.

### **Rate Changes**

The Energy Secretary signed the firm power, transmission and ancillary services rate order for Salt Lake City Area/Integrated Projects and the rates became effective Oct. 1, 2002. This signing culminated the Federal rate order process that began in 2001 and included informal

rate meetings with firm power customers, as well as informational and comment forums.

Other rate actions included a rate extension for the Loveland Area Projects, which became effective on July 1, 2002.

### **Regional Science Bowls**

Western sponsored seven regional competitions from North Dakota to California and winning teams participated in the Department of Energy's National Science Bowl in May. RM-sponsored Boulder High School won second place in the national competition.

### **Reliability Centered Maintenance**

Implementation of the Reliability Centered Maintenance program, which focuses resources on preserving overall system function, continued in FY 2002. RCM is a maintenance management tool that helps optimize Western's maintenance efforts. For example, some periodic equipment overhauls can be eliminated in favor of careful monitoring of potential failure, while non-critical items may be "run to failure" before maintenance is performed. A Western RCM coordinating team oversaw and coordinated program implementation. This work includes modifying the computerized maintenance management system to reflect revised maintenance practices, investigating condition monitoring, and remote monitoring of equipment condition in real-time. Program implementation builds upon a pilot project undertaken by RM in FY 2001.

### **RTOs, Seams Steering Group**

Western met with numerous other utilities to discuss the costs and benefits of various regional transmission organization options, including the Midwest

Independent System Operator and West Connect RTO. Western staff also participated in the Seams Steering Group-Western Interconnection work groups to discuss procedures for transactions among regional transmission organizations. Seams are boundaries between control areas that could lead to disruptions in transmission. Western has determined that it will pursue RTO membership when benefits outweigh costs and after conducting an environmental review and public process.

### **Shared Safety Training**

Western, Bonneville and Southwestern power administrations formed a partnership to develop an online training program for the agencies' 1,478 craftsmen. The Online Safety Training Team will develop industry-uniform training that can be delivered just in time to a geographically dispersed staff. When completed, the Web-based safety courses will be added to the Energy Online Learning Center. The new system will also allow training to be recorded automatically, reducing labor and costs.

### **Standard Market Design 2002**

Western established three working groups to prepare a response to the Federal Energy Regulatory Commission's Standard Market Design Notice of Proposed Rulemaking. The FERC NOPR includes far-reaching proposals to establish a more competitive bulk power system.

### **Strike Team Evaluates Business System Needs**

Western formed an agencywide Common Electronic Scheduling Sub-team, referred to as the "Strike Team," to evaluate business system needs as the Sierra Nevada Region prepares to implement its 2004 Marketing Plan and considering forming a Federal control area

in northern California. The team provides guidance, direction and perspectives in identifying all the components and functional systems necessary to operate as a control area, transmission provider, and purchasing-selling entity. The Strike Team's involvement helped assure the promotion of inter-regional coordination of business, process and implementation architectures as part of this effort. Using this team's input, Western is preparing a Request for Proposals that focuses specifically on control area/transmission provider scheduling and purchasing-selling entity scheduling needs, including settlements with the California Independent System Operator.

### **Virginia Smith Station Granted Flexibility**

Western's Virginia Smith Converter Station near Sidney, Neb., began operating in the opposite direction of the Tri-State Generation and Transmission Association's David Hamil Converter Station at Stegall, Neb. The new arrangement removes a significant obstacle to transmission operations. The Virginia Smith Converter Station ties together the eastern and western power grids by converting up to 200 MW of alternating current electricity

on one side to direct current and then back to alternating current, allowing power to flow between the two grids.

### **"Wings of Honor" Awarded to Western**

Western earned the "Wings of Honor" award from the Flight for Life of Colorado Springs, Colo., for supporting the organization's communications needs. Western provides a no-cost lease to Flight for Life for two microwave channels, and also provided no-cost power to operate the associated equipment, which is located at Methodist Mountain, south of Salida, Colo.

### **25th Anniversary Celebrations**

In December Western invited customers and retirees to celebrate our 25th-year anniversary as a Federal power marketing administration. In addition to hosting numerous open houses and receptions agencywide, we produced a history book and developed a history Web site. Staff also contributed items for a time capsule, which was made from a steel transmission structure section and will be on permanent display at the Corporate Services Office in Lakewood, Colo., and opened in 2027. ▼



## 2002 IRP SUMMARY

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**W**estern updated the Integrated Resource Planning requirements outlined in Section 114 of the Energy Policy Act of 1992, giving customers several additional options to meet or streamline these requirements. The updated requirements now better reflect changes in the utility industry and our customers' varying size and structure. These changes also streamlined the reporting requirements without sacrificing the EAct's intent.

Customers must submit annual progress reports and new integrated resource plans every five years, but they may now submit them individually or cooperatively when they belong to member-based associations.

The new IRP regulations allow customers to set action plan timelines (instead of a five-year minimum) to better correspond with their own situations. The regulations no longer require customers to provide a complete load forecast, only a brief summary verifying that one was conducted. Customers no longer must provide methods of validating predicted performance to determine whether they met IRP objectives. Instead, they can submit a brief description of measurement strategies for the options identified in the IRP.

Western also made changes to IRP alternatives. Members of MBAs and Joint Action Agencies may now file a small customer plan if their sales/use is under 25 GWh per year.

Another alternative to the IRP is the minimum investment report. Customers under state, tribal or Fed-

eral regulation to make a mandated minimum financial/resource investment in demand-side-management or renewable energy programs may file a minimum investment report consisting of an initial report and an annual letter.

The Energy Efficiency/Renewable Energy Report allows state, tribal or Federal end-use customers required by state, tribal or Federal mandate to conduct energy efficiency/renewable energy programs to provide an initial report and an annual report on these activities to comply with Western's requirements.

All firm power customers have submitted one of these options. In FY 2002, Western received 76 IRPs from individual customers, 49 integrated resource plans from cooperatives, 34 minimum investment reports and 112 small customer plans. These plans represent 725 long-term firm power customers and customer members.

Customer-reported trends include:

- High interest/demand for renewable energy technologies

- Bundling a variety of services to improve customer satisfaction and increase revenues
- Strong support for public power
- Continued re-emergence of demand-side-management activities/programs

The most frequent demand-side-management activities cited by Western's customers are:

- Lighting technologies
- HVAC technologies with emphasis on cooling and ventilation
- Audits for residential, commercial and industrial facilities
- Load management
- Rebate programs

The top five renewable energy activities are:

- Hydro (large & small)
- Wind generation
- Solar – PV
- Geothermal
- Biomass/gas

IRPs are driven by customer needs/requests. Cost and reliability are still the highest priority, but the proponents of renewable energy technologies have an ever-increasing influence on both of them. They include: foreign energy dependability, environmental issues, security issues, developing technologies, affordable options and regulations. ▼

## FY 2002 Customer IRP Accomplishments

ITEM	CRSP	DSW	RM	SN	UGP	TOTALS
DSM kW savings	39,320	133,555	47,277	48,949	866,284	1,135,385
DSM kWh savings	99,224,578	185,380,626	44,562,092	167,526,867	52,836,538	549,530,701
DSM expenditure	1,040,036	41,378,000	3,225,810	48,483,828	18,315,652	112,443,326
DSM deviations	294,834	12,132,250	273,349	4,015,502	814,287	17,530,222
kW renewables	94,000	2,192,530	67,985	497,755	538,950	3,391,220
kWh renewables	155,480,329	3,161,955,402	216,145,538	1,975,469,077	26,922,504,342	8,201,300,780
Renewable expenditures	8,013,141	20,201,500	2,130,939	89,005,640	47,337,243	166,688,463
Renewable program types	Hydro Geothermal Wind	Solar-PV Solar-thermal Hydro	Wind Solar PV Geothermal Hydro Fuel Cell	Solar PV Geothermal Hydro Purchased Power Contract	Large wind Muni. WTE Solar-PV Hydro	

## REPAYMENT SUMMARY

### Western Consolidated Status of Repayment (Dollars in millions)

	Cumulative 2001	Adjustments	Annual 2002	Cumulative 2002
<b>Revenue:</b>				
Gross operating revenue	18,405	25	934	19,364
Income transfers (net)	(806)	5	(107)	(908)
<b>Total operating revenue</b>	<b>17,599</b>	<b>30</b>	<b>827</b>	<b>18,456</b>
<b>Expenses:</b>				
O & M and other	6,438	2	328	6,767
Purchase power and other	5,138	49	333	5,520
Interest				
Federally financed	3,196	(26)	155	3,325
Non-Federally financed	152	0	11	163
Total interest	3,348	(26)	166	3,488
<b>Total expense</b>	<b>14,924</b>	<b>25</b>	<b>827</b>	<b>15,775</b>
(Deficit)/surplus revenue	(103)	(27)	(21)	(151)
<b>Investment:</b>				
Federally financed power	5,160	(55)	135	5,240
Non-Federally financed power	195	4	1	200
Federally financed nonpower	3,579	0	(32)	3,547
Non-Federally financed nonpower	1	0	0	1
<b>Total investment</b>	<b>8,935</b>	<b>(51)</b>	<b>104</b>	<b>8,988</b>
<b>Investment repaid:</b>				
Federally financed power	2,686	33	20	2,739
Non-Federally financed power	46	0	4	50
Federally financed nonpower	39	(4)	4	39
Non-Federally financed nonpower	1	0	0	1
<b>Total investment repaid</b>	<b>2,772</b>	<b>29</b>	<b>28</b>	<b>2,829</b>
<b>Investment unpaid:</b>				
Federally financed power	2,474	(87)	115	2,501
Non-Federally financed power	149	4	(3)	150
Federally financed nonpower	3,540	4	(36)	3,508
Non-Federally financed nonpower	0	0	0	0
<b>Total investment unpaid</b>	<b>6,163</b>	<b>(80)</b>	<b>76</b>	<b>6,159</b>
<b>Fund balances:</b>				
Colorado River Development	5	3	(5)	3
Working capital	1	0	(1)	0
<b>Percent of investment repaid to date:</b>				
Federally financed power	52.05%			52.27%
Non-Federally financed power	23.59%			25.00%
Federally financed nonpower	1.09%			1.10%
Non-Federally financed nonpower	100%			100%

Note: Repayment status is based on audited data as of Sept. 30, 2002.

Difference between the Annual 2002 data in this table and the Combined Power System Statements of Revenues and Expenses on page 38 are footnoted in the individual power systems' Status of Repayment tables in the Statistical Appendix.

## CUSTOMER SERVICE TERRITORIES



# FINANCIAL DATA



## MANAGEMENT'S DISCUSSION AND ANALYSIS

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### Outlook

**W**estern remains focused on its goal of maintaining the reliability and safety of its transmission system while managing power delivery costs and meeting our repayment responsibilities. Furthering this goal, Western is strengthening its partnerships with affiliated generating agencies and customers through its success in controlling costs, coordinating funding agreements, and prioritizing construction and rehabilitation projects. Western and the generating agencies continue to be accountable and responsive to their customers and the needs of the utility industry.

Over the last year, changes in the electric utility environment have directly impacted Western. The President's National Energy Policy outlines more than 100 proposals to ensure the nation's energy supply is reliable, affordable and environmentally sound for America's future. In keeping with this mandate, Western will further its efforts to promote conservation, diversify and expand the national energy supply, and improve energy transportation systems. In concert with the National Energy Policy, the Department of Energy issued the National Transmission Grid Study identifying major transmission constraints and remedies. Western is currently addressing these issues by using innovative equipment and new technology to gain transmission efficiencies or by expanding the grid, as is the case with construction of the Path 15 Upgrade Project.

Furthermore, the North American Electric Reli-

ability Council launched efforts to bolster grid reliability standards to meet the needs of the competitive marketplace. Similarly, the Western Electricity Coordinating Council issued guidance to coordinate and promote electric system reliability across Western's interconnection. Western adopted and incorporated these standards providing further evidence of its commitment to a reliable, competitive energy supply. Finally, the Federal Energy Regulatory Commission issued a new proposal addressing the formation of Regional Transmission Organizations, generator interconnections and Standard Market Design in guiding the future of wholesale bulk power and transmission markets. Western's regional offices are fully engaged in these activities with future participation to be determined, based on benefits and business advantages to our customers. Through these efforts, Western will maintain a leadership role in the changing electricity generation and transmission environment.

After the events of September 11, 2001, the security of Western's infrastructure and computer systems has taken on increased importance. Federal Power Program entities (Power Marketing Administrations, the Bureau of Reclamation and the U.S. Army Corps of Engineers) have conducted comprehensive reviews of their infrastructure assets and associated operational systems to identify potential vulnerabilities and enhance security where necessary. Western and the generating agencies believe that with continuing assessments and necessary enhancements, risk is being managed.



## Results of Operations

Fiscal Year 2002 was drier than average for the hydropower systems from which Western markets electricity. Generation was relatively constant, down 1 percent from FY 2001 levels to 24,574 GWh (excluding the Central Arizona Project's 4,412 GWh of coal-fired generation) as a result of the continued drought across the West. Consequences of drought are lower water inflows, reduced reservoir levels, and decreased operating and generating capacity, resulting in lower-than-normal revenue from firm and non-firm sales of electric power. Drought conditions negatively impacted operational results of some power systems, resulting in operating losses of \$21 million. Conversely, other power systems that were not significantly impacted by drought were able to contribute \$24.0 million toward repayment. Specifically, Western was able to repay \$19.7 million of Federally financed power investment (up from \$8.0 million in FY 2001) and \$4.0 million of non-Federally financed power investment, and \$0.3 million of non-power investment (irrigation assistance). Leading the way in repayment was the Boulder Canyon Power System (\$8.2 million), the Central Valley Power System (\$8.8 million), and the Colorado River Storage Power System (\$6.4 million). An additional \$33.2 million of repayment was applied in FY 2002 as a result of replacing estimated revenues and expenses used in prior-year power repayment studies with actual information. The total repayment for FY 2002, as contained in the power repayment studies for FY 2002, is approximately \$57.2 million.

## Revenues

Operating revenues for FY 2002 were \$837.3 million, down \$250.8 million (23 percent) compared to FY 2001. Major decreases in electric power sales were due to

continued drought conditions and the decline of power prices in FY 2002, as compared to the unusually high prices in FY 2001 resulting from the California energy crisis. Sales of electric power (excluding the Central Arizona Project, project use and interproject transfers of \$73.4 million in FY 2002, \$75.8 million in FY 2001 and \$74.0 million in FY 2000) amounted to \$595.6 million in FY 2002, \$855.3 million in FY 2001 and \$692.4 million in FY 2000. Average revenue per MWh on these sales was \$18.90 in FY 2002 on sales of 31.5 million MWhs, \$24.50 in FY 2001 on sales of 34.9 million MWhs and \$17.82 in FY 2000 on sales of 38.9 million MWhs.

Approximately \$53.0 million of the FY 2002 change was due to decreased sales of electric power from the P-SMBP Joint Marketing Program (agreements with customers to take advantage of Western's ability to market and sell surplus power). Additionally, the P-SMBP experienced a decrease in non-firm energy sales (\$49.4 million) from reduced generation as a result of the drought.

## Expenses

Total operating expenses for FY 2002 were \$760.6 million, down \$258.8 million (25 percent) from FY 2001 primarily due to a decrease in purchase power costs of \$265.5 million (48 percent). Total purchased power costs decreased from \$554.0 million in FY 2001, on purchases of 13.1 million MWhs, to \$288.5 million in FY 2002 on purchases of 10.8 million MWhs. Purchased power costs decreased at CRSP (\$147.9 million) as compared to the unusually high power costs in FY 2001 that resulted from the California energy crisis and at P-SMBP (\$151.9 million) from decreased purchases associated with the Joint Marketing Program and for firming energy.

Operation and Maintenance expenses increased a modest 2 percent in FY 2002 from FY 2001, while admin-

istrative and general expenses increased by 4 percent for the same period. These results are in line with Western's Strategic Plan and cost objective of keeping O&M and AGE increases at or below the rate of inflation.

### **Capital Expenditures**

As a result of reduced Congressional funding and associated change in mission focus for construction projects, Western and the generating agencies have concentrated on maintaining, rehabilitating, and replacing generation and transmission assets. As a result, the power system's capital investment programs have decreased significantly over the last few years.

During FY 2002, Western and the generating agen-

cies spent \$88.4 million for capital investments compared with \$94.8 million in FY 2001. These included new substations, warehouses and service centers, fiber optic work and assorted replacements to transmission and generation assets. During FY 2002, Western and the generating agencies placed into service approximately \$74.4 million of utility plant, previously under construction. Completed construction projects occurred at CRSP (\$10.2 million) for re-routing the Curecanti-Lost Canyon transmission lines, Parker-Davis Power System (\$15.2 million) primarily for Hila Substation modifications and pole replacements on the Parker-Hila 161-kV line, and P-SMBP (\$20.3 million) for various replacements of utility plant assets. ▼



## PERFORMANCE MEASUREMENTS

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### Performance Measurements

The Chief Financial Officers Act of 1990 requires Federal entities to develop performance measures to assist managers in evaluating the efficiency and effectiveness of their programs. This requirement was further emphasized in the Government Performance and Results Act of 1993. The financial performance measures outlined here relate to Western's and the generating agencies' (Bureau of Reclamation, U.S. Army Corps of Engineers and the International Boundary and Water Commission) organizational objectives and management responsibilities and were selected from industry-standard financial ratios used by public power systems for comparison in assessing electric utility performance. The operational measures outlined below are Western specific and selected from Department of Labor and utility industry standards for comparing and assessing Western's operational performance.

### Financial Performance Measures

The **investment repayment indicator** measures the ratio of cumulative investment (federally and non-federally financed power projects and irrigation assistance) repaid as a percentage of total investment at the end of each year. Total investment at the end of FY 2002 was \$8.9 billion. During FY 2002, a total of \$57.2 million was applied toward repayment offset in part by \$53.4 million in new investment. As a result, the FY 2002 investment repayment ratio of 31.48 percent increased slightly from the FY 2001 ratio of 31.02 percent.

During FY 2002, \$19.7 million from current year operations (up from \$8.0 million in FY 2001) was applied to the repayment of the federally financed power investment. An additional repayment of \$32.8 million was applied as a result of replacing estimates of revenues and expenses in previous power repayment studies with actual amounts. This occurred because audited financial information was not available at the time power repayment studies were performed. In total, repayment of federally financed power investment increased by \$52.5 million to an overall level of 52.27 percent. Similarly, during FY 2002, \$4.0 million of non-federally financed power investment was applied, which increased the level of repaid non-federally financed power investment to 25.00 percent. During FY 2002, the repayment for non-power investment (irrigation assistance) showed a small increase (\$0.7 million) to an overall level of 1.10 percent from 1.09 percent in FY 2001.

The **variance in planned payments** indicator measures the ratio of all payment activity to planned investment payments. This indicator is zero if the actual payment is equal to the planned payment. During FY 2002, power generation and transmission activities provided for total payment of unpaid investment of \$24.0 million (\$19.7 million - Federal, \$4.0 million - non-Federal, \$0.3 million - non-power) up from \$15.7 million in FY 2001. Additional net repayment of \$33.2 million (\$32.8 million - Federal, \$0.4 million - non-power) was made as a result of replacing estimates of revenues and

expenses used in previous power repayment studies with actual amounts. As a result, total payment activity in FY 2002 equaled \$57.2 million. This adjusted amount exceeded the planned principal repayment of \$30.9 million by \$26.3 million, resulting in a variance ratio of 85.31 percent.

Western tracks several financial performance measures, which allow Western to benchmark its efficiency and effectiveness against other power generating utilities. The most recent utility industry statistics, which are used because there are no industry comparables for the generation and sale of hydroelectric power, are listed in Selected Financial and Operating Ratios of Public Power Systems, 1999, dated February 2001, as prepared by the American Public Power Association and are calculated based on data from more than 400 of the largest publicly owned electric utilities in the United States.

**Operation and Maintenance and Administrative and General Expense costs per firm kilowatt-hour generated and sold** is a measure of the cost to operate and maintain the generation and transmission systems. The ratio increased slightly in FY 2002 due to a proportionately larger increase in operation and maintenance and administrative and general expense (3 percent over FY 2001) and a slight decrease in firm kWh generated and sold (1 percent), due to drought conditions. The result was \$0.0132/kWh in FY 2002 as compared with \$0.0128/kilowatthour in FY 2001. The most recent industry average was \$0.0380/kWh.

The **operating ratio** measures the proportion of revenues received from electricity sales and other activi-

ties required to cover operating costs (which include O&M, AGE, Purchased Power and Purchased Transmission) associated with producing and selling electricity. Western's FY 2002 ratio decreased to 79 percent from the FY 2001 ratio of 85 percent primarily due to lower operating expenses (\$258.8 million) offset by lower total operating revenues (\$250.8 million). The drop in operating expenses occurred primarily because of the abatement of the California energy crisis and the decrease in purchased power costs. The decrease in operating revenues was attributable to lower generation because of drought conditions and the abatement of the California energy crisis resulting in lower surplus power sales at lower prices. The most recent industry ratio was approximately 66 percent.

**Revenues per kWh sold** decreased slightly from FY 2001 (\$0.0245/kWh) to \$0.0189/kWh in FY 2002, primarily because of reduced revenues attributable to lower and more stable energy prices. Revenues were also negatively impacted by lower generation because of drought conditions and the abatement of the California energy crisis both resulting in lower surplus power sales at lower prices. The most recent industry rate was \$0.057/kWh.

The **total power supply expenses** (O&M, AGE, Purchased Power and Purchased Transmission) **per kWh sold** measures all power supply costs, including generation and purchased power, associated with the sale of each kWh of electricity. The FY 2002 rate of \$0.0210/kWh was lower than the FY 2001 rate of \$0.0265/kWh primarily because of lower power supply expenses and lower generation. The most recent industry average was \$0.026/kWh.

## Financial Performance Measures

(Dollars in thousands)

<b>Investment repayment</b>	<b>2002</b>	<b>2001</b>
Ratio	31.48%	31.02%
Paid investment	\$2,829,187	\$2,771,938
Total investment	\$8,988,195	\$8,934,708
<b>Variance in planned payments</b>		
Ratio	85.31%	198.92%
Excess payment (actual payment plus adjustments less planned principal payment)	\$26,356	\$36,024
Planned principal payment	\$30,893	\$18,110
<b>O&amp;M and AGE costs per firm kWh generated and sold</b>		
Rate	\$0.0132	\$0.0128
O&M and AGE	\$324,530	\$316,601
MWh generated & sold-firm	24,574,000	24,762,000
<b>Operating ratio</b>		
Ratio	79.01%	85.03%
O&M, AGE, PP and PT	\$661,542	\$925,318
Total operating revenues	\$837,339	\$1,088,167
<b>Revenues per kWh sold</b>		
Rate	\$0.0189	\$0.0245
Total operating revenues	\$595,598	\$855,333
MWh sold	31,525,000	34,916,000
<b>Total power supply expenses per kWh sold</b>		
Rate	\$0.0210	\$0.0265
O&M, AGE, PP and PT	\$661,542	\$925,318
MWh sold	31,525,000	34,916,000

Note: The above-noted financial performance indicators exclude Central Arizona Project assets, liabilities, and operating expenses. Western, as the marketing agent, transfers all CAP revenue collected to Bureau of Reclamation, after deducting Western's associated costs. In addition, MWh sales exclude interproject and project use sales.

## Operational Performance Measures

Western is committed to maintaining a safe, accident-free workplace. This commitment is demonstrated by Western's establishment of a Safety and Health program dedicated to increasing awareness of safe work practices and the inclusion of safety goals in Western's Bonus Goals Program. Western is also committed to a safe, efficient and reliable transmission system and reports on a number of operational measures for occupational safety and health and transmission system efficiency.

Occupational safety and health performance measures, as adopted by the U.S. Department of Energy for occupational injuries, are recognized throughout the electric utility industry (public and private utilities) and by information gathering entities which include the National Safety Council, the U.S. Department of Labor Bureau of Labor Statistics, and the National Institute for Occupational Safety and Health. Industry statistics are provided on a calendar year basis, accordingly, Western's measures have been calculated for the same time period. The latest statistics currently available (CY 2001) are as provided by the DOL Bureau of Labor Statistics Web site and the DOE.

**Lost workday case rate** measures the lost-time injury frequency rate by multiplying the number of cases that involve days away from work by 200,000 (common base of 100 full-time workers), then dividing by the total hours worked. Western's CY 2002 rate of 0.09 increased slightly from the CY 2001 rate of 0.08. The CY 2001 standard industry rate was 2.5.

**Total recordable case rate** measures the recordable accident frequency rate by multiplying the number of recordable cases by 200,000 (common base of 100 full-time workers), then dividing by the total hours worked. Western's CY 2002 rate of 1.7 decreased from the CY 2001 rate of 1.9. The CY 2001 standard industry rate was 5.0.

**The motor vehicle accident rate** measures the accident frequency rate by multiplying the number of recordable accidents by 1 million (rate calculated per million miles driven), and then dividing by the recorded miles driven. This rate does not distinguish between preventable or non-preventable accidents. Western's CY 2002 rate of 0.7 decreased from the CY 2001 rate of 1.1. Currently, there is no industry standard with which to compare Western's rate.

**Transmission system performance** is measured using the instantaneous difference between loads and generation. Performance for each control area is measured using North American Electric Reliability Council Control Performance Standards 1 and 2 (CPS1 and CPS2). A Control Compliance Rating of "Pass" is achieved when a power system receives, for each month of the fiscal year, a CPS1 performance level of 100 percent minimum and a CPS2 performance level of 90 percent minimum. Western's performance for FY 2002 was 185.66 percent for CPS1 and 98.51 percent for CPS2, exceeding the minimum requirements, as well as exceeding the industry averages of 172.95 percent for CPS1 and 96.29 percent for CPS2. Western's FY 2002 reliability results are consistent with FY 2001 (CPS1 – 186.93 percent and CPS2 – 98.48 percent). ▼

# INDEPENDENT AUDITORS' REPORT

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## The Administrator

### Western Area Power Administration

#### United States Department of Energy:

We have audited the accompanying combined power system balance sheets of the Western Area Power Administration (Western), an agency of the U.S. Department of Energy, and the Western affiliated power generating functions of the U.S. Department of the Interior, Bureau of Reclamation; the U.S. Department of Defense, Army Corps of Engineers; and the U.S. Department of State, International Boundary and Water Commission (collectively, the generating agencies) as of September 30, 2002 and 2001, and the related combined power system statements of revenues and expenses and accumulated net revenues and cash flows for the years then ended. These combined power system financial statements are the responsibility of Western and the generating agencies' management. Our responsibility is to express an opinion on these combined power system financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, Audit Requirements for Federal Financial Statements. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined power system financial statements referred to above present fairly, in all material respects, the combined financial position of Western and its affiliated power generating agencies as of September 30, 2002 and 2001, and their operations, changes in accumulated net revenues, and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued reports dated December 13, 2002 on our consideration of Western's internal control over financial reporting and its compliance with certain provisions of laws and regulations. Those reports are an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

**KPMG LLP**

December 13, 2002

## Combined Power System Balance Sheets

As of September 30, 2002 and 2001 (in thousands)

	2002	2001
<b>Assets</b>		
Utility plant:		
Completed plant	\$ 5,441,749	\$ 5,386,698
Accumulated depreciation	<u>(2,293,967)</u>	<u>(2,201,484)</u>
	3,147,782	3,185,214
Construction work-in-progress	<u>194,713</u>	<u>166,337</u>
Net utility plant	<u>3,342,495</u>	<u>3,351,551</u>
Cash	422,582	378,112
Accounts receivable	176,921	186,200
Other assets	141,851	209,321
<b>Total assets</b>	<b>\$ 4,083,849</b>	<b>\$ 4,125,184</b>

<b>Federal investment &amp; liabilities</b>		
Federal investment:		
Congressional appropriations	\$ 10,199,982	\$ 9,824,542
Interest on Federal investment	3,969,530	3,809,155
Transfer of property & services, net	<u>659,236</u>	<u>667,630</u>
Gross Federal investment	14,828,748	14,301,327
Funds returned to U.S. Treasury	<u>(11,215,514)</u>	<u>(10,787,906)</u>
Net outstanding Federal investment	3,613,234	3,513,421
Accumulated net revenues	21,265	110,738
<b>Total Federal investment</b>	<b>3,634,499</b>	<b>3,624,159</b>

Commitments and contingencies (notes 1, 5, 7, 8 and 9)

Liabilities:

Accounts payable	128,279	112,647
Other liabilities	321,071	388,378
<b>Total liabilities</b>	<u><b>449,350</b></u>	<u><b>501,025</b></u>
<b>Total Federal investment &amp; liabilities</b>	<b>\$ 4,083,849</b>	<b>\$ 4,125,184</b>

See accompanying notes to combined power system financial statements.

## Combined Power System Statements of Revenues and Expenses, and Accumulated Net Revenues

Years ended September 30, 2002 and 2001 (in thousands)

	2002	2001
<b>Operating revenues:</b>		
Sales of electric power	\$ 669,054	\$ 931,179
Other operating income	<u>275,571</u>	<u>262,391</u>
Gross operating revenues	944,625	1,193,570
Income transfers, net	(107,286)	(105,403)
<b>Total operating revenues</b>	<b>837,339</b>	<b>1,088,167</b>
<b>Operating expenses:</b>		
Operation and maintenance	276,903	270,833
Administration and general	47,627	45,768
Purchased power	288,482	553,994
Purchased transmission services	48,530	54,723
Depreciation	99,073	94,129
<b>Total operating expenses</b>	<b><u>760,615</u></b>	<b><u>1,019,447</u></b>
<b>Net operating revenues</b>	<b>76,724</b>	<b>68,720</b>
<b>Interest expenses:</b>		
Interest on Federal investment	163,442	143,575
Interest on customer funded financing	10,849	8,439
Allowance for funds used during construction	(8,094)	2,756
<b>Net interest expenses</b>	<b><u>166,197</u></b>	<b><u>154,770</u></b>
<b>Net deficit</b>	<b>(89,473)</b>	<b>(86,050)</b>
<b>Accumulated net revenues, beginning of year</b>	<b>110,738</b>	<b>201,344</b>
<b>Irrigation assistance</b>	<b>0</b>	<b>(4,556)</b>
<b>Accumulated net revenues, end of year</b>	<b>\$ 21,265</b>	<b>\$ 110,738</b>

See accompanying notes to combined power system financial statements.



## Combined Power System Statements of Cash Flows

For the years ended September 30, 2002 and 2001 (in thousands)

	2002	2001
<b>Cash flows from operating activities:</b>		
Net deficit	\$ (89,473)	\$ (86,050)
Adjustments to reconcile net deficit to net cash provided by operating activities:		
Depreciation	99,073	94,129
Interest on Federal investment	155,348	146,331
Loss on disposition of assets	2,665	1,200
(Increase) decrease in assets:		
Accounts receivables	9,279	(67,735)
Other assets	67,150	(29,274)
Increase (decrease) in liabilities:		
Accounts payable	15,632	28,017
Other liabilities	(63,373)	69,574
<b>Net cash provided by operating activities:</b>	<b>196,301</b>	<b>156,192</b>
<b>Cash flows from investing activities:</b>		
Investment in utility plant	(88,462)	(94,803)
<b>Cash flows from financing activities:</b>		
Congressional appropriations, net	368,173	373,835
Funds returned to U.S. Treasury	(427,608)	(374,736)
Irrigation assistance	0	(4,556)
Customer funded financing	0	27,522
Principal payments on customer funded financing	(3,934)	(3,217)
<b>Net cash provided by (used in) financing activities</b>	<b>(63,369)</b>	<b>18,848</b>
<b>Net Increase in cash</b>	<b>44,470</b>	<b>80,237</b>
<b>Cash, beginning of year</b>	<b>378,112</b>	<b>297,875</b>
<b>Cash, end of year</b>	<b>\$ 422,582</b>	<b>\$ 378,112</b>

### Supplemental schedule of noncash investing and financing activities

Transfer of construction work-in-progress to completed plant	\$ 74,391	\$ 99,260
Capitalized interest during construction	\$ 8,094	\$ (2,756)

See accompanying notes to combined power system financial statements.

# NOTES TO COMBINED POWER SYSTEM FINANCIAL STATEMENTS

September 30, 2002 and 2001

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## (1) Basis of Presentation and Summary of Significant Accounting Policies

### (a) Principles of Combination

The combined power system financial statements include the financial position, results of operations and cash flows of the Western Area Power Administration (Western), an agency of the U.S. Department of Energy (DOE), and the power generating function of the U.S. Department of Interior, Bureau of Reclamation (Reclamation); the U.S. Department of Defense, Army Corps of Engineers (Corps); and the U.S. Department of State, International Boundary and Water Commission (IBWC) (collectively known as the generating agencies) for the individual power systems listed in Note 2. Each power system is separately managed and financed and maintains separate accounting records. Western, as a Federal power marketing administration, markets and transmits hydroelectric power generated from these power systems operated and maintained by Reclamation, the Corps and IBWC throughout 15 western states. The power systems, with the exception of the Central Arizona Project (CAP) and the Pacific Northwest-Pacific Southwest Intertie (Intertie), are part of multipurpose water resource projects and include certain Western transmission facilities and certain generating agency facilities.

Operating expenses and net assets of multipurpose water resource projects are allocated among projects' activities, principally power, irrigation, municipal and industrial water, navigation and flood control (see Note 5). The combined power system financial statements include only those expenses and net assets which are expected to be recovered through the sale of power and other related income.

Although Reclamation holds an entitlement to power from the Navajo Generating Station and capacity from the CAP transmission facilities, the Federal government has no ownership in these facilities. As such, neither the CAP assets nor the associated entitlements are included in the combined power system financial statements.

Accounts are maintained in accordance with generally accepted accounting principles (GAAP) and the Federal Energy Regulatory Commission's (FERC) prescribed uniform system of accounts for electric utilities. Accounting policies also reflect specific legislation and executive directives issued by departments of the Federal government. The combined power system financial statements are generally presented in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effect of Certain Types of Regulation*. The provisions of SFAS No. 71 require, among other things, that regulated enterprises reflect the regulator's rate

actions in their financial statements, when appropriate. These rate actions can provide reasonable assurance of the existence of an asset, reduce or eliminate the value of an asset, or impose a liability on a regulated enterprise.

For purposes of financial reporting, the facilities and related operations of Western and the generating agencies are considered one entity. All material intraentity balances and transactions have been eliminated from the combined power system financial statements.

### (b) Confirmation and Approval of Rates

The Secretary of Energy (Secretary) has delegated authority to Western's Administrator to develop power and transmission rates for the power systems. The Deputy Secretary of Energy has the authority to confirm, approve and place such rates in effect on an interim basis. The Secretary delegated to the FERC the authority to confirm, approve and place such rates in effect on a final basis, to remand, or to disapprove such rates. Refunds with interest, as determined by the FERC, are authorized if rates finally approved are lower than rates approved on an interim basis. However, if at any time the FERC determines that the administrative cost of a refund would exceed the amount to be refunded, no refunds will be required. No refunds are anticipated in connection with rates approved on an interim basis through September 30, 2002.

### (c) Operating Revenues

Operating revenues are recorded on the basis of power and services provided. Except for power systems using revolving funds, cash received from sales is deposited directly with the U.S. Department of the Treasury (U.S. Treasury) and is reflected as Funds Returned to U.S. Treasury in the Combined Power System Balance Sheets. For power systems using revolving funds, cash received is deposited in the U.S. Treasury and remains available to the power system. Cash collected into revolving funds in excess of expenditures is used for repayment of Federal investment and interest.

Power and transmission rates are established under requirements of the power systems' authorizing legislation and related Federal statutes and are intended to provide sufficient revenue to recover all costs allocated to power and, in some power systems, a portion of irrigation-related costs (see Note 8). Costs allocated to power include repayment to the U.S. Treasury of Federal investment in power facilities and associated interest. Rates are structured to provide for repayment of Federal investment in power facilities, generally over 50 years, while operating expenses and interest on Federal investment are recovered annually. Replacements of utility plant are generally to be repaid over their expected service lives.

The power systems' enacting legislation does not recognize annual depreciation based on actual service lives as a measure of the required repayment for investment in utility plant. This results in some assets being fully depreciated before costs are recovered; whereas, annual depreciation costs on other assets may continue after such costs have been recovered through revenues. Over the life of the combined power systems, accumulated net revenues represent timing differences between the recognition of expenses and related revenues. Because Western and the generating agencies are nonprofit Federal agencies, accumulated net revenues are committed to Federal investment repayment.

Income transfers, net, represent the surplus generation billed from the Navajo Generating Station by Western, on behalf of Reclamation's CAP and subsequently transferred to Reclamation.

For the Central Valley Power System (CVP), the net revenue forecasted in the rate case is compared to the actual net revenue by December 31 for the previous fiscal year (FY). If the actual net revenue is less than the projected net revenue, a surcharge may be assessed. If the actual net revenue is greater than the projected net revenue, a credit may be granted. The surcharge or credit is then applied to CVP firm power customers' bills from January through September.

Billing methods utilized by Western include net billing and bill crediting. Net billing is a two-way agreement between Western and a customer, whereby both buy and sell power to each other. Monthly sales and purchases, including any customer advances received, are netted between the two parties and the customer is provided either an invoice or a credit. Bill crediting involves a three-way net billing arrangement among Western, a customer and a third party. For example, Western purchases power from a third-party supplier, delivers it to the customer and the customer will pay the third-party supplier and receive a credit on its bill from Western.

#### **(d) Cash**

For purposes of the Combined Power System Statements of Cash Flows, cash consists principally of the unexpended balance of funds authorized by Congress, customer advances and revolving fund balances at the U.S. Treasury.

#### **(e) Utility Plant**

Utility plant is stated at original cost, net of contributions in aid of construction by entities outside of the combined power system. Costs include direct labor and materials; payments to contractors; indirect charges for engineering, supervision and administrative and general expense; and interest during construction. The costs of additions, major replacements and betterments are capitalized; whereas, repairs are charged to operation and maintenance expense.

The cost of retired utility plant, net of accumulated depreciation, is charged to operation and maintenance expense as a gain/loss and the net of removal costs and salvage credits is capitalized as part of the direct replacement asset. If there is not a replacement asset, the net of removal costs and salvage credits is charged

to operation and maintenance expense. Plant assets of the combined power system are currently depreciated using the straight-line method over estimated service lives ranging from 10 to 50 years for transmission assets and 25 to 100 years for generation assets. Power rights are amortized over 40 years.

#### **(f) Interest on Federal Investment**

Interest is accrued annually on the Federal investment based on Western and the generating agencies' interpretation of Federal statute and power system legislation. Such interest is reflected as an expense in the Combined Power System Statements of Revenues and Expenses with a corresponding increase in Federal investment. Western and the generating agencies calculate interest annually based on the unpaid Federal investment owed to the U.S. Treasury using rates set by law, administrative orders pursuant to law or administrative policies.

All power systems, except for the CAP, Colorado River Storage, Dolores and Seedskadee, recognize an annual interest credit for payments of accrued interest made monthly on obligations that are due annually to the U.S. Treasury. As of September 30, 2002, interest rates range from 2.5 to 12.4 percent, depending on the year in which construction on the transmission and generation facilities was initiated or on the authorizing legislation. Interest rates on unpaid Federal investments ranged from 2.5 to 11.4 percent for the years ended September 30, 2002 and 2001.

As provided by Federal law, interest is not accrued on Federal investment in irrigation facilities anticipated to be repaid through power sales (see Note 8).

#### **(g) Interest During Construction**

Interest During Construction (IDC or Allowance for Funds Used During Construction) represents interest on funds borrowed from the U.S. Treasury during the construction of all generating and transmission facilities. Western calculates IDC based on the average annual outstanding balance of construction work-in-progress. Western and the generating agencies' policy is to capitalize IDC through the end of the fiscal year in which assets are placed in service. IDC is recovered over the repayment period of the related plant asset. Applicable interest rates ranged from 2.5 to 12.4 percent for the years ended September 30, 2002 and 2001, depending on the year in which construction on the transmission and generation facilities was initiated or on the authorizing legislation.

#### **(h) Pension and Other Retirement Benefits**

Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, and SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, direct the full cost reporting of employment benefits by employing entity. These statements require Federal agencies to record the government's cost of providing pension, life and health insurance and other post-employment benefits (severance payment, counseling and training, workers' compensation benefits, etc.) regardless of the funding agency.

## **(i) Taxes**

The facilities and net revenues included in these combined power system financial statements are exempt from taxation.

## **(j) Use of Estimates**

Management of Western and the generating agencies has made many estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these combined power system financial statements in conformity with GAAP. Actual results could differ significantly from those estimates.

## **(k) Derivative and Hedging Activities**

SFAS No. 133, *Accounting for Derivative Instrument and Hedging Activities*, SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activity, an Amendment of SFAS No. 133*, and related interpretations require that all derivative instruments be recorded on the balance sheet as an asset or liability measured at their fair value and that changes in fair value be recognized currently in earnings unless specific hedge accounting exception criteria are met. SFAS Nos. 133 and 138 require that as of the date of initial adoption, the difference between the fair value of derivative instruments recorded on the balance sheet and the previous carrying amount of those derivatives be reported in net income or other comprehensive income, as appropriate.

In June 2001, the Financial Accounting Standards Board (FASB) issued definitive guidance on scope exceptions related to normal purchases and normal sales for option- and forward-type contracts in electricity including "bookout" transactions. This guidance provides that purchases and sales of forward electricity and option contracts that require physical delivery and which are expected to be used or sold by the reporting entity in the normal course of business are generally considered "normal purchases and normal sales" under SFAS No. 133. Accordingly, these transactions are not required to be marked to fair value in the financial statements.

Western's policy is to fulfill all derivative and hedging contracts through either providing power to a third party or by taking delivery of power from a third party as provided in the contracts. Accordingly, Western applies the "normal purchase and normal sales" exception under SFAS No. 133 for its derivative and hedging contracts. Western's policy does not authorize the use of derivative or hedging instruments for speculative purposes such as hedging electricity pricing fluctuations beyond Western's estimated capacity to deliver or receive power.

Western adopted SFAS Nos. 133 and 138 on October 1, 2001, with no impact on the combined power system financial statements. As of September 30, 2002 and 2001, all of Western's derivative and hedging instruments qualified for the normal purchase and normal sales exception under SFAS No. 133.

## **(l) Recent Accounting Pronouncements**

In June 2001, the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligations*. SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated

retirement costs. SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. SFAS No. 143 will become effective for the fiscal year ending September 30, 2003.

In August 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 establishes a single accounting model, based on the framework established in SFAS No. 121, for long-lived assets to be disposed of by sale. SFAS No. 144 will become effective for the fiscal year ending September 30, 2003.

In April 2002, the FASB issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections*. SFAS No. 145 addresses rescissions for statements which are no longer needed and the amendment requiring consistent treatment of certain sale-leaseback transactions that have been modified. SFAS No. 145 has been evaluated and determined to have no impact on the combined power system financial statements.

In June 2002, the FASB issued SFAS No. 146, *Accounting for Cost Associated with Exit or Disposal Activities*. SFAS No. 146 addresses accounting and reporting for costs associated with exit or disposal activities and the liabilities thereof. SFAS No. 146 will become effective for the fiscal year ending September 30, 2003.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an Interpretation of FASB Statements No. 5, 57 and 107 and a Rescission of FASB Interpretation No. 34*. Interpretation No. 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. Interpretation No. 45 also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of Interpretation No. 45 are applicable to guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for financial statements ending September 30, 2003.

Western and the generating agencies have not yet determined whether the implementation of SFAS Nos. 143, 144 and 146 or Interpretation No. 45 will be material to their results of operations or financial position.

## **(m) Concentrations of Credit Risks**

### **General Credit Risk**

Financial instruments, which potentially subject Western and the generating agencies to credit risk, include accounts receivable for customer purchases of power, transmission, or other products and services. These receivables are primarily with a group of diverse customers who are generally large, stable and established organizations that do not represent a significant credit risk. Although Western and the generating agencies are affected

by the well being of the utility industry, management does not believe a significant risk of loss from a concentration of credit exists. Credit losses to date have not been significant. No single customer accounted for more than five percent of accounts receivable at September 30, 2002 and 2001.

### Credit Risk from California

Defaults by Pacific Gas & Electric (PG&E), which filed for bankruptcy protection in April 2001, and Southern California Edison (SCE), which has established a creditor payment plan for energy and transmission payments to the California Independent System Operator (Cal-ISO), have resulted in concerns by energy suppliers that the Cal-ISO may not be creditworthy. In addition, the California Power Exchange (Cal-PX) has substantial outstanding payment obligations due from California investor-owned utilities. The Cal-PX filed for bankruptcy protection in March 2001.

Western entered into certain power sales through the Cal-PX and the Cal-ISO for which Western has not yet been paid. The amounts due as of September 30, 2002 from the Cal-PX and the Cal-ISO are \$2.6 million and \$1.2 million, respectively. The timing of payments from the Cal-ISO and the Cal-PX are pending resolution of PG&E and SCE financial situations in addition to the FEREC's proceedings relative to refunds due buyers in the California energy markets (see Note 8). Due to the uncertainty resulting from these bankruptcy proceedings, management is unable to reasonably estimate the potential loss, if any. No allowance for bad debt has been recorded in the combined power system financial statements as a result of this contingency.

## (2) Power Systems and Authorizing Legislation

The combined power system financial statements include the financial position, results of operations and cash flows of 15 separate power systems. The following is a list of the Federal power systems and related authorizing legislation with transmission and generating facilities operating as individual integrated power systems.

### Boulder Canyon Power System

Boulder Canyon Project Act of 1928, as amended

### Central Arizona Project

Colorado River Basin Project Act of 1968, as amended

### Central Valley Power System

Act of Aug. 26, 1937, as amended

### Collbran Power System

Act of July 3, 1952

### Colorado River Storage Power System

Colorado River Storage Project Act of April 11, 1956, as amended

### Dolores Power System

As a participating project of the Colorado River Storage Power System, it utilizes the same authorizing legislation

### Falcon-Amistad Power System

Treaty between the United States and Mexico, Feb. 3, 1944; Acts of Oct. 5, 1949, June 18, 1954 and July 7, 1960

### Fryingpan-Arkansas Power System

Act of Aug. 16, 1962, as amended

### Pacific Northwest-Pacific Southwest Intertie Project

Act of Aug. 31, 1964

### Parker-Davis Power System

Act of May 28, 1954

### Pick-Sloan Missouri Basin Power System

Flood Control Act of 1944, as amended

### Provo River Power System

Finding of Feasibility by the Secretary of the Interior, Nov. 13, 1935

### Rio Grande Power System

Act of Feb. 25, 1905

### Seedskadee Power System

As a participating project of the Colorado River Storage Power System, it utilizes the same authorizing legislation

### Washoe Power System

Act of Aug. 1, 1956

## (3) Other Assets

Other assets as of September 30, 2002 and 2001 consist of the following (in thousands):

	2002	2001
Workers' compensation (see Note 6)	\$44,734	\$54,979
Moveable equipment, net	41,810	47,380
Abandoned project costs, net	15,650	22,646
Stores inventory	12,114	11,757
Interchange energy	4,987	14,930
Energy banking deferral	4,460	3,765
Purchase power termination settlement (see Note 6)	2,800	3,400
Deposit funds available	1,165	34,678
Other	14,131	15,786
<b>Total</b>	<b>\$141,851</b>	<b>\$209,321</b>

Abandoned project costs, net include the Celio-Mead transmission line of \$15.7 million and \$16.3 million for FY 2002 and FY 2001, respectively, which is being amortized over 22 years and investigation costs associated with the Bonneville Unit of the Central Utah Project of \$6.3 million for FY 2001. In FY 2002, legislation was passed which deemed the Bonneville investigation costs to be nonreimbursable to the U.S. Treasury.

The energy banking deferral is an arrangement between Western and a customer whereby excess power and/or transmission capacity is banked with the customer until power is needed to meet contractual obligations. Banked power and/or transmission capacity is recorded at a contractually agreed-upon amount. The net revenue or expense associated with the banking activity is deferred and recorded as an other liability.

#### (4) Utility Plant

Net utility plant as of September 30, 2002 and 2001 consists of the following (in thousands):

	2002			2001		
	Western	Generating Agencies	Total	Western	Generating Agencies	Total
Completed plant	\$ 2,614,829	\$ 2,826,920	\$ 5,441,749	\$ 2,575,317	\$ 2,811,381	\$ 5,386,698
Accumulated depreciation	(1,057,814)	(1,236,153)	(2,293,967)	(999,798)	(1,201,686)	(2,201,484)
	1,557,015	1,590,767	3,147,782	1,575,519	1,609,695	3,185,214
Construction work-in-progress	127,535	67,178	194,713	113,974	52,363	166,337
<b>Net utility plant</b>	<b>\$ 1,684,550</b>	<b>\$ 1,657,945</b>	<b>\$ 3,342,495</b>	<b>\$ 1,689,493</b>	<b>\$ 1,662,058</b>	<b>\$ 3,351,551</b>

Completed plant includes \$162.6 million of power rights as of September 30, 2002 and 2001.

#### (5) Federal Investment and Cost Allocation

##### (a) General

Federal investment consists of congressional appropriations, accumulated interest on unpaid Federal investment and the net transfers of property and services from other Federal agencies. Congressional appropriations is comprised of the cumulative appropriations received, net of expenses legislatively deemed nonreimbursable, and postretirement benefits (see Note 9). Cumulative appropriations received, net of nonreimbursable expenses, totaled \$10.1 billion and \$9.8 billion as of September 30, 2002 and 2001, respectively, while postretirement benefits for the same time period totaled \$57.0 million and \$44.4 million, respectively. All power systems (except Dolores, Seedskaadee, Boulder Canyon (BC) and the operations and maintenance and purchased power programs of the Colorado River Storage Power System (CRSP)) are primarily financed through congressional appropriations for operation and maintenance, construction and rehabilitation and purchased power expenditures. A portion of construction and rehabilitation and purchased power expenditures are financed through other methods, such as advances from non-Federal entities; reimbursements from other Federal agencies; use of receipts authorization; and alternative methods such as net billing and bill crediting; or any combination thereof.

Operating expenses (excluding depreciation expense) and interest on the unpaid Federal investment should be repaid annually. To the extent that funds are not available for repayment, such unpaid annual net deficits, become payable from the subsequent years' revenues prior to any other repayment. Interest is accrued on cumulative annual net deficits until paid. Deficits for operating expenses, net of depreciation expense, begin to accrue interest in the year they occur. Interest expense deficits begin to accrue interest in the year following occurrence. As of September 30, 2002 and 2001, certain power systems have incurred operating and interest expense deficits aggregating approximately \$151.5 million and \$103.0 million, respectively. To the extent funds are available, while still complying with

established repayment periods for each increment of Federal investment, and unless otherwise required by legislation, repayment of Federal investment is applied to the increment bearing the highest rate of interest.

##### (b) Federal Investment in Multipurpose Facilities

The Federal investment in certain multipurpose facilities (primarily dams and appurtenant structures integral to the generation of power), required to be repaid from the sale of power, has been determined from preliminary cost allocation studies based on project evaluation standards approved by Congress. Allocations between power and non-power activities may be changed in future years; however, the project evaluation standards cannot be changed unless approved by Congress.

Final studies will be performed by Reclamation and the Corps, as appropriate, upon completion of each individual power project and are still pending for all but the Fryingpan-Arkansas Power System (FryArk). Reclamation completed the final FryArk study in 1993. The BC and Parker-Davis power systems are not subject to cost allocation studies since the power systems' enacting legislation require the total costs of the dams and appurtenant structures to be repaid through power revenues.

With final cost allocation studies still pending for many of the individual power systems, the potential exists for significant future adjustment in the Federal investment for the cost of multi-purpose facilities allocated to power and the related accrued interest on the unpaid Federal investment. Such reallocations could affect the individual power system rates. For example, in 1997, Reclamation studied the implications of a cost reallocation of the Pick-Sloan Missouri Basin Program (P-SMBP) on existing water and power rates. The study resulted in additional costs, ranging from \$0 to \$416 million (depending on the assumptions of the cost methodologies used), which may be reallocated to power facilities.



## (6) Other Liabilities

Other liabilities as of September 30, 2002 and 2001 consist of the following (in thousands):

	2002	2001
Long-term construction financing	\$ 173,416	\$ 177,289
Workers' compensation	48,707	58,952
Customer advances	34,440	61,934
Accrued annual leave	11,424	12,172
Accrued payroll benefits	11,027	10,337
Deposit funds available	6,315	35,004
Interchange energy	4,987	14,930
Energy banking deferral (see Note 3)	4,460	3,765
Purchased power termination settlement	2,800	3,400
Other	23,495	10,595
<b>Total</b>	<b>\$ 321,071</b>	<b>\$ 388,378</b>

Long-term construction financing consists of three contractual arrangements. The first arrangement provides customer financing for the BC power system to upgrade each of the generating units at Hoover Dam. The obligation to these customers is scheduled to be satisfied through the issuance of credits on power bills over a period through FY 2017, at interest rates ranging between 5.5 and 8.2 percent. As of September 30, 2002 and 2001, the outstanding obligation was \$125.4 million and \$128.4 million, respectively.

The second arrangement consists of the principal payable to the State of Wyoming for providing partial financing for improvements at the Buffalo Bill Dam (P-SMBP Power System) and associated power plants. This liability is being repaid over a period of 35 years, beginning in 1996, at an approximate interest rate of 11.1 percent. The outstanding liability amounts to \$21.4 million and \$21.5 million as of September 30, 2002 and 2001, respectively.

The third arrangement is principal due to a customer for providing financing for the construction of the Griffith-McConnico and Griffith-Peacock transmission lines along with certain assets at the Peacock substation, and the McConnico switching station. The obligation bears imputed interest at a rate of 8.5 percent and is being repaid through FY 2018, beginning in 2001. As of September 30, 2002 and 2001, the outstanding obligation totaled \$26.6 million and \$27.4 million, respectively.

The carrying value of these financial instruments described above approximates fair market value.

Outstanding long-term construction financing as of September 30, 2002 is scheduled to be credited or repaid as follows (in thousands):

Year ending September 30:	
2003	\$ 3,961
2004	5,023
2005	5,216
2006	5,643
2007	6,661
Thereafter	146,912
<b>Total</b>	<b>\$ 173,416</b>

Workers' compensation consists of two elements: a liability for expenses from actual claims incurred and paid by the Department of Labor (DOL) that Western and the generating agencies must reimburse; and an actuarial liability associated with cases incurred for which additional future claims may be made. In conjunction with SFAS Nos. 4 and 5, the DOL determined the actuarial liability associated with future claims using historical benefit payment patterns discounted to present value (37 years) using economic assumptions for 10-year U.S. Treasury notes and bonds. Western and the generating agencies included \$44.7 million and \$55.0 million as an actuarial liability for future claims in the Combined Power System Balance Sheets as of September 30, 2002 and 2001, respectively.

The recovery of future claims will be deferred for rate-making purposes until such time the claims are submitted to and paid by the DOL. Therefore, the recognition of the expense associated with the actuarially determined liability has been deferred as an other asset in the Combined Power System Balance Sheets in accordance with SFAS No. 71 (see Note 3) to reflect the effects of the rate-making process. Cumulative unpaid expenses associated with actual claims incurred for Western and the generating agencies were \$4.0 million as of September 30, 2002 and 2001.

Accrued unused annual leave represents benefits which would be paid out to employees upon retirement or separation from employment with the government. The amount not funded by revolving funds has been deferred as an other asset in the Combined Power System Balance Sheets in accordance with SFAS No. 71.

Western renegotiated certain CRSP long-term contractual obligations with third-party power providers. Under the terms of the settlement agreements, annual payments of \$0.6 million will be made through FY 2007. The recovery of these payment obligations will be deferred for rate-making purposes until the obligations become due. Therefore, the recognition of the expense associated with the settlements has been deferred as an other asset in the Combined Power System Balance Sheets in accordance with SFAS No. 71 (see Note 3).



## **(7) Lease Commitments**

Western and the generating agencies have several cancelable operating leases, primarily for general purpose motor vehicles and office and warehouse space that expire over the next 15 years. Western has two non-cancelable leases that expire in 2004 and 2009 for the Electric Power Training Center (EPTC) and Western's Corporate Service Office, respectively. These leases represent an annual expense of approximately \$2.3 million. The General Services Administration is the leaseholder for all locations with the exception of the EPTC to which Western is the leaseholder. The right to relinquish space on cancelable leases is available with 120-day notice to terminate. These leases generally contain renewal options for periods ranging from three to five years and require the lessee to pay all executory costs such as maintenance and insurance. Rental expense for operating leases was approximately \$6.0 million and \$6.2 million for the years ended September 30, 2002 and 2001, respectively (Reclamation data was unavailable).

## **(8) Commitments and Contingencies**

### **(a) General**

Western and the generating agencies are involved in various claims, suits and complaints routine to the nature of their business. These Federal government organizations are self-insured for claims pertaining to litigation, unemployment, long-term disability and health and life insurance. Liabilities for these claims, as reported in the combined power system financial statements, are based on reported pending claims, estimates of claims incurred but not yet reported, actuarial reports and historical analysis. It is management's opinion that the ultimate disposition of these claims will not have a material adverse affect on the combined power system financial statements.

### **(b) Irrigation Assistance**

Federal statute requires that certain individual power systems repay the U.S. Treasury that portion of Reclamation's project capital costs allocated to irrigation purposes determined by the Secretary of the Interior to be beyond the ability of the irrigation customers to repay. Although these repayments may be recovered through power sales, they do not represent an operating cost of the individual power systems and are treated as distributions from accumulated net revenues at the time of repayment.

Power repayment studies for fiscal years ended September 30, 2002 and 2001 indicate that approximately \$3.5 billion of existing non-power Federal investment will be repaid from future power revenues over a period not to exceed 60 years. In FY 2001, Western made an irrigation assistance payment of \$4.6 million to the U.S. Treasury.

### **(c) Fish and Wildlife Conservation**

Section 8 of the Colorado River Storage Project Act of 1956, as amended, mandates that the Department of the Interior establish and implement programs to conserve fish and wildlife. Under this act and other legislation, Reclamation has established programs to preserve the habitat and otherwise aid endangered fish and wildlife. The Recovery Implementation Program (RIP) is one such program and is managed by the U.S. Fish and Wildlife Service.

On October 30, 2000, Congress passed Public Law 106-392 that authorized additional funding to Reclamation to continue the RIP. The legislation specifies that a total of \$17.0 million is to be collected by Western from its power customers to finance capital costs and up to \$6.0 million a year for operating expenses. Furthermore, the legislation states that operating expenses are considered non-reimbursable to the U.S. Treasury and a repayment of the Federal investment. Conversely, capital funded costs must be repaid to the U.S. Treasury through future power sales. Operating expenses were \$4.6 million and \$3.3 million for the years ended September 30, 2002 and 2001, respectively. Capital costs for the same periods were \$4.9 million and \$0.8 million, respectively.

### **(d) Boulder Canyon Power System Improvements**

In 1987, Reclamation initiated a project designed to increase (uprate) the generating capacity of the BC power system. Certain BC customers agreed to provide funding for these improvements, primarily through the issuance of long-term bonds. In some cases, proceeds from the bonds exceeded the amount required to fund the improvements.

For purposes of measuring the liability related to the Uprating Program (the Program), Reclamation reports only the total amount of the advances received from customers in the Combined Power System Balance Sheets (see Note 6). Bond issuance costs are included in the determination of interest expense and are recognized over the term of debt repayment. Net proceeds from the issuance of the debt, in excess of the amount advanced to Reclamation, have similarly been excluded from the assets of the power system. Interest expense on the liability is measured based on the total outstanding bonded indebtedness. Interest income from excess proceeds reduces interest costs subject to arbitrage regulations. Until any remaining excess funds are applied against outstanding debt, the total interest cost of financing the Program will be subject to uncertainty.

### **(e) Colorado River Storage Project**

In October 1992, Congress passed the Grand Canyon Protection Act of 1992 (the Act) to "protect . . . and improve the values for which the Grand Canyon National Park and Glen Canyon National Recreation Area were established."

The Act relieves CRSP power customers of repayment obligations for costs equivalent to certain expenses of environmental impact studies, associated purchased power, and other miscellaneous expenses related to the Glen Canyon Dam. For the fiscal years ended September 30, 2002 and 2001, Western and Reclamation combined incurred \$7.9 million and \$8.9 million, respectively, in environmental costs which were deemed nonreimbursable. Accordingly, such costs have been recognized as a reduction of congressional appropriations in the Combined Power System Balance Sheets.

### **(f) Power Contract Commitments**

Western has entered into various agreements for power and transmission purchases that vary in length but generally do not exceed 20 years. Western's long-term commitments for these

power and transmission contracts, subject to the availability of Federal funds and contingent upon annual appropriations from Congress, are as follows (in thousands):

Year ending September 30:	Purchased power	Purchased transmission	Total
2003	\$ 16,864	\$ 25,654	\$ 42,518
2004	16,864	25,654	42,518
2005	5,014	10,817	15,831
2006	1,768	7,571	9,339
2007	1,768	7,455	9,223
Thereafter	12,817	52,801	65,618
<b>Total</b>	<b>\$ 55,095</b>	<b>\$ 129,952</b>	<b>\$ 185,047</b>

In addition to these contracts, Western maintains other long-term contracts which provide the ability to purchase unspecified quantities of transmission services within a contractually determined range and rate. To fulfill its contractual obligations to deliver power, Western has historically had to purchase a certain level of transmission services under these agreements. Western fully intends to provide ongoing services to power customers and anticipates it will be necessary to acquire resources under these contracts up to a maximum of \$81.5 million.

#### (g) Pacific Gas & Electric Company Settlement

Under the terms of the integration contract between PG&E and Western, Western pays PG&E an estimated rate each year for energy purchases and records this amount as purchased power expense in the Combined Power System Statements of Revenues and Expenses. Provisions of the contract require the estimated rate to be adjusted to reflect PG&E's actual annual average thermal production costs, resulting in either Western paying an additional amount or receiving a refund for any overpayment. In the Combined Power System Statements of Revenues and Expense for FY 2001, Western recorded a reduction to purchased power expense for a refund of \$36.5 million related to calendar years 1998 through 2000. During that time period, Western purchased approximately \$101.0 million in power from PG&E. No adjustment to the estimated rate has been made for purchases during calendar years 2001 or 2002. Western is unable to estimate the potential adjustment for those years because the cost data is maintained by PG&E and is outside of Western's control. Accordingly, any adjustment to purchased power expense will be recorded when it becomes known.

#### (h) FERC Proceedings

The FERC proceedings, beginning in August 2000, are a result of an investigation into wholesale power markets and in particular the California wholesale electricity market. This investigation has validated claims that wholesale generators and marketers of electricity manipulated the gas and electricity market. Initial findings are that generators and marketers inflated pricing and would be required to relinquish profits made from any illegal activity. FERC investigators found that the manipulation was wide-spread and recommended open investigations into a number of companies. As such, it is not yet determinable as to the scope or how further investigations might impact Western and the generating agencies. Any refunds or costs incurred would be adjusted through the future power rates.

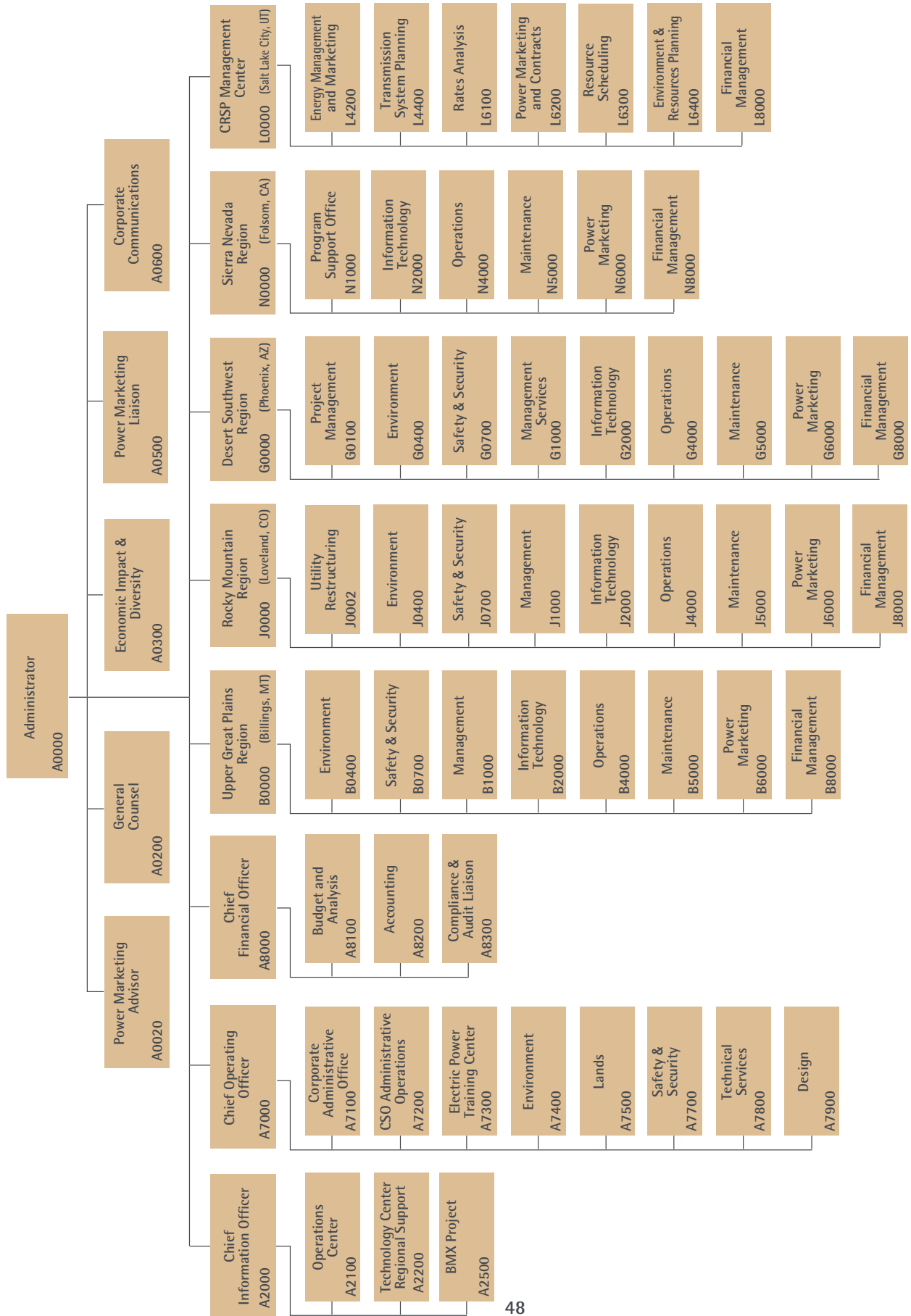
#### (9) Pension and Other Retirement Benefits

Western, Reclamation, the Corps, and IBWC employees participate in one of the following contributory defined benefit plans: the Civil Service Retirement System (CSRS) or Federal Employees Retirement System (FERS). Agency contributions are based on eligible employee compensation and total 8.51 percent for CSRS and up to 11.5 percent for FERS. These contributions are submitted to benefit program trust funds administered by the Office of Personnel Management (OPM). Western and the generating agencies' contributions for the two plans amount to \$16.6 million and \$15.2 million for the years ended September 30, 2002 and 2001, respectively.

The contribution levels as legislatively mandated do not reflect the full cost requirements to fund the CSRS pension plan (approximately 24.2 percent of base salary). Other post-retirement benefits administered and partially funded by the OPM are the Federal Employees Health and Benefits Program (FEHB) and the Federal Employee Group Life Insurance Program (FEGLI). FEHB is calculated at \$3,473 and \$2,999 per employee in FY 2002 and FY 2001, respectively, and FEGLI is based on 0.02 percent of base salary for each employee enrolled in these programs. In addition to the amounts contributed to the CSRS and FERS as stated above, Western and the generating agencies recorded an expense for the pension and other retirement benefits in the Combined Power System Statements of Revenues and Expenses of \$12.6 million for the year ended September 30, 2002 and \$11.8 million for the year ended September 30, 2001. This amount reflects the contribution made on behalf of Western and the generating agencies by OPM to the trust funds.

# WESTERN AREA POWER ADMINISTRATION

## June 2003





## TO REACH US

Call or write your local Western office or the Corporate Communications Office at our Corporate Services Office in Lakewood, Colo., to share your comments or to find out more about Western. Our addresses and phone numbers are listed below.

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