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April 30, 2010

To the Energy, Technology, and Civil Rights Committee
City of Seattle – City Light Department
700 Fifth Avenue, Suite 3200
Seattle, WA 98124-3402

Dear Committee Members:

We have completed our audit of the financial statements of the City of Seattle – City Light Department (the "Department") for the year ended December 31, 2009, and have issued our report thereon dated April 30, 2010. This letter presents communications required by our professional standards.

### *Our Responsibility Under Auditing Standards Generally Accepted in the United States of America and Government Auditing Standards*

The objective of a financial statement audit is the expression of an opinion on the financial statements. We conducted the audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*. These standards require that we plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements prepared by management with your oversight are free of material misstatement, whether caused by error or fraud. Our audit included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit does not relieve management or (those charged with governance) of their responsibilities.

As part of the audit we obtained an understanding of the entity and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing and extent of further audit procedures. The audit was not designed to provide assurance on internal control or to identify deficiencies in internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Department's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

### *Other Information in Documents Containing Audited Financial Statements*

Our responsibility does not extend beyond the audited financial statements identified in this report. We do not have any obligation to and have not performed any procedures to corroborate other information contained in client prepared documents, such as official statements related to debt issues.

### *Planned Scope and Timing of the Audit*

We performed the audit according to the planned scope and timing previously communicated to you in our letter about planning matters dated October 20, 2009.

### *Qualitative Aspects of the Entity's Significant Accounting Practices*

#### ***Accounting Policies***

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Department are described in Note 1 to the financial statements. As described in Note 1 to the financial statements, the Department changed accounting policies related to derivatives by adopting Statement of Governmental Accounting Standards (GASB Statement) No. 53, *Accounting and Financial Reporting for Derivative Instruments*, in 2009. Accordingly, the effect of the accounting change was to restate the 2008 financial statements. There was no effect to the statements of revenues, expenses, and changes in equity for 2008. We noted no other transactions entered into by the Department during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

#### ***Accounting Estimates***

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Other postemployment benefit (OPEB) cost, net OPEB obligation and employee benefits self-insurance fund
- Allowance for doubtful accounts
- Unbilled revenues
- The Department's portion of the City of Seattle's Industrial Insurance Fund and Self-Insured Liability losses
- Environmental remediation liabilities

#### ***Financial Statement Disclosures***

The disclosures in the financial statements are neutral, consistent, and clear.

### *Difficulties Encountered in Performing the Audit*

We encountered no significant difficulties in dealing with management in performing our audit.

### *Audit Adjustments*

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management.

A summary of uncorrected financial statement misstatements is attached. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

### *Disagreements with Management*

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

### *Consultations with Other Independent Accountants*

In some cases, management may decide to consult with other accountants about auditing and accounting matters. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

### *Management Representations*

We have requested certain representations from management that are included in the management representation letter. This letter is attached.

### *Independence*

We are not aware of any relationships between Baker Tilly Virchow Krause, LLP and the Department that, in our professional judgment, may reasonably be thought to bear on our independence.

Relating to our audit of the financial statements for the year ended December 31, 2009, Baker Tilly Virchow Krause, LLP hereby confirms in accordance with the Code of Professional Conduct issued by the American Institute of Certified Public Accountants, that we are, in our professional judgment, independent with respect to the Department and provided no services to the Department other than the audit of the current year's financial statements.

### *Other Audit Findings or Issues*

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Department's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the Energy, Technology and Civil Rights Committee and management and is not intended to be, and should not be, used by anyone other than the specified parties.

We welcome the opportunity to discuss the information included in this letter and any other matters.

We appreciate the courtesy and assistance extended to us by your personnel during the audit. If you have any questions on our comments, or if we can offer our services in any other way during the year, please don't hesitate to contact us. Thank you for allowing us to serve you.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
April 30, 2010

City of Seattle

**Seattle City Light**

April 30, 2010

Baker Tilly Virchow Krause, LLP
Ten Terrace Court
P.O. Box 7398
Madison, WI 53707-7398

Dear Auditors:

We are providing this letter in connection with your audits of the financial statements of The City of Seattle – City Light Department (the Department) as of December 31, 2009 and 2008 and for the years then ended for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the Department in conformity with generally accepted accounting principles in the United States of America. We are also responsible for adopting sound accounting policies, establishing and maintaining internal control, and preventing and detecting fraud.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, as of April 26, 2010, the following representations made to you during your audits.

1. We are responsible for the fair presentation in the financial statements of financial position, results of operations, and cash flows of the Department in conformity with generally accepted accounting principles. The financial statements are fairly presented in conformity with generally accepted accounting principles in the United States of America.

2. We are responsible for the fair representation of supplementary information accompanying the basic financial statements that are presented for the purpose of additional analysis of the basic financial statements, in conformity with the accounting principles generally accepted in the United States of America.

3. We have made available to you all –

   a. Financial records and related data.
   b. Minutes of the meetings of the Energy & Technology Committee and summaries of actions of recent meetings for which minutes have not yet been prepared.

4. There have been no -

   a. Fraudulent financial reporting or misappropriation of assets involving management or employees who have significant roles in internal control.
   b. Fraudulent financial reporting or misappropriation of assets involving others that could have a material effect on the financial statements.
   c. Communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.

5. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud.

6. We believe the effects of the uncorrected financial statement misstatements summarized in the enclosed schedule are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. All other known audit and bookkeeping adjustments have been included in our financial statements.

7. The following, if any, have been properly recorded or disclosed in the financial statements:

   a. Joint ventures and related party transactions.
   b. Collateralization agreements with financial institutions.
   c. Guarantees, whether written or oral, under which the Department is contingently liable.
   d. All accounting estimates that could be material to the financial statements, including the key factors and significant assumptions underlying those estimates, and we believe the estimates are reasonable in the circumstances.
   e. All off-balance sheet derivative financial instruments (i.e., futures, options, swaps), including outstanding commitments to purchase or sell securities under forward placement and standby commitments.
   f. Financial instruments with significant individual or group concentration of credit risk.
   g. Sales with recourse provisions, including all price adjustment provisions.

h. All impaired loans receivable.
i. Loans that have been restructured to provide a reduction or deferral of interest or principal payments because of borrower financial difficulties.
j. Agreements to repurchase assets previously sold.
k. Contingent assets and liabilities.

8. There are no -

   a. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.
   b. Violations of restrictions placed on revenues as a result of a bond ordinance covenant - such as revenue distribution, or debt service funding.
   c. Unasserted claims or assessments that our lawyer has advised us are probable of assertion and must be disclosed in accordance with Financial Accounting Standards Board (FASB) Statement No. 5, *Accounting for Contingencies*.
   d. Other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by Statement of Financial Accounting Standards No. 5.

9. All claims, assessments, or pending lawsuits against the Department that may have a material effect on the Department's financial statements were brought to your attention at the time of the audit.

10. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.

11. Provision, when material, has been made to reduce excess or obsolete inventories to their estimated net realizable value.

12. The Department has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral other than liens created by our revenue debt.

13. We are responsible for compliance with laws, regulations and provisions of contracts and agreements applicable to us; including debt contracts and debt covenants and we have identified, and disclosed to you, all laws, regulations and provisions of contracts and grant agreements that we believe have a direct and material effect on the determination of financial statement amounts. We have complied with all aspects of

laws, regulations, and contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

14. Capital assets are properly capitalized and depreciated. Any known impairments have been disclosed and recorded.

15. We believe that we have properly identified all derivative instruments and any embedded derivative instruments that require bifurcation. Our hedging activities, if any, are in accordance with our documented and approved hedging and risk management policies. We follow the valuation, accounting, reporting and disclosure requirements outlined in GASB No. 53. We believe the timing, nature, and amounts of all forecasted transactions are probable of occurring. The fair values of all derivatives and hedged items disclosed in the notes to the financial statements have been determined based on prevailing market prices or by using financial models that we believe are the most appropriate models for valuing such instruments and that incorporate market data and other assumptions that we have determined to be reasonable and appropriate at year end.

16. As disclosed in the notes to the financial statements, we have appropriately described the impacts that proposed accounting pronouncements may have on our financial position or operations, or the status of our evaluation or accounting pronouncements to be adopted in future years.

17. No events have occurred and no facts have been discovered which indicate that the fair value of any security is significantly affected by the credit standing of the issuer or by other specific factors.

18. We continue to meet the criteria for application of FASB Statement No. 71.

19. Funds held for respective trust accounts are sufficient to service and redeem defeased bonds.

20. Tax-exempt bonds issued have retained their tax-exempt status.

21. Equity components (invested in capital assets, net of related debt; restricted; and unrestricted) are properly classified.

22. We have no plans or intentions that may affect the carrying value or classification of assets and liabilities.

23. Risks associated with concentrations, based on information known to management, that meet all of the following criteria have been disclosed in the financial statements:

    a. The concentration exists at the date of the financial statements.
    b. The concentration makes the enterprise vulnerable to the risk of a near-term severe impact.
    c. It is at least possible that the events that could cause the severe impact will occur in the near term.

24. The accounts receivable recorded in the financial statements represent valid claims against debtors for sales or other charges arising on or before the balance sheet date and have been appropriately reduced to their estimated net realizable value.

25. We are responsible for determining and maintaining the adequacy of the allowance for doubtful notes, loans, accounts receivable, unbilled revenue and incurred but not reported claims, as well as estimates used to determine such amounts. Management believes the allowances are adequate to absorb currently estimated bad debts in the account balance.

26. We believe that all expenditures that have been deferred to future periods are recoverable.

27. Provision has been made for any loss to be sustained in the fulfillment of, or from inability to fulfill, any sales commitments.

28. We have no intention of terminating our participation in the Seattle City Employee's Retirement System (SCERS) or withdrawing from any multi-employer plans, or taking any other action that could result in an effective termination or reportable event for any of the plans. We are not aware of any occurrences that could result in the termination of any of our participation in the "SCERS" defined benefit plan or multi-employer plans to which we contribute. We believe that the actuarial assumptions and methods used to measure the pension liabilities and costs for financial accounting purposes are appropriate in the circumstances.

29. We agree with the work of specialists in evaluating the pension liabilities, other post employment benefit liabilities, pollution remediation liabilities, provision for injuries and damages, and have adequately considered the qualifications of specialists in determining amounts and disclosures used in the financial statements and underlying accounting records. We did not give any instructions, nor cause any instructions to be given, to specialists with respect to values or amounts derived in an attempt to bias their work, and we are not aware of any matters that have affected the independence or objectivity of the specialists.

30. We have complied with GASB No. 49, and believe that the estimate made for our pollution remediation liability is in accordance with this standard and reflects all known available facts at the time it was recorded.

31. Provision has been made for any loss to be sustained as a result of purchase commitments for inventory quantities in excess of normal requirements or at prices in excess of the prevailing market prices.

32. All charges to the property accounts consist of replacements or additions for the purpose of increasing capacity, extending facilities, reducing operating costs, or meeting changed operating conditions.

33. There were no items of physical property contained in the property accounts that were either (a) abandoned or (b) out of service and not regarded as either (i) standby property or equipment or (ii) property held for use only temporarily out of service, as that term is commonly understood in the public utility business.

34. The accumulated provision for depreciation has been determined in accordance with the orders of and the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission. Based on the present operating conditions and the probable lives of the properties, we believe that the provisions being made using the depreciation rates in effect will be adequate to depreciate the properties over their respective useful lives.

35. All regulatory assets and liabilities have been recorded in accordance with the orders or other guidance of the regulatory commission, and they are probable of recovery or refund in accordance with the provisions with FASB Statement No. 71. Regulatory assets represent incurred costs that are probable of recovery from future revenues. Regulatory liabilities represent amounts imposed by rate actions of the regulators that

may require refunds to customers, represent amounts provided in current rates that are intended to recover costs that are expected to be incurred in the future for which we remain accountable, or represent a gain or other reduction of allowable costs to be given to customers over future periods.

36. Under the deferred compensation plan offered to City employees and officers, we do not accept nor assume any of the risks associated with the Plan and its administration.

37. All purpose and eligibility requirements have been met to assure proper recognition of capital fees and grant revenue in connection with the standards outlined by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions.*

38. We properly disclosed the economic gain, cash savings, and accounting loss as a result of advanced refunding of revenue bonds in accordance with GASB Statement No. 7, *Advance Refunding from Defeasance of Debt.* The accounting losses for bonds refunded have been properly deferred in accordance with GASB Statement No. 23, *Accounting and Financial Reporting for Refunding of Debt Reported by the Proprietary Activities.*

39. Interfund activity and balances have been appropriately classified and reported.

40. Special and extraordinary items are appropriately classified and reported.

41. Deposits and investment securities are properly classified in category of custodial credit risk.

42. Required supplementary information (RSI) is measured and presented within prescribed guidelines.

43. No events have occurred subsequent to the balance sheet date that would require adjustments to, or disclosure in, the financial statements except as stated in Note 16 as of the date of this letter.

44. We have appropriately applied the provisions of FASB Statement No.157, Fair Value Measurements, to the applicable assets and liabilities that are reported or disclosed at fair value at year end. We believe the inputs are observable and standard in the industry and that the most appropriate valuation models were used. These same or comparable inputs and approaches were used for reporting assets and liabilities on the balance sheet in the prior year.

a. Forward energy expected under power exchange contracts were reported at fair value based on an income valuation approach using forward electric power curves from Platts subscription services.

Sincerely,

Jorge Carrasco
Superintendent

Phil Leiber
Chief Financial Officer

Fernando G. Estudillo
Manager, General Accounting

FE:feb

Enclosure

## CITY OF SEATTLE - CITY LIGHT DEPARTMENT

SUMMARY OF PASSED ADJUSTING JOURNAL ENTRIES
December 31, 2009 and 2008

| | 2009 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Financial Statements Effect - Increase (Decrease) to Financial Statement Total | | | | | | | | | |
| | Current Assets | Long-Term Assets | Total Assets | Current Liabilities | Long-Term Liabilities | Total Liabilities | Total Net Assets | Total Revenues | Total Expenses | Net Income |
| Total Net Audit Differences | $ 617,932 | $ 1,586,468 | $ 1,410,860 | $ - | $ 793,540 | $ 793,540 | $ 617,320 | $ (1,038,764) | $ (617,320) | $ (421,444) |