



OFFICE OF THE CITY AUDITOR COLORADO SPRINGS, COLORADO

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17-19 Colorado Springs Utilities Allowance for Funds Used During Construction (AFUDC)

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Purpose

The purpose of this audit was to ensure adequate controls were being used related to the accurate calculation and reporting of the Allowance for Funds Used During Construction (AFUDC).

Highlights

We concluded Colorado Springs Utilities (Utilities) controls to ensure the method of computing AFUDC and the accounting entries made as a result of the calculation were adequate. During our review, we identified and communicated to management minor process improvements to which management agreed.

AFUDC is a component of construction costs representing the net cost of interest on borrowed funds used during the period of construction. If not capitalized, the interest would be expensed in the current year. Once the project is placed in service, all accumulated construction costs are capitalized as an asset. Capitalized assets are depreciated on the financial statements over the life of the asset. Treatment of capital asset construction costs for rate making depends on the method used to finance a project.

The AFUDC rate was recalculated annually and applied to the balance of Construction Work in Progress (CWIP) each month for those projects meeting certain criteria. The 2016 AFUDC rate was 4.17% and applied on multiple construction projects in the amount of \$10.9M. Interest paid on Southern Delivery System (SDS) specific revenue bonds was capitalized rather than using an AFUDC rate. In 2016, \$5.8M in interest costs were capitalized to the SDS program bringing the total SDS capitalized interest to \$93M.

In our review, we found immaterial miscalculations that appear to have been caused by miscommunication or timing of communications. These minor errors were communicated to management.

Opportunity for Improvement

Utilities currently includes only direct costs in applying the AFUDC rate. We recommend Utilities consider including all costs associated with a project rather than just direct costs. For rate making purposes, debt service and cash funded capital are part of the cost of service and they represent a recovery of capital and debt used to acquire capital assets. By applying AFUDC only to direct costs, some interest cost was included in the current year cost of service rather than being matched to the life of the asset. The impact of including indirect costs in the application of AFUDC was not calculated for this review..

Management Response

Management agrees to review the possibility of including indirect costs when applying the AFUDC rate.

This audit was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing, a part of the Professional Practices Framework promulgated by the Institute of Internal Auditors.