


CHUGACH ELECTRIC ASSOCIATION, INC.
Anchorage, Alaska

May 11, 2005

TO: Finance Committee of the Board of Directors

FROM: Mike Cunningham, Chief Financial Officer 

SUBJECT: Management Response to RCA Ruling Requiring Prior Approval of New Depreciation Rates

The General Counsel's March board report advised of the Regulatory Commission of Alaska's (RCA) ruling¹ that it must approve depreciation rates **before** Chugach can implement revised rates on its financial records. This memorandum summarizes management's intentions in response to the order.

For Chugach's 2004 financial records, Chugach had calculated depreciation expense based on a 2002 depreciation study that has not yet been approved by the RCA.² Chugach used these new depreciation rates for its 2004 financial records because they reflected the best information available about Chugach depreciation expense. *It is important to note Chugach has not asked for a change in electric rates charged to its customers.* Nevertheless, the RCA has stated that it must issue an order approving rates of depreciation before Chugach may implement them.

In considering the various actions available, Chugach has determined that it is unnecessary to restate the 2004 financial records. The difference between depreciation expense for Chugach as a whole based on previously approved depreciation rates based on the 1999 study and depreciation expense based on the 2002 depreciation study (currently pending approval) is only approximately \$200,000 lower³ on an annual basis. For this reason, Chugach's management, in consultation with its outside auditing firm, KPMG, concluded that the difference is *de minimus* and there is no need to make any adjustment to the 2004 financial records.

¹ Dated March 9, 2005.

² Chugach submitted the 2002 depreciation study to the RCA on November 19, 2004.

³ The impact of using the 2002 depreciation study results is significant from a functionally unbundled perspective. G&T depreciation expense increases by approximately \$2 million annually under the 2002 depreciation study rates pending approval vs. Distribution depreciation expense which decreases \$2.2 million under the new rates.

Chugach plans to wait for the Commission's final ruling to adjust the 2005 financials which the Commission has indicated will be issued this Fall. These changes will reflect impacts of the final ruling on 2004 and 2005 depreciation expense. Waiting for a final ruling will avoid the unnecessary work of making revisions now only to find that different adjustments may be required later in the year based on the final RCA decision.