



City Council's Office of the City Auditor

Date: April 15, 2010
To: Mayor and City Council Members
Re: Water Rate Phase-in Program

The Office of the City Auditor (OCA) has reviewed the Water Rate Phase-in Program submitted to City Council by Colorado Springs Utilities (Springs Utilities) on March 23, 2010. The case is scheduled to be heard during a public hearing on April 27, 2010.

Executive Summary

The purpose of this review is to evaluate whether Springs Utilities prepared the submitted Water Rate Phase-in Program in a manner which is adequately supported and consistent with previous policy direction of City Council. As this is the first time such a Water Rate Phase-in Program is being presented, staff reviewed the information Springs Utilities is submitting as Schedule 1 and the supporting documents for the Schedule. This review is not an audit, but rather a review of the inputs to and calculations embedded within Springs Utilities' 10-year Financial Forecast Model (Model).

The main purpose of the Multi-Year Water Rate Program is to provide financing to support the Southern Delivery System (SDS). Accordingly, staff reviewed the cost projections associated with SDS. Attention to Development Charges (also known as Development Fees) was also included in this review.

This review is focused on four main issues:

1. Does the data in the 10-year Financial Forecast Model support the data in Schedule 1?
 - Answer – Yes
2. What is the cumulative total amount of projected new revenue generated by 12% increases for each of the years 2011 to 2016?
 - Answer – \$383,495,000
3. What is the cumulative total amount of projected new revenue generated by the 12% increases for each of the years 2011 to 2016 that will be spent on SDS?
 - Answer – Approximately 78.5% totaling \$300.9 million. The remaining 21.5% totaling \$82.6 million will go toward the general water system.
4. Are Development charges appropriately incorporated into the Model?
 - Answer – Yes, but the data needs to be updated.

INTERIM CITY AUDITOR, DENNY L. NESTER, MBA CPA CIA CGFM CFE CGAP

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Authorization

The OCA conducted this examination under the authority of Chapter 12, Article 1, Part 107 and Rules and Procedures of City Council as adopted by Resolution 20-00. These documents state:

“12.1.107: REGULATION OF ELECTRIC, STREETLIGHT, NATURAL GAS, WATER AND WASTEWATER RATES, CHARGES AND REGULATIONS:

C. Adopted By Resolution; Hearing: Base rates or regulations or any change shall be adopted by resolution, which shall adopt by reference the appropriate tariff sheet or sheets to be established or revised.

1. Preliminary Information For The City Auditor And City Attorney: When Utilities proposes to change base rates, and the proposed change will result in the determination of a new revenue requirement supported by a cost of service study, Utilities will provide a draft of the proposal and cost of service study to the City Auditor and the City Attorney at least thirty (30) days prior to filing the proposed resolution with City Council. When changes to base rates are proposed, but do not involve a cost of service study, a draft of the proposal will be provided to the City Auditor and the City Attorney seven (7) days prior to the filing of a proposed resolution. Any request for additional information by the City Auditor and any response by Utilities, will be in writing. Drafts of the proposed resolution and tariff sheets will be provided to the City Attorney seven (7) days prior to filing of the final proposed resolution with City Council.”

Rules and Procedures of City Council, adopted by resolution 20-00:

“Part 4 – UTILITIES PRICING AND TARIFF HEARING PROCEDURE

1. HEARING PROCESS

A. Pre-hearing Procedures

4) If the change in pricing is supported by a cost of service study, Utilities shall provide a draft copy of the proposal and cost of service study to the City Auditor at least thirty (30) calendar days prior to the filing. If the proposed changes do not require a supporting cost of service study, Utilities shall provide a draft of the proposal to the City Auditor seven (7) calendar days prior to the filing of the proposed resolution. If the City Auditor chooses to file a report on the proposal, such report shall be filed with the City Clerk and Utilities at least five (5) calendar days prior to the public hearing.”

Background and Scope

On October 13, 2009, Springs Utilities submitted a Water Rate Case. The submittal included a cost of service study supporting the 2010 rates and, using 2010 rates as a base, applying annual increases of 12% for the period 2011 to 2017. A public hearing for all years was set for November 24, 2009. However, Springs Utilities subsequently requested the public hearing exclude years 2011 to 2017 and indicated those years would be brought back at a later date. Springs Utilities is now proposing a public hearing for years 2011 to 2012 be set for April 27, 2010, with future years to be brought back at a later date.

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Multi-Year Water Rate Phase-in Program

1. Does the data in the 10-year Financial Forecast Model support the data in Schedule 1?

Springs Utilities has developed a complex 10-year Financial Forecast Model (Model), that the Financial Planning and Pricing unit is responsible for managing/updating. The City Auditor's 2009 Audit Plan included a performance audit of the Financial Planning and Pricing unit. While that audit was started in 2009, it is being performed in four stages and will not be completed until 2011. In reaching the opinion in this report, staff reviewed the portions of the Model that relate to Water.

After reviewing the Model and other information supporting the increases, we are issuing an opinion the Model supports the financial information contained in Schedule 1.

2. What is the cumulative total amount of projected new revenue generated by 12% increases for each of the years 2011 to 2016?

As indicated in the Rate Program Filing for 2011 and 2012, the cumulative effect of the 12% rate increases for each year from 2011 to 2016 is to generate about \$383.5 million dollars of new revenue. For the years 2011 and 2012, the anticipated revenue is approximately \$45.5 million.

We agree that the Model supports the financial information contained in Schedule 1.

3. What is the cumulative total amount of projected new revenue generated by the 12% increases for each of the years 2011 to 2016 that will be spent on SDS?

The magnitude of the SDS project and the need to provide adequate funding, coupled with the desire to reduce the impact of the project on existing and future customers necessitates a phased in approach. A 12% increase for the period from 2011 to 2016 equates to a 97% increase in rates over the current (2010) rates. We also acknowledge (and support) Springs Utilities presentation of a levelized approach to cover projected costs for the 2011 to 2016 period.

Of the \$383.5 million in additional revenue anticipated from the increased rates, approximately \$300.9 million is expected to go toward SDS while \$82.6 million will go toward the general water system.

4. Are Development Charges appropriately incorporated into the model?

Historically, Development Charges have been used to offset operations and maintenance charges. However, starting with the 2009 Water Rate Case, Springs Utilities began using Development Charges to offset capital improvements spending as recommended by the Utilities Policy Advisory Committee (UPAC) and approved by the Utilities Board. Development Charges were last calculated for a rate case in 2007 for implementation in 2008. However, due to a declining economy, these fees were implemented over 2 years, resulting in a partial increase in both 2008 and 2009. The current rate is \$9,292 per single family equivalent. The Model is forecasting increases of approximately 9.2% in 2011 and 4.9% in 2012, but these rates are subject to change once a new development charge study is completed.

We recommend Springs Utilities conduct a complete Development Charge study in 2010 and bring any material changes back to City Council for approval.

Conclusion

The OCA found that the Model supports the financial information contained in Schedule 1 and agrees with the figures provided by Springs Utilities. It has been clearly stated that 78.5% of the anticipated revenue will go toward the SDS program, while 21.5% is slated for the remainder of the general water system. Development Charges were incorporated into the Model; however, we recommend that a complete Development Charge study be completed in 2010 with the results reported to City Council.

In addition, we recommend that Springs Utilities annually provide an update and report on the financial model to the OCA. The reports should address the annual revenue requirement surplus and deficiencies based on forecasted projections compared to actual results. The OCA also suggests the report determine if current cost allocation factors between water service rate classes are still appropriate to ensure that each rate class is responsible for its equitable share of the water system revenue requirement. The OCA has discussed this with Springs Utilities and they agree with this recommendation.

Closing

In closing, I would like to acknowledge the tremendous effort put forth by my staff and the staff of Colorado Springs Utilities. As always, please let me know if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Denny Nester". The signature is fluid and cursive, with the first name "Denny" being more prominent than the last name "Nester".

Denny Nester
Interim City Auditor

Cc: Jerry Forte, Chief Executive Officer, Colorado Springs Utilities
Bill Cherrier, Chief Planning and Financial Officer, Colorado Springs Utilities
Stella Chan, Manager, Financial Planning and Pricing, Colorado Springs Utilities