



Office of the City Auditor

Date: November 14, 2006

To: Honorable Mayor and Members of City Council
Kathy Young, City Clerk

Re: 06-230 - 2007 Rate Case Review Report
06-263 – Meter Ratio Audit Report

AUTHORIZATION

We have reviewed the rate cases and tariffs submitted to you by Colorado Springs Utilities (Springs Utilities). These rate cases included the Wastewater Cost of Service, Water Development Charge, Water and Wastewater Reconnection Charges and Electric Cost Adjustment. The filings are scheduled to be heard during your November 28th meeting. We also audited the Meter Ratio Review prepared by Springs Utilities as a result of direction received during the 2006 Rate Case Reviews.

We 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.

CITY AUDITOR JEFF LITCHFIELD, CPA CIA CFE

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D. Procedure To Change Certain Rates Or Charges And Authorize Refunds By Resolution Without Notice And Public Hearing:

1. When Utilities proposes changes for electric cost adjustments or gas cost adjustments, the drafts of the proposal, the proposed resolution and tariffs will be provided to the City Auditor and City Attorney seven (7) days before filing 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

Springs Utilities periodically files rate adjustments with the City Council. These rates become the basis for bills produced by Springs Utilities and are it’s primary revenue source. When rate changes are proposed, they are reviewed by the City Auditor.

The purpose of the audit is to evaluate whether Springs Utilities had prepared the submitted Rate Cases and Cost Adjustment in an accurate and consistent manner.

The audit was conducted in a manner that met or exceeded the Standards of the Professional Practice of Internal Auditing, a part of the Professional Practices Framework promulgated by the Institute of Internal Auditors. The audit included such tests of records and other supporting documentation as we deemed necessary in the circumstance.

Overall, the filings appear to be in line with the direction provided by the Executive Limitations and are fairly consistent with prior filings. However, there are a few areas where comments are warranted.

Our comments are based on information submitted to our Office as of 1:00 p.m. November 14, 2006.

METER RATIO REVIEW AND WATER DEVELOPMENT CHARGE

1. In last year's report, we noted the Black and Veatch (B&V) Study, which is used in determining the Water Development Charge, was based on 1995 consumption data. We recommended the study be updated with recent information and multiple consumption periods (i.e. three to five year averages) be incorporated to smooth out any anomalies in consumption patterns. Springs Utilities prepared the study and elected to use a three year consumption average. We reviewed the study and agreed with the methodology used and the accuracy of the calculations.

The Water Development Charge for 2007 was calculated using the results of the study, however, Springs Utilities elected to continue using the B&V Study data in the actual rate proposed to be charged to customers. The impact of this can be seen in Table 6 of the Water Development Charge Study tab of the 2007 Rate Case Filing. On page 2 of that report, the data in Column 7, rows 46 to 60 show the Indicated Charge, which is the calculated result of the Cost Study using data primarily based on a three year consumption average of years 2003 to 2005. Column 8 of those same rows shows the Proposed Charge based on B&V third year phase-in.

2. An additional comment on the Water Development Charge is the method of phasing in the B&V Study. In the 2005 and 2006 Rate Cases, Springs Utilities took the position the phasing in of the Water Development Charges based on the B&V Study was to be done in 20% increases each year until the B&V Study Ratios were reached. In preparing the 2007 Study, they have taken the position the Study should be phased in over a five year period with each meter size increasing in an amount to arrive at the B&V Study Ratio at the end of the five year period.

In a letter to the Colorado Springs Utilities Board dated July 14, 2004, the Chair of the Utilities Policy Advisory Committee made the following comment regarding this issue:

"The Utilities Policy Advisory Committee (UPAC) recommends that the Utilities Board should establish a goal to fully implement the February 1999 Black and Veatch recommended demand ratios to close the gap for commercial water meter development charges within five years".

The letter to the Colorado Springs Utilities Board was presented to the Board at the July 21, 2004 meeting. The following is an excerpt from the Minutes of the Colorado Springs Joint Meeting of the Utilities Board and Utilities Policy Advisory Committee for Wednesday, July 21, 2004:

"Mr. Tollefson reviewed the outcome of the discussion on the recommendation by stating that he believed that the Utilities Board was asking Springs Utilities to do the following: incorporate into the preparation of their next rate case the UPAC recommendation for implementing the Black & Veatch study on commercial and industrial charges by 20% in each of the next five years"

In a letter to the Colorado Springs Utility Board dated January 12, 2005, the Chair of the Utilities Policy Advisory Committee made the following comment regarding this issue:

"As a result of UPAC's recommendations, Utilities Board directed Colorado Springs Utilities to phase in the 1999 B&V recommendations no less than 20% per year in no more than five years beginning with the 2004 rate filing".

We believe the current method of calculating the implementation of the B&V Study is more in line with the intentions of UPAC.

3. A third comment for this area again focuses on the implementation of the charge. In reviewing the details supporting the calculation, we found the B&V calculated fee for a ¾" or less meter to be 1.21% less than the charge being proposed and the B&V calculated fee for a 1" meter to be 3.19% less than the charge being proposed. We also found the calculated fee for the 5,000 to 6,999 sf lot size to be 6.42% less than the charge being proposed and the calculated fee for the 7,000 to 8,999 sf lot size to be .81% less than the charge being proposed.

WATER RECONNECTION CHARGE

1. The Water Reconnection Study Schedule shows the proposed Tariff for 2007 but does not show the current rate as a comparison. We believe it important to point out the charges for the 6" meter and 8" and larger meter categories are proposed to change by -25% and 122% respectively. The remaining meter size changes are in the 7% to 15% range. We explored the reason why the 6" and 8" and larger meter categories were not in line with the other meter sizes and found the consumption data submitted with last year's Study was substantially different than the data submitted with this year's Study. Upon further testing, we believe the data submitted with this year's Study is the most accurate. As far as we can tell, there were no reconnections for inactive service in either the 6" or 8" and larger meter categories in 2006.

In the section of this report entitled "Overall" is a discussion on our plans for a new process to review consumptions and meter counts each year. Once implemented, this step should provide historical data that does not change from year to year.

2. Because the perceived amount of activity in this rate class is rather low, we believe this Study should not be done on an annual basis. We recommend the number of inactive accounts that reactivate in the 2 to 9 year period the rate covers be tracked over the next few years and a determination be made as to how often this study should be done.

WASTEWATER RECONNECTION CHARGE

1. The Wastewater Reconnection Study Schedule shows the proposed Tariff for 2007 but does not show the current rate as a comparison. We believe it important to point out the charges are proposed to change by -15.77 to 50.01%, as follows:

Meter Size	Existing	Proposed	% Change
¾ inch or less	114.00	111.00	-2.63
1 inch	139.00	143.80	3.45
1 ½ inch	209.00	215.20	2.97
2 inch	277.00	301.40	8.81
3 inch	502.00	560.20	11.59
4 inch	959.00	807.80	-15.77
6 inch	1,988.00	1,735.60	-12.70
8 inch or greater	16,863.00	25,296.40	50.01

We explored the reasons for these changes and, similar to the Water Reconnection Study, found the consumption data submitted with last year's Study was substantially different than the

data submitted with this year's Study. Upon further testing, we believe the data submitted with this year's Study is the most accurate.

In the section of this report entitled "Overall" is a discussion on our plans for a new process to review consumptions and meter counts each year. Once implemented, this step should provide historical data that does not change from year to year.

2. Because the perceived amount of activity in this rate class is rather low, we believe this Study should not be done on an annual basis. We recommend the number of inactive accounts that reactivate in the 2 to 9 year period the rate covers be tracked over the next few years and a determination be made as to how often this study should be done.

WASTEWATER

1. The wastewater charge for customers located outside the City is 1.5 times that of a customer located within the City. The current tariff only applies the 1.5 factor to the daily service charge and not to the normal quantity charge. The 2007 rate case proposes the 1.5 times rate apply to the normal quantity charge. While we agree the surcharge factor should apply to the normal quantity charge, we believe it important to identify that approximately 225 outside residential customers will receive rate increases that average about 40% and another 25 outside non-residential customers will receive rate increases that average about 55%.

ELECTRIC COST ADJUSTMENT

1. The Electric Cost Adjustment (ECA) contains a calculation for the over- or under- collected amount as of the most recently completed month. The expense or cost portion of the calculation is based on the actual costs as of the end of the month while the revenue portion of the calculation is based on the consumption that has been billed through the end of the month. This means the ECA calculation for actual over- or under- collections will always be off by the amount of unbilled consumption at the end of the most recent completed month.

2. The Tariff governing the calculation of the ECA is Sheet 31 of the Electric Rate Schedules. An excerpt is as follows:

The ECA will be computed, as follows:

The sum of:

- a) the projected cost of purchased power and generation fuel for the future recovery period, divided by
- b) the projected retail kWh sales subject to the ECA for the same period used in a) above.
Plus:
- c) the cumulative under- or over-recovery of purchased power and generation fuel costs used to serve customers subject to the ECA, divided by
- d) projected retail kWh sales, subject to the ECA for a period to be determined by Springs Utilities.
Minus:
- e) the base cost of purchased power and generation fuel in the current retail electric rates.

We recalculated the proposed rate based on the tariff and arrived at a result that was the same as that proposed by Springs Utilities. We did notice the base cost of purchased power and generation fuel in the current retail electric rates mentioned in step e) is a rate that was originally calculated in 2003 and adopted via the Modified Rate Case approved in 2004. In our discussions with Springs Utilities, they have indicated the rate will be reviewed in the near future. We encourage that review.

OVERALL

1. The City Auditor's Audit Plan for 2006 contained the following audits:

06-231 - Consumption Data Review

Springs Utilities annual rate filings are based, in part, on consumption information obtained from their internal data systems. The purpose of this audit is to review the historical consumption and meter count data prior to rate filings.

06-258 - Rate Filings - Post Adoption Review

The purpose of this audit is to review the impact of adopted rate changes to determine how effective they were in producing the revenue needed to operate the system. There will be a two year offset of rates reviewed, for example in 2006, we will review the impact of the rate changes adopted in 2004, effective for 2005.

Because Springs Utilities is currently developing a new Customer Information System (CIS 20/20), we decided to not perform these audits this year. It is our intent for them to become annual reviews and we will perform them once the new system is operational.

We believe the first audit, the Consumption Data Review, will have a very positive impact on our ability to review rate cases presented to Council. By providing consistency in consumption and meter counts from year to year, the time we spend verifying that information will be reduced.

The second audit will allow us to analyze the effectiveness of decisions made during the rate making process.

2. Once the new system (CIS 20/20) is operational and we start gathering consumption and account data from the system (via the consumption data review project mentioned above), we recommend Springs Utilities establish a Single Data Source for this and other data used in their rate cases. This process could be performed in the spring, once the activity for the year has been concluded. The consumption and other account data would be extracted from the system for any and all components of the system that might be needed as historical data in a future rate case. This process would help in several ways including speeding up the rate review process because we would have already audited the consumption data.

CONCLUSION

In conclusion, we will restate that overall, the filings appear to be in line with the direction provided by the Executive Limitations and are consistent with prior filings. Springs Utilities Pricing Staff have worked diligently to prepare rate cases that are thorough and complete. However, we continue to have a concern with the consistency of some of the consumption amounts used in calculating the rates. We believe the incorporation of the recommendations in this letter, especially the establishment of a Single Data Source, will improve our comfort level with the consumption data and how it fits into the overall rate making process.

We thank Springs Utilities and especially their Pricing Department for their cooperation during this review.

Please contact me if you have any questions regarding this report.

Sincerely,



Jeff Litchfield
City Auditor

cc: Jerry Forte, Utilities Executive Director
Edward Easterlin, Chief Planning & Finance Officer
Stella Chan, Manager Pricing and Forecasting
Cathy Rezendes, Corporate Economist
Jeanne Brown, Utilities Continuous Improvement Manager
Sandi Yukman, Integrated Resources Division Officer
Henry Henderson, Principal Pricing Analyst