Secretary of State

State of Oregon

FARMERS IRRIGATION DISTRICT

SELP BOND DEBT? SPECIAL REVIEW

July 1, 1995 to June 30, 1996

Audits Division

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No. 97-62

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This report encompasses a review of the Farmers Irrigation District (district) for the period July 1, 1995 to June 30, 1996. The objective of our review was to determine if the district is complying with the terms of its Bond Purchase Agreements with the Department of Consumer and Business Services, Office of Energy's Small Scale Energy Loan Program (SELP).

In conducting this review, our procedures primarily related to determining the allowability of operation and maintenance expenses allocated to the hydrogeneration fund. We interviewed both district and SELP staff; reviewed the related records and the Bond Purchase Agreements; and analyzed each expense category on the district's accounting records that totaled 5 percent or more of its total fiscal year 1996 expenses.

Our review was limited to the specific matters described above, and was based on tests and procedures we considered necessary in the circumstances.

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Our review determined that the district and SELP have significantly different definitions for the term “Project.” The district’s broad interpretation of allowable project operation and maintenance expenses includes maintenance expenses of its water collection and distribution systems. Our interpretation of the Bond Purchase Agreements’ definitions of “project” and “operation and maintenance expense” disallows $91,000 of costs allocated by the district to the hydrogeneration fund and questions the allowability of additional costs totaling $431,000. Based on the large amount of questioned expenses, we recommend that SELP and the district reach agreement on the allowability of certain district expenses being charged to hydrogeneration and establish agreed-upon cost allocation methods. Additionally, we recommend that the district reimburse those costs determined to be unallowable; and that SELP and the district determine what amount of the questionable costs should be reimbursed to the hydrogeneration fund.

OREGON AUDITS DIVISION

John N. Lattimer
State Auditor

Fieldwork Completion Date:
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SUMMARY

The Farmers Irrigation District (district) is organized under the provisions of Chapter 545 of the Oregon Revised Statutes. The district's primary activities are to maintain its 5,900-acre irrigation system and operate two hydrogeneration plants.

Between March 1983 and February 1989, the Oregon Department of Energy (now the Office of Energy) purchased four bond issues totaling $12 million from the district through the Department's Small Scale Energy Loan Program (SELP). These bonds were issued to fund feasibility studies for and construction of the two hydro-electric power plants. The Bond Purchase Agreements (agreements) for each of these bond issues specify, among other legal provisions, the use of revenues from the projects, the allowable operation and maintenance expenses, and the allocation of net revenues after expenses.

SELP personnel had become increasingly concerned about the district's methods for charging expenses to the hydrogeneration fund. The objective of our review was to determine if the district was complying with the terms of its Bond Purchase Agreements with SELP. Our procedures were primarily related to determining allowability of operation and maintenance expenses allocated to the hydrogeneration fund. We interviewed both district and SELP staff; reviewed the related records and correspondence of both SELP and the district; and reviewed the Bond Purchase Agreements, loan applications, exhibits, and other supplementary materials. To evaluate the appropriateness of charges against hydrogeneration revenues, we analyzed the following expense categories on the district's accounting records totaling 5 percent or more of its total fiscal year 1996 expenses: Payroll and Benefits; Professional Services; Equipment; Lease/Purchase Agreements; Miscellaneous Contingency; Systems Materials and Special Assessment Bond Payments.

Our review of district expenses charged to hydrogeneration determined that the district and SELP have significantly different interpretations of the term "Project" and the expenses that are chargeable to hydrogeneration as project operation and maintenance. The district broadly interprets "Project" to include the water collection and distribution systems; therefore, the district allocates operation and maintenance costs of these systems between hydrogeneration and irrigation. Additionally, the district has allocated other general overhead and operation costs, such as fees paid in its attempts to refinance the SELP bonds, to the hydrogeneration fund. SELP limits its project definition to the wording provided in the Bond Purchase Agreements. Based on our review of the Bond Purchase Agreements and related documents, we identified $91,476 of unallowable costs allocated by the district to the hydrogeneration fund and question the allowability of additional costs totaling $431,609.

We recommend that SELP and the district reach agreement on the allowability and allocation of certain district expenses being charged to hydrogeneration. In addition, we recommend that the district reimburse those costs determined to be unallowable, and that SELP and the district determine what amount of the questioned costs should be

reimbursed to the hydrogeneration fund and ensure that reimbursement is made. Based on the resolution of fiscal year 1996 questioned costs, SELP personnel may need to determine whether prior years' allocations to hydrogeneration are reasonable or whether additional amounts need to be reimbursed to the hydrogeneration fund.

As of July 1996, the district is indebted to SELP for approximately $9 million and to the Special Districts Association of Oregon Lease/Purchase Program for $680,000. Hydrogeneration reserve funds totaling $1.3 million were established at the bonds' inception to ensure payment of debt service obligations, but SELP advances and related interest charges to the district against these funds have drawn down the reserves to approximately $95,000 over the last 13 years. The district's audited financial statements as of June 30, 1995 report the market value of the reserve fund investments as approximately $1.5 million.

The district's hydrogeneration budget is presently funded with power sales revenue from the district's two hydrogeneration facilities, and the irrigation budget is funded through assessments to water users. Unaudited expenses of the district's hydrogeneration and irrigation funds showed a combined total of $1,224,428 for fiscal year 1996. Consequently, the district's unaudited fiscal year 1996 irrigation revenues of $378,617 are insufficient to pay the unallowable and questioned irrigation expenses of $523,085 allocated to the projects. It appears that the district may need to increase irrigation revenues or decrease irrigation spending to reimburse costs determined to be improperly allocated to the hydrogeneration fund.

SELP concurred with the audit recommendations. The district, based on its differing interpretation of the Bond Purchase Agreements and related documents, did not.

INTRODUCTION

BACKGROUND

The Farmers Irrigation District (district) is organized under the provisions of Chapter 545 of the Oregon Revised Statutes. As of July 1996, the district had a bonded indebtedness of approximately $9 million to the Department of Consumer and Business Services' Small Scale Energy Loan Program (SELP). These bonds funded the district's two hydrogeneration plants, and the related bond agreements establish specific uses for the revenues resulting from the plants' operation.

SELP personnel had become increasingly concerned about the district's methods for charging operation and maintenance expenses to and its uses of net revenues in the hydrogeneration fund. Noncompliance with the bond agreements could jeopardize the district's ability to make bond payments. According to SELP personnel, the district was unable to satisfactorily explain its use of hydrogeneration revenues to repay advances from irrigation funds. Furthermore, SELP personnel observed a significant increase in the amount of operation and maintenance expenses being charged against the hydrogeneration funds. As a result, SELP requested that the Oregon Audits Division review the district's compliance with the bond agreements.

ORGANIZATION AND FUNCTIONS

The district, which is managed by a Board of Directors, currently has a staff of 11 employees. The district's primary activities are to maintain two hydrogeneration plants and an irrigation system consisting of diversions, canals, and pipelines that service 5,900 acres of property for 1,430 customer accounts.

The district, which is located in northern Hood River County, Oregon, began irrigation in 1906 when the Farmer's Irrigation Company was organized. Over the last 90 years, the district has acquired irrigation and hydrogeneration water rights on the Hood River and numerous creeks and springs.

Irrigation History

What is now the Farmers Irrigation District began as two adjacent irrigation districts with the sole function of providing irrigation to landowners in the Hood River area. The Farmers Irrigation District and the Hood River Irrigation District merged in 1978 to more efficiently utilize the combined water resources, expand the account base for increased operating capital, and take advantage of the extreme elevation changes to generate electricity to provide revenue for a fully pressurized irrigation system.

The water collection system consists of the diversions and conveyance canals for all district water sources. A diversion redirects water from a natural source into the district's collection system; the district maintains 34 points of diversion. Each of the district's conveyance canals is located at a different elevation. The distribution system consists of irrigation laterals and regulation facilities which branch from the main conveyance canals to provide water to groups of individual users. The distribution system consists primarily of gravity flow canals and pipes. Together, the collection and distribution systems comprise the irrigation system of the district.

Hydrogeneration History

Prior to establishing its hydrogeneration plants, the district developed a system of canals and pipelines to provide irrigation during the summer months. To utilize the system during the non-summer months, the district built two hydrogeneration plants. Forebays, which are similar to water reservoirs, serve as regulation facilities for penstocks that provide water to the hydroelectric power plants. Penstocks are gravity-fed pipelines conveying water from the forebays to the generation plants, thus producing the water pressure required to operate the power generators.

Financial Activities

The district operates on a fiscal year of July 1 to June 30. Since 1985, the district has established three budgets:
1) irrigation operation and maintenance;
2) hydrogeneration operation, maintenance, and bond payment; and 3) construction.

The irrigation budget is funded through water assessments. For fiscal year 1996, the district's irrigation revenues totaling $378,617 were generated through a $42 per acre assessment and a $50 account fee. The district's fiscal year 1996 expense allocations to irrigation totaled $363,172.

The hydrogeneration budget is presently funded with power sales revenue from the district's two hydrogeneration facilities. For fiscal year 1996, the district's generation revenues totaled $2,328,769. The district's fiscal year 1996 expense allocations to generation totaled $938,188. Additionally, the district's fiscal year 1996 bond payments to SELP totaled $1,213,208. If hydrogeneration revenues become less than required to meet debt service payments, the district can assess customer accounts based on its general obligation bonds. Reserve funds totaling $1.3 million were established at the bonds' inception to ensure payment of debt service obligations, but SELP advances and the related interest charges to the district against these funds have drawn down the reserves to approximately $95,000 over the past 13 years. The district's fiscal year 1995 audited financial statements report the market value of the reserve fund investments as approximately $1.5 million.

The construction budget is funded by surplus hydrogeneration revenue, lease/purchase agreement proceeds, and system development fees. Additionally, the construction account is used to record conservation project funding and related expenditures.

As of July 1996, the district's bonded indebtedness to SELP was approximately $9 million. Roughly 40 percent of that bonded indebtedness consists of a special assessment bond and a revenue bond, while the remaining 60 percent consists of two general obligation bonds. Additionally, the district has lease payment obligations through the Special Districts Association of Oregon

Lease/Purchase program for equipment and improvements totaling $680,000.

Small Scale Energy Loan Program

The 1981 Legislature created the Small Scale Energy Loan Program (SELP) within the Department of Energy[1]. The loan program finances energy projects to meet local community or regional energy needs in Oregon. Program loans are made to individual residents, Oregon businesses, nonprofit organizations, municipal organizations, and state agencies.

Between March 1983 and February 1989, the Oregon Department of Energy purchased four bond issues totaling $12 million from the district through SELP. These bonds were issued to fund feasibility studies for and construction of the two hydroelectric power plants.

Table 1 summarizes the four district bonds purchased by SELP and the bonds' type, amount, and purpose.

Table 1

SELP Purchases of Farmers Irrigation District Bonds

SELP Loan No.	Bond Type	Amount	Issued to Fund
L00062	Special Assessment	$ 115,000	Project Feasibility Studies
L00088	Revenue	5,400,000	Construction of Plant #2
L00136	General Obligation	5,700,000	Construction of Plant #3
L00278	General Obligation	785,000	Extension of the Project's Water Collection System
Total		$12,000,000.	

The Bond Purchase Agreements (agreements) for each of these bond issues specify, among other legal provisions, the use of revenues from the projects, the allowable operation and maintenance expenses, and the allocation of net revenues after expenses.

1 The 1995 Legislature changed the Department of Energy to the Office of Energy and placed it within the Department of Consumer and Business Services.

Over the past fiscal year, the district prepared to obtain private funding to repay its bonded indebtedness to SELP. As of December 1996, the district has discontinued refunding activities due to market conditions.

SCOPE AND METHODOLOGY

The objective of this review was to determine if the district is complying with the terms of its agreements with SELP. To accomplish this objective, we interviewed both district and SELP staff, reviewed the related records and correspondence of both SELP and the district, and reviewed the Bond Purchase Agreements, bond applications, exhibits, and other supplementary materials. Our procedures primarily related to determining allowability of operation and maintenance expenses allocated to the hydrogeneration fund. Our review did not determine whether the expenditures incurred by the district were necessary for the district's operations. To evaluate the appropriateness of expenses charged against the hydrogeneration fund, we analyzed each expense category on the district's accounting records that totaled 5 percent or more of its total fiscal year 1996 expenses.

We limited our review to those areas specified in this section of the report.

REVIEW RESULTS

BOND PURCHASE AGREEMENTS

The bonds issued for construction of the hydrogeneration projects contain Bond Purchase Agreements (agreements) that stipulate how hydrogeneration revenues may be used. For the revenue and general obligation bonds, operation and maintenance expenses for the two hydroelectric plants may be paid using hydrogeneration revenues. These costs include direct expenses, indirect expenses, and an allocated share of general overhead expenses. The remaining hydrogeneration revenues must be transferred to the Project Revenue Fund to meet the principal and interest payments on the SELP bonds. The Project Revenue Fund contains the Bond Payment, Revenue Loss and Reserve, and Repair and Replacement accounts. Furthermore, modifications to the agreements are not allowed without written consent of SELP.

QUESTIONED EXPENSES CHARGED TO HYDROGENERATION

Our review of district expenses charged to hydrogeneration during fiscal year 1996 determined the district's interpretation of allowable operation and maintenance expenses includes expenses to operate the water collection and distribution systems. The district coordinator stated that the district allocates an expense between hydrogeneration and irrigation if the expense is integral to supplying water to the hydrogeneration facilities. Therefore, the district allocates costs of the water collection and distribution systems between hydrogeneration and irrigation. Additionally, the district allocated to the hydrogeneration fund fees it paid when attempting to refinance the SELP bonds.

Because of SELP's concerns regarding operation and maintenance expenses being charged to the hydrogeneration fund, we reviewed the allocations of certain expense categories made by the district. To conclude upon the propriety of district expense allocations, we reviewed the agreements' definitions of "Project" and "Operation and Maintenance Expenses."

"PROJECT" DEFINITION

Project is defined in the agreement for bond L00136 (originally executed in connection with Plant # 3) as:

> "...the items of machinery, equipment, improvements and all related property constituting the project to be located in Oregon to provide electricity from water, as set forth in the Issuer's Small Scale Energy Loan Program loan application and any exhibits and supplementary material as has been submitted by Issuer to Department in plans, specifications, contracts, invoices or other documents submitted to and accepted by Department hereafter."
>
> "The term 'Project' also includes all items of property acquired and installed at any time on the Premises in substitution for or in addition to any of said items of machinery, equipment, improvements or related property referred to in those documents."[2]

Additionally, Project is defined in the application for loan L00088 (originally executed in connection with Plant # 2) as:

> "The Project consists of 7,000 feet of pipeline, a diversion structure with screening and a generator building and equipment. Water will be supplied through the farmers irrigation main canal which was constructed in 1898 and has been in use since that date."
>
> "The Project will use water which is excess of spray, fertilizing, frost and irrigation requirements for the production of electricity."

In question D on page two of the district's application for loan L00088, SELP asked whether part of the project already exists and the district responded: "main canal constructed 1898."[3]

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2 The definition of "Project" in the agreement for loan L00088 is almost identical but includes the phrase, after the word "constituting": "Farmers Ditch Hydroelectric Project No. 2 to be located in Oregon using water resources to provide electricity to meet a local community or regional energy need in Oregon..."

3 The district's application for bond L00136 contains a nearly identical question to which the district responded: "will be extension of existing canal built in 1800's."

Article 1, part 4 of the agreement for loan L00088 describes the project as:

> "That 3.0 megawatt hydroelectric project consisting of Diversion structures, conduit, penstock, powerhouse, equipment, and transmission lines more fully described in Federal Energy Regulatory Commission Exemption Nos. 7532-000 and 2659-002."

The Federal Energy Regulatory Commission (FERC) Exemption Nos. 7532-000 and 2659-002 refer to descriptions of the project contained in the district's exemption application filed August 16, 1983. Exhibit "A" to the exemption application is the "Project Description" that states:

> "The Applicant proposes to develop a new hydroelectric generation project on a portion of their irrigation system using excess flows in their canals as the water source. The purpose of the project is to develop a generation project that can utilize the potential of this excess water."

Exhibit "A" to the FERC exemption application further delineates the Project and includes descriptions for only the diversion and penstock facilities, the hydroelectric power plant, and the electricity transmission line.

Exhibit "E" to the exemption application is the Environmental Report. Section 1.0 contains a description of the "Project". Paragraphs one and two of this section state:

> "The District owns and operates several irrigation canals and an extensive distribution system."
>
> "The District is proposing to develop the resources of the Farmers Ditch, Low Line Ditch and Ditch Creek as a hydrogenerating project. They presently have surplus water flowing from October to June of each year that can be used to generate electricity. Some of these canals date back to 1875 when irrigation was first developed within the District."

Section 3.0 of Exhibit "E" contains information regarding the operation of the project and states:

> "Because the water used in the project comes from irrigation canals the impact of fish and wildlife will be minimal."

Additionally, SELP manager C.D. White wrote in his narrative summary of the loan L00088 application dated April 26, 1983, a description of the project that states:

> "A diversion structure is to be built by the district on their main canal to divert water into this project with a 48 inch, 7,000 foot penstock feeding two 900 kW turbine/generators with discharge back into the Hood River."

A letter from the project's engineers, Gray and Osborne, Inc., P.S. included in SELP's loan L00088 correspondence pre-closing file, states:

> "This correspondence is to advise that the subject Project consists of a reinforced concrete Powerhouse, a concrete and steel pipeline, and equipment; all of long-life materials and construction ..."[4]

In the loan application submitted by the district for loan L00136, the "Project Description" on page two states:

> "The Project consists of 3600 feet of low-pressure pipeline to extend low line canal to the new reservoir location, a small reservoir-screening structure, 22,000 feet of 33" or 36" main line (to be determined by bid cost/benefit ratio) and a 1800 kW Pelton Turbine/Generator."

> "The Project will use water which is surplus above irrigation, spray, and temperature control requirements."

Included with the application was a hand-drawn map of the proposed project. This map shows water from Ditch Creek, Lowline Canal, and other tributaries entering the reservoir for Plant #3. Additionally, the application includes a page narrating "Project Description" which states:

[4] A nearly identical letter exists from the project's engineer, Gray and Osborne, Inc., P.S. for bond L00136 but includes prior to the word "Powerhouse" the words: "and metal..."

> "The project begins at Ditch Creek on the Low Line Canal. An inverted siphon will carry Low Line water across Ditch Creek with a low pressure pipeline carrying the water on contour around to the new reservoir. A small parallel pipeline will be installed from the inlet at the end of Low Line Canal down to Ditch Creek to allow for overflow in case of screen clogging, flooding conditions, or failure of the turbine bypass system."

> "The reservoir will be a small structure with the dam height of approximately eight feet and a total surface area of 5,000 - 8,000 square feet. Its main purposes are to allow screening and settling and to extend reaction times for pumping and generation control. The pipeline/penstock conveys the water a total distance of 22,000 feet from the reservoir to the Powerhouse site."

> "The #3 powerhouse will be designed in combination with a pump plant and screening station."

The construction of Plant #3, funded by loan L00136, was completed under FERC exemption 6801-000. Exhibit B-1, section J, to this exemption includes a "Description of Project" stating:

> "The proposed project would consist of: (1) a diversion structure in the Low Line Ditch; (2) a 30-inch-diameter, 21,500-foot-long penstock; and (3) a powerhouse to to [*sic*] contain a turbine-generating unit with a rated capacity..."

Additionally, prior to issuing bonds for the construction of Plant #3, the district's Board of Directors unanimously passed Resolution No. 22-85 which states the following about the district's water collection system:

> "WHEREAS, the Board of Directors of Farmers Irrigation District has determined that the irrigation lines and ditches of the District are in need of repairs and improvements, and

> "WHEREAS, the Board has determined that funds to make the necessary improvements can be raised by building hydro electric [*sic*] project #3 and selling the

> electricity so produced to raise the funds for the system improvements, and..."

This resolution was included as Exhibit "A" to a petition submitted to the Circuit Court of the State of Oregon on July 19, 1985, for judicial examination and judgment as to the regularity and legality of all proceedings taken and had by the Board of Directors of the Farmers Irrigation District, providing for and authorizing the issuance and sale of bonds of the District with respect to the Farmers Irrigation District Hydro-Electric Project #3 valid in all respects. The Circuit Court approved and confirmed the petition on October 24, 1985[5].

Based on our review of the agreements, loan applications, exhibits, and other supplementary material the definition of "Project" does contain a degree of ambiguity. However, the preponderance of material reviewed that describes or defines the term "Project" limits the term to the facilities directly constructed from SELP loan proceeds; i.e. diversions, forebays, penstocks, and hydropower plant facilities.

Farmers Irrigation District Board Resolution 22-85 notes that the district's "irrigation lines and ditches are in need of repairs and improvements." However, the agreements provide specific parameters restricting the use of hydrogeneration revenues and preclude the district from using these revenues for canal repair and improvement if the reserve funds are not fully funded. In a letter to the district dated September 27, 1989, SELP Program Manager Gregory S. Jeffrey demonstrates this understanding. He wrote:

> "You [the district] indicated one issue of concern to all involved parties is canal failures. Increased winter flow may aggravate canal failures. That is a concern to the Small Scale Energy Loan Program as well. A reliable water delivery system serves both irrigation and hydroelectric project purposes. Our most recent loan to FID provided the funds ($785,000) to convert canals to enclosed pipe along the low line ditch. Incurring that loan obligation completely depleted the FID debt authority. Hence, additional piping projects

[5] Hood River County Circuit Court Case No. CC 85-83.

> will most likely be funded out of hydro project [*sic*] revenues."
>
> "You are well aware that hydro project [*sic*] revenues will not be available in the near term. At present, loan payment reserves are unfunded. This is a very serious matter for both SELP and the District."
>
> "We are prepared to continue to work with FID toward a solution of both the financial strength of the energy project and canal needs."

We found no further correspondence between SELP and the district that modifies the term of the agreements in regards to use of hydrogeneration revenues.

"OPERATION AND MAINTENANCE EXPENSE" DEFINITION

The agreements for loans L00088 and L00136 include identical definitions for "Operation and Maintenance Expense":

> "the reasonable and necessary costs of maintaining and operating the Project, calculated on sound accounting principles, including (among other things) reasonable expenses of management, repair and other expenses necessary to maintain and preserve the Project in good repair and working order, and reasonable amounts for administration, overhead, insurance, taxes (if any) and other similar costs, but excluding in all cases depreciation and obsolescence charges or reserves therefore and amortization of intangibles or other bookkeeping entries of a similar nature."

In addition to wording contained in the agreements, we reviewed the district's loan applications, exhibits, and other documents relating to the district's anticipated operation and maintenance costs for the projects. These documents detail the understandings of the district and SELP regarding the use of project revenues to pay operation and maintenance costs.

The district's application for loan L00088 (Plant #2), question 43, asks the district to list the positions the project will employ. The district responded one "Power Plant

Operator" at "40 hours per week." The application for loan L00136 (Plant #3) asks the same question and the district responded one "Power Plant Operator" at "40 hours per week" and then in parentheses indicates that the Power Plant Operator "will be shared with plant #2."

On page HE3 of the district's application for loan L00136, question 4 inquires about the project's "proposed operation mode and manpower requirements." The district responded: "will be automatic with monitors in two homes and office."[6]

Exhibit P to loan application L00088 contains a financial analysis section for Plant #2. In regards to project operation and maintenance the district stated:

> "We have used $55,000.00 as the beginning O & M cost. This should be excessive for the first 10 years when the equipment is new. The excess funds would be allowed to accumulate, if not used, to be available as a reserve. It is doubtful that another full time man will be needed as water regulation for the irrigation district is accomplished during 9 - 10 months at present."

Exhibit P also includes a schedule of operation and maintenance expenses for the project's first 20 years. Expenses for 1996, year 11, were estimated to be approximately $120,000. Actual unaudited expenses for fiscal year 1996 allocated to the projects were $938,188.

Included in the narrative summary prepared by SELP Senior Loan Officer Dave Neitling dated October 25, 1985 for loan L00136, one indirect advantage of the project was that "It will provide two to three permanent jobs with an annual payroll of $60,000 in Hood River County."

SELP's loan files contain a district-prepared fiscal year 1989 budget showing various expenses budgeted to the hydrogeneration and irrigation accounts. This budget includes estimates for the operation and maintenance of both Plants #2 and #3[7]. The salary section of the hydrogeneration budget allocates the salaries of the

[6] The bond application submitted by the district for bond L00088 asks the same question and the district replied: "remote monitoring at office with daily site visits - 1 person."

[7] Both of the hydropower plants have been in commercial production since 1988.

manager, assistant manager, and construction operator 50 percent to hydrogeneration. The administrative assistant's salary is allocated 25 percent to hydrogeneration. The remainder of these salaries are allocated to irrigation. In addition to the administration salaries allocated above, the district budgeted three technical and maintenance personnel to the hydrogeneration system.

In contrast to plans outlined in the agreements, the district has charged substantial portions of its personnel costs to hydrogeneration revenues. For fiscal year ending 1989, the district's budgeted salaries expense for hydrogeneration was $91,503 (48 percent), while irrigation was $98,651 (52 percent). The district's actual payroll expense allocations for fiscal year ending 1996 were $302,912 (69 percent) to hydrogeneration and $137,872 (31 percent) to irrigation.

The differences between the district's and the audit's definitions of allowable project operation and maintenance expenses have resulted in our questioning expenses which were charged to the hydrogeneration fund. These expenses are described in the sections below and are summarized in Appendix A.

A. Payroll and Benefits

In fiscal year 1996, payroll expenses totaled $440,784; the district allocated $302,912 (69 percent) to hydrogeneration and $137,872 (31 percent) to irrigation. The related benefit expenses totaled $117,763; the district allocated $79,116 (67 percent) to hydrogeneration and $38,647 (33 percent) to irrigation. According to district management, these allocation percentages were determined based upon the number of months in the year the district operates the hydrogeneration and irrigation systems. The irrigation system operates approximately four months per year, while hydroelectric generation facilities function nearly year round. This method of allocating payroll costs is not consistent with the district's statement in Exhibit P to loan L00088, as quoted above, which states: "..water regulation for the irrigation district is accomplished during 9 - 10 months at present."

In reviewing the appropriateness of this allocation, we determined that district employees can be categorized into three areas: water rights and seasonal workers, maintenance, and administration.

Duties of the district's water rights specialist and seasonal workers are essentially entirely irrigation related; therefore, we allocated the related payroll expenses of $71,579 to irrigation.

As stated earlier in the "Project Definition" section, the preponderance of material that describes or defines the term "Project" limits the term to the facilities directly constructed from SELP loan proceeds; i.e. diversions, forebays, penstocks, and hydropower plant facilities.

Based on an interview with the district's maintenance supervisor regarding estimated employee time spent maintaining the project's forebays, penstocks, and generation facilities, we determined approximately 17 percent of the maintenance crew's annual hours are spent on the hydrogeneration projects to perform routine and annual maintenance. Therefore, we allocated $37,850 (17 percent) of the maintenance crew's total payroll expenses of $221,413 to the Projects. We allocated the remaining maintenance payroll expenses of $183,563 (83 percent), including the water collection and distribution system, to the hydrogeneration fund.

Generally, administrative staff time is proportionate to the functions and activities of field staff in service organizations. Based on this relationship, the allocation percentages developed for the maintenance payroll, 17 percent to generation and 83 percent to irrigation, appear to provide a reasonable basis for allocating administration payroll. Using these percentages, we allocated administration payroll $25,125 to hydrogeneration and $122,667 to irrigation.

Benefit expenses should be apportioned between hydrogeneration and irrigation using the payroll allocation percentages described above. Thus, benefit costs allocated to hydrogeneration equal $16,487 and $101,276 for irrigation.

The differences between the district's payroll and benefit expense allocations and our allocations are $239,937 in payroll expenses and benefit expenses of $62,628.

B. Professional Services

The professional services expense category is comprised of the district's audit, legal, and engineering fees. Of the $93,624 incurred in fiscal year 1996, the district allocated $77,116 (90 percent) to hydrogeneration and $16,509 (18 percent) to irrigation.

We reviewed $84,321 (90 percent) of the district's professional services expenses. Of this amount, the district allocated $68,471 (81 percent) to hydrogeneration and $15,850 (19 percent) to irrigation.

Based on reviews of supporting documentation and interviews with district management, we allocated professional service expenses of $15,763 (19 percent) to hydrogeneration and $68,558 (81 percent) to irrigation. The major difference between our allocations and district allocations is attributable to the district's legal fees of $46,227 to refinance its SELP bond debt through the private sector. The agreements do not include bond refinancing costs, such as legal fees, as allowable Project operation and maintenance expenses; however, the district allocated these costs to hydrogeneration. Attorney legal fees comprise the remaining $6,481 of questioned expenses. We were unable to determine, after reviewing the district's support for the billings, the method used by the district to allocate the fees to hydrogeneration. As a result, we were unable to verify the appropriateness of these expenses being allocated to the generation fund.

C. Equipment

The equipment expense total is comprised of the purchase, rental, fuel, and maintenance expenses of district owned and rented equipment. Of the fiscal year 1996 equipment expenses totaling $66,759, the district allocated $41,182 (62 percent) to hydrogeneration and $25,577 (38 percent) to irrigation.

Based on the district's combined general ledger for fiscal year 1996, the district allocated the costs of equipment purchases ($20,456) and rental ($11,747) approximately 70 percent to hydrogeneration and 30 percent to irrigation. Additionally, the district's fuel expenses of $10,577, and equipment maintenance costs of $23,979, were allocated equally between hydrogeneration and irrigation.

The district did not specify its reason for allocating 70 percent of equipment purchases to hydrogeneration while allocating equipment maintenance and fuel costs 50 percent to hydrogeneration. Due to their interrelated nature, these allocations should approximate one another.

The district's equipment is directly used by employees to operate and maintain the district's water collection and distribution systems and the hydrogeneration projects. Therefore, the allocation percentages for equipment should correlate with the percentages developed for the maintenance crew's payroll. Based on our payroll audit results, we allocated payroll costs approximately 17 percent to hydrogeneration and 83 percent to irrigation. Therefore, using these same percentages, we allocated equipment expenses of $11,349 to hydrogeneration. We question the remaining $29,833 of expenses allocated by the district to hydrogeneration.

D. Lease/Purchase Agreements

Between October 1993 and December 1994, the district entered into three lease/purchase agreements through the Special Districts Association of Oregon Lease/Purchase program for the acquisition of heavy equipment, plastic water piping for two water conveyance canals, and telemetry equipment. According to district records and the district's 1996 Flood Reports, the heavy equipment is generally used to maintain the water collection and distribution systems. These lease/purchase agreements provided the district $680,000 of capital to be repaid with interest by January 1, 2006.

The district's fiscal year 1996 lease payments of $76,932 were allocated $63,617 (83 percent) to hydrogeneration and $13,315 (17 percent) to irrigation.

After reviewing the lease purchase agreements and documents that disclosed how the purchases were used, we determined the lease payments are not allowable Project charges because the equipment and materials were used to maintain the water collection and distribution systems. Based on the definition of "Project" contained in the Bond Purchase Agreements, we question the lease payments totaling $63,617, which were allocated by the district to hydrogeneration.

E. Miscellaneous Contingency

The miscellaneous contingency balance is composed of February 1996 flood damage repair costs, telemetry equipment acquisition expenses, and expenses of a canal piping project. Of miscellaneous contingency expenses totaling $226,038, the district allocated $157,701 (70 percent) to hydrogeneration and $68,337 (30 percent) to irrigation.

Miscellaneous contingency expenses allocated to the hydrogeneration account include telemetry expenses totaling $108,959. The agreements do not include system improvements, such as telemetry, as allowable Project operation and maintenance expenses. However, the district reimbursed $106,477 of the telemetry expenses to the hydrogeneration account from lease/purchase agreement proceeds. The district has not reimbursed the remaining telemetry balance of $2,482 to the hydrogeneration fund.

The miscellaneous contingency hydrogeneration account also contains February 1996 flood repair expenses of $48,742. We analyzed the district's 1996 Scheduled and Unscheduled Flood Claims Reports and determined that expenses to repair and inspect Project facilities totaled $19,629. The remaining $29,113 of flood repair expenses were for the water collection and distribution system and, therefore, we question the district's allocation of these expenses to the hydrogeneration fund.

Furthermore, the district used $54,357 in hydrogeneration funds to cover the cost of repairing flood damage in the non-Project areas of highline canal, lowline canal and the golf course. Based on its review of district financial reports, SELP personnel asked the district to reimburse the $54,357 to the hydrogeneration fund. Between March 1996 and May 1996, the district made book transfers of $54,357 from the miscellaneous contingency hydrogeneration account to the miscellaneous contingency irrigation account. However, we were able to verify only the cash transfer of $25,226 from the irrigation fund to the hydrogeneration fund as reimbursement of these expenses.

According to the district analyst, the remaining balance of $29,131 has yet to be repaid.

F. Systems Materials

The systems materials account is comprised of materials, tools, and improvement expenses. Additionally, the district accounts for expenses to comply with state and federal regulatory agencies' requirements in this account. Of the fiscal year 1996 systems materials expenses totaling $134,481, the district allocated $85,119 (63 percent) to hydrogeneration and $49,362 (37 percent) to irrigation.

Compliance costs of $50,831, which were accounted for as hydrogeneration expenses, represent the largest component in systems materials. Through interviews with district and SELP personnel, we determined these compliance expenses are required due to the hydroelectric generation plants being in operation. Therefore, these charges are reasonable Project operation and maintenance expenses.

The remaining expenses allocated to hydrogeneration for system's materials total $34,289. This expense total is comprised of many, relatively small costs. Due to the nature and amount of the transactions, we did not review this expense total of $34,289 in detail; therefore, we did not conclude upon the appropriateness of the allocations to the hydrogeneration fund.

G. Special Assessment Bond

On November 16, 1983, the district received $115,000 through the sale of a special assessment bond to SELP. The special assessment bond agreement requires the district to make semiannual debt service payments of $6,818 each May and November until the principal is repaid. Through a review of district records and interviews with district personnel, we determined that this bond's $13,636 debt service payments made in fiscal year 1996 were funded entirely from the hydrogeneration account.

The Bond Purchase Agreements for the district's revenue and general obligation bonds restrict the use of hydrogeneration revenues to the payment of Project operation and maintenance expenses unless the Project Revenue Funds are fully funded. During the fiscal year ending June 30, 1996, no deposits were made into the

Bond Payment or the Repair and Replacement Accounts. Both accounts were deficient in the amounts of ($109,052) and ($65,606), respectively. The Revenue Loss/Reserve Account had a balance of approximately $95,000 at June 30, 1996, while the required balance was $1,305,000. Therefore, the use of hydrogeneration revenues to pay the special assessment bond debt service is not allowed.

As summarized in Appendix A, the net effect of the findings described above is $91,476 in costs not allowed by the Bond Purchase Agreements and another $431,609 in costs we question.

RECOMMENDATIONS

We recommend that SELP, in conjunction with the district:

- Reach agreement on the definitions of "Project" and "Operation and Maintenance expense" and the allowability of district expenses being charged to hydrogeneration.

- Establish clear allocation methods for expenses that are operation and maintenance expenses of both the hydrogeneration projects and the water collection and distribution systems.

- Request the district to reimburse the hydrogeneration fund the $91,476 of unallowable expenses charged to the fund.

- Determine the amount of the questioned expenses that should be reimbursed to the hydrogeneration funds and ensure that reimbursement is made.

- Determine whether prior years' expense allocations to hydrogeneration are reasonable based on the fiscal year 1996 analysis and whether additional amounts need to be reimbursed to the hydrogeneration fund.

OTHER MATTERS

As of July 1996, the district is indebted to the Department of Energy's Small Scale Energy Loan Program for approximately $9 million and to the Special Districts Association of Oregon Lease/Purchase Program for

$680,000. Hydrogeneration reserve funds totaling $1.3 million were established at the bonds' inception to ensure payment of debt service obligations, but these funds have been drawn down to approximately $95,000 over the past 13 years.

The district's hydrogeneration budget is presently funded with power sales revenue from the district's two hydrogeneration facilities. In the recent past, the hydrogeneration power revenues have been insufficient to meet the district's debt service and operating expenses allocated to the Projects. Based on the district's audited financial statements at June 30, 1993, 1994, and 1995, the hydrogeneration fund incurred net income/(losses) of ($287,263), ($553,126), and $125,896, respectively. The previous net losses have contributed to accumulated deficit retained earnings for those years in the amounts of ($561,549), ($1,114,675), and ($988,779), respectively, for the hydrogeneration fund. Additionally, the Independent Auditor's Reports on the district's financial statements, for fiscal years ending June 30, 1994 and 1995 include a paragraph emphasizing that "...Farmers Irrigation District, Hood River, Oregon, has been unable to make required bonded debt payments on behalf of their generation projects and are drawing upon reserve funds to meet these debt service payments. The general purpose financial statements do not include any adjustment relating to the amounts and classification of liabilities that might be necessary if Farmer's Irrigation District, Hood River, Oregon, is not able to meet its debts as they come due."

The irrigation budget is funded through water assessments. Based on the district's audited financial statements ending June 30, 1993, 1994, and 1995, the irrigation fund's net income was $112,707, $33,839, and $82,887, respectively.

The unaudited expenses of the district's irrigation and hydrogeneration funds totaled $1,224,428 for fiscal year 1996. Of these expenses, our review identified $91,476 in costs that were not allowed by the agreements allocated by the district to the hydrogeneration fund. Further, our review questions the allowability of additional costs totaling $431,609. The district's unaudited fiscal year 1996 irrigation revenues of $378,617 are insufficient to pay these unallowable and questioned expenses.

Therefore, it appears the district would need to either increase irrigation revenues or decrease irrigation expenses to fund its related costs through assessments to water users.

REPORT DISTRIBUTION

This report is a public record and is intended for the Office of Energy management, the Farmers Irrigation District, the governor of the state of Oregon, the Oregon Legislative Assembly, and all other interested parties.

COMMENDATION

The courtesies and cooperation extended by officials and employees of the Office of Energy and the Farmers Irrigation District during the course of this review were commendable and sincerely appreciated.

AUDIT TEAM

Sharron E. Walker, CPA, CFE - Deputy State Auditor
Sylvia Gercke, CFE
Craig Stroud, CPA

QUESTIONED AND UNALLOWED EXPENSES
FISCAL YEAR 1996

Review Area	Questioned Costs	Unallowed Costs	Total
Payroll	$239,937		$239,937
Benefits	$62,628		$62,628
Professional Services			
Bond Refinancing Costs		$46,227	$46,227
Allocation of Attorney Fees	$6,481		$6,481
Equipment	$29,833		$29,833
Lease/Purchase Agreements	$63,617		$63,617
Miscellaneous Contingency			
Telemetry		$2,482	$2,482
Flood Repairs	$29,113		$29,113
Lowline, Highline, and Golf Course Expenses Not Reimbursed		$29,131	$29,131
Systems Materials[8]	0		0
Special Assessment Bond		$13,636	$13,636
TOTAL	**$431,609**	**$91,476**	**$523,085**

[8] Determined allowability of $50,831 of systems materials costs. Due to nature of remaining costs totaling $83,650, we were unable to conclude upon their allowability.

RESPONSES TO THE AUDIT REPORT

Oregon

DEPARTMENT OF ENERGY

April 14, 1997

Sharron W. Goggins, CPA, CFE
Deputy State Auditor
Secretary of State's Office - Audits Division
255 Capitol St. NE - Suite 500
Salem, OR 97310

Dear Ms. Goggins:

We have reviewed the draft report of the Farmer's Irrigation District, SELP Bond Debt-Special Review.

We believe the Draft Audit Report satisfactorily examines the areas in which SELP expressed concerns in my July 16, 1996 letter to you.

We believe the comments and findings of the draft Report appropriately interpret the bond and loan agreements between FID and SELP. We also believe the recommendations are appropriate.

SELP and FID met in February to discuss potential solutions to the differences evidenced in the draft Report. We plan to continue meeting with FID. The Office of Energy intends to expeditiously pursue a course that will lead to a successful resolution of the issues addressed in the draft Report's recommendations in a way that is mutually acceptable.

We thank you for the services you have provided to our program, and we applaud the professionalism of your staff.

Sincerely,

Larry V. Gray

Larry V. Gray
Administrator
Energy Loan Division
Oregon Office of Energy

John A. Kitzhaber
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Hood River, Oregon 97031
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April 14, 1997

Sharon Goggins
Secretary of State Audits Division
255 Capitol Street NE, Suite 500
Salem, Oregon 97310

Subject: Response of Farmers Irrigation District to Second Draft Audit Report

Dear Ms. Goggins:

We have reviewed the second draft report prepared by the Audits Division for the SELP Bond Debt Special Review. Since the first audit draft report was issued, SELP has agreed to discuss alternative means of accounting for our revenues and expenditures that may result in a revision of the Bond Purchase Agreements and resolve the source of disagreement as to whether any particular expenditure can be paid from Project revenues.

To save further expense, we have limited this response to a few general observations about the second draft report. To the extent that portions of the audit report that we objected to in our first response remain in the audit report, we hereby incorporate the relevant portions of our first response in this second response, and anticipate that this response, as well as our first response, will be appended to the Audits Division's final report. * 1

Status and Effect of Audit

Although we understand that the audit report merely makes certain recommendations to SELP, the use of the term "disallowed" to refer to certain of our expense allocations, with which the audit team disagrees, implies that either the Audits Division or SELP has some constitutional, statutory or contractual power or right to allow or disallow any expenditure or allocation made by the District. Neither SELP nor the Audits Division has any jurisdiction over the financial affairs of the District, and the District relies on its own independent auditors, on an ongoing basis, for guidance in its accounting activities.

The Bond Purchase Agreements, that are the subject of this audit, do not give SELP the right to have the District's accounts audited, but merely allow SELP to inspect the District's records. The District has allowed the audit team to inspect its records in the capacity of agent for SELP. Of course, we accept the fact that SELP and its agent may disagree with our decisions as to how particular expenditures are allocated, but neither SELP, nor its agent, has any power to "disallow" or otherwise mandate any decision, activity, allocation or finding of the District. We therefore request that the words "disallow," "unallowed," and other words and phrases of similar import, be changed to the word "disagree," or terms of similar meaning, to match the actual status and relationship between the District and the Audits Division under this audit. 2

* The Audits Division has footnoted three of the district's statements to provide clarity and our perspective. The footnotes begin on page 35.

Statements Erroneously Attributed to the District

The second draft repeatedly contends that the District "broadly" defines the term "Project" to include all of its "water collection and distribution systems." The District has never indicated in any manner that it considers it's distribution system to be a part of the Project or that it considers maintenance and operation of its distribution system essential to the production of electricity from the Project, nor has the District ever taken the position that expenses of operation and maintenance of its distribution system are operation and maintenance expenses of the Project. For the audit report to attribute such a position to the District can only suggest that the District's allocation of expenditures is irrational.

In addition, the District has never indicated that it considers all of its collection system to be a part of the Project or essential to the operation and maintenance of the Project. The District has repeatedly stated that only the main canals that deliver water to the hydroelectric generators and any other facilities that, if absent, would cause the Project to be shut down or suffer significant revenue loss are considered essential to the operation and maintenance of the Project.

Definition of Project

During discussion of our response to the first draft audit report, the Audits Division agreed to seek the advice of its legal counsel as to the appropriate interpretation of the definition of the word "project." Apparently upon reconsideration, the auditors have concluded that there are legitimate grounds for disagreement between SELP and the District as to the proper allocation of expenditures because they have changed the bulk of the expenses that were found "misallocated" in the first draft report to the category "questionable," and the District agrees that this is a step in the right direction.

As the second draft report clarifies, the exact wording in the Bond Purchase Agreements does not contain any accurate description of the Project. In fact, the definition of "Project" specifically refers to all descriptions of the hydroelectric facilities contained in any and all documents submitted to SELP in connection with the District's borrowings. SELP's definition of the Project therefore, limited as it is to the forebays, penstock, and power houses, cannot possibly be described as limited to the "wording in the Bond Purchase Agreements" as the second draft report states.

The District would like to point out that, even if the definition of the term "Project" under the Bond Purchase Agreements is limited to only those items of property constructed with SELP loan proceeds, the Project must include portions of its main water conveyance system, because portions of Lowline Canal were rebuilt with SELP Loan 278 proceeds. Once one accepts that the SELP loans were used to reconstruct portions of the District's water conveyance system, one can begin to understand that the "Project," in terms of its purpose and function as a "hydroelectric facility," is much more than penstocks, forebays and turbines operating in isolation. The loan application, construction, and other documents cited by the second draft report clearly indicate that the Project was intended to use, benefit from, and integrate with existing irrigation facilities.

Limiting the definition of Project to those items of property acquired with loan proceeds has value for the purpose of determining which pieces of physical property are pledged (mortgaged) as security for the loans, but for purposes of producing Project revenues, the Project must include all of the portions of the irrigation system that are required to generate hydroelectric energy. In other words, a very limited interpretation of the term "Project" is useful for determining the extent of SELP's collateral but entirely insufficient for determining which functions must be performed, and which property must be operated and maintained, to produce Project revenues. In the District's view, the "Project," defined to mean that hydroelectric facility that produces Project revenues, includes all parts of its combined facilities that must be operated and maintained to produce Project revenues. Therefore, for purposes of its operation and maintenance expense tracking, the District prefers to think of the Project in terms of its function as a "hydroelectric facility" rather than in terms of financed collateral.

Definition of Operation and Maintenance Expenses

The definition of "Operation and Maintenance Expense" is the crucial definition for purposes of the audit because the audit examines whether the District properly timed its use of Project revenues to the payment of Operation and Maintenance Expenses as defined in the Bond Purchase Agreements. The definition of "Operation and Maintenance Expense" (reproduced in the second draft report) does not incorporate or even refer to any documents submitted in connection with the District's initial loan application (or to any extraneous documents at all) and is a standard type of "expenses required to keep a business running" definition. Thus, while the definition of "Project" requires reference to the original loan applications and other related documents, the definition of "Operation and Maintenance Expense" does not, and, once the scope and function of the Project is defined, reference to extraneous documents to define operational expenses is neither helpful nor appropriate.

We disagree, therefore, with the second draft report's extensive discussion of, and reliance on, expense predictions made in the District's loan applications over twelve years ago to determine what the actual operating costs of the Project are today. Those predictions were made while the Project was still in its design phase, by irrigation personnel with no experience or training in the operation of a hydroelectric facility. As everyone connected with the District's hydroelectric facilities now knows, those initial predictions of what it would take to operate the Project were grossly underestimated by both SELP and the District. Pre-Project predictions should not be used to limit the District's ability to hire necessary staff, or to use any other resources reasonably required to run the Projects in a safe and efficient manner.

For the purpose of determining what is required to "Operate" and "Maintain" the Project, the District focuses on what the Project does when it operates, which is to produce hydroelectric power, and, for that purposes considers its "hydroelectric facilities" to include all property which must be operated and maintained to avoid damage to or wasting of the financed facilities, or to avoid the loss of significant hydroelectric revenues. The concept of making electricity is what drives the District's decision as to what constitutes an expense of "operating" and "maintaining" the Project.

Failed Refinancing Costs

Over 51% of the "disallowed" expenses in the second draft report were moneys spent by the District for legal and financial advice in its failed attempt to refinance the SELP loans with which the Project was built. Our independent auditor has indicated that, under generally accepted accounting principals, the costs of financing or refinancing a capital project in an enterprise fund should be accounted for in the enterprise fund. If the refinancing is successful, the costs are capitalized and amortized over the life of the corresponding debt. If the refinancing is unsuccessful, the costs are properly expensed within the enterprise fund. Such costs are specifically included in the Bond Purchase Agreements definition of Operation and Maintenance Expense.

The audit report appears to reject generally accepted accounting principals by stating that Project financing costs, in this particular case, should be charged to non-Project accounts. Moreover, although we can understand SELP's disappointment that the refinancing was not completed, SELP was fully aware of, encouraged, and substantially participated in the District's refinancing activities, and SELP never indicated that it did not consider the refinancing activities to be Project expenses. Considering the fact that, under GAAP, the District would reasonably believe its financing costs to be properly chargeable to the Project, and considering the fact that SELP is in the business of making loans and performing other financial and accounting activities, if SELP objected to the District's use of generally accepted accounting principals to classify Project financing expenses, it should have raised the issue prior to engaging with the District in prolonged and complicated financing discussions. 3

Conclusion

All in all, we are pleased that the Audits Division has taken the time to research the Projects' history and rewrite its draft report, but, as discussed above, and as more fully discussed in our response to the first draft, we do not agree with most of its legal and factual findings. We would like to point out that this audit was not instigated by any missed loan payments on the District's part, and that the District attempted to avoid the audit expense by inviting SELP to inspect its facilities and records and to discuss its concerns in person with District staff well in advance of SELP's request for this audit.

Tim Annala

Tim Annala, Chairman
Farmers Irrigation District

cc:

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OREGON AUDITS DIVISION'S FOOTNOTES TO THE DISTRICT'S RESPONSE LETTER

1. Because of the length of the district's first response (referred to in the body of the attached second response), we chose not to include it in our report. The full text of the district's first response, and our comments concerning specific statements made in that response, is available for review at the Oregon Audits Division.

2. While we refer to certain costs as being unallowable, our use of this term is appropriate because we measured the district's allocation of costs against the criteria specified in the Bond Purchase Agreements. Thus, the costs are unallowable under the terms of the agreements, not because the Oregon Audits Division has "disallowed" them. The district acknowledges that our recommendations are directed to SELP, not to the district.

3. The district states that under GAAP refinancing costs are properly accounted for in the enterprise fund to which they relate. The audit does not question the proper accounting for such funds under GAAP; but rather, questions the allowability of charging such costs to the hydrogeneration funds under the terms of the Bond Purchase Agreements. It is our position that the agreements do not include refinancing costs as allowable Project operation and maintenance expenses. Additionally, modifications of the agreements are not allowed without the written consent of SELP, and we are unaware of any agreement changes relating to these expenses.