



Office of the City Auditor

Date: November 19, 2009

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

Re: ⁰⁹⁻¹⁹ 2010 Rate Case Filing Review Report for Electric, Water, and Wastewater Rates

We have reviewed the rate cases, cost of service studies and tariffs submitted by Colorado Springs Utilities (CSU). These filings included the Electric Service Cost of Service Study, Water Service Cost of Service Study, and Wastewater Service Cost of Service Study. The filings are scheduled to be heard during a Public Hearing on November 24, 2009. This report contains our comments on the information we reviewed. Please note that the Executive Summary and Electric Service Report submitted with these filings include anticipated ECA/GCA summary data. While our review included a review of preliminary data, we plan to submit a separate report on the ECA and GCA when they are filed.

EXECUTIVE SUMMARY

The purpose of our audit was to evaluate whether CSU prepared and submitted the cost of service studies supporting the rate cases in an accurate and consistent manner. The major elements of the cost of service studies are expected expenses and revenues for the coming year based on the budget and sales forecasts.

Our review for accuracy generally focuses on the mathematical accuracy of the calculations within the cost of service studies. Projected operations and maintenance expenses per the cost of service study are agreed to the budget submitted to Council for the coming year and to the cost of service model. Because the cost of service study is based on expected revenues and expenses for the coming year, our review did not include verification to the accounting records.

Our review for consistency compares data submitted this year with that submitted in prior years.

A summary of our findings are as follows:

We noted that electric revenues from wheeling were not included in the electric case. Although wheeling is not a significant source of revenue (\$964,718 in 2008), CSU should include all electric revenue sources when developing electric rates. Prior to the 2011 case, we recommend that CSU ensure all electric revenues are properly considered in the cost of service study that supports the electric case.

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CSU implemented a new definition of the ECA which resulted in significant reclassification of costs and revenues from the 2010 Electric Cost of Service Rate Case into the ECA. During our review, we noted instances where \$5,066,144 in costs were included both in the 2009 electric base rates and the proposed ECA as reflected in the Executive Summary and Electric Service Report submitted with this filing. CSU has indicated that they will be correcting this duplication in the ECA filing planned for early December. Due to the potential for errors related to reclassification, we recommend greater review and coordination efforts for staff preparing ECA/GCA and cost of service studies. This coordination should ensure costs are not duplicated and recovered in both base and ECA/GCA rates.

Payment in Lieu of Taxes (PILT) rates were not increased in the last Electric and Gas Cost of Service Study base rate case filings as required by Council Resolution 205-00, resulting in underpayment of PILT to the City. The electric rate case as presented does not include an automatic increase "to reflect subsequent changes in the base rates for natural gas and electric service as approved by Council." (From Resolution 205-00) The current base electric rate case filing proposes an increase of 9.4% to base electric rates. Non-ECA electric rates increased 13.71% effective February 1, 2009 and Non-GCA gas base rates increased 11.28% effective in January 1, 2008. However, PILT, which is collected per unit of Mcf or kWh delivered, was not automatically increased at the time of these three rate case filings.

The Office of the City Auditor is currently reviewing this PILT issue separately. The review of PILT is complicated by an Executive Agreement signed in April 2007. At this time, we are working with the City Attorney to determine the impact of that Executive Agreement on PILT adjustments. While the recent voter approval of Ballot Issue 300 may impact the payment of PILT to the City, the calculation of the amount of the PILT per kWh of electricity and Mcf of natural gas delivered should be accurate and up to date. The City Auditor plans to issue a separate report on PILT adjustments and related calculations.

AUTHORIZATION

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

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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

CSU periodically files rate adjustments with City Council. These rates become the basis for customer bills produced by Colorado Springs Utilities and are its primary revenue source. When rate changes are proposed, they are reviewed by the City Auditor. The rates are developed from 2010 Budget information with considerations for forecasting capital projects, financial ratios and funding activities. Since this is not historical data, it is not verifiable to accounting records.

CSU's last base electric service rate case was approved by City Council in January, 2009. For the 2010 electric rate filing, some costs and revenues were reclassified from electric base rates into the Electric Cost Adjustment (ECA).

As described in the Executive Summary of the 2010 Electric Service Rate Case filing, CSU performed an analysis that resulted in a change to the ECA and GCA definitions and purpose. These changes were approved by CSU management and documented in policy QBD 12652. This policy change resulted in significant reclassification of costs and revenues from the 2010 Electric Cost of Service Rate Case into the ECA. This reclassification should allow for more responsive pricing changes by modifying the ECA if there are major shifts in variable costs associated with fuel, power production, and purchased power.

The City Auditor has been noting changes in the composition of ECA and GCA filing for several years. The prior City Auditor noted the following in his report to Council on September 20, 2002, "Utilities has changed something in the methodology every year. I think it would be advisable and in the best interest of the ratepayers to have some stability and consistency in the

ECA and GCA ratemaking methodology." It is our understanding that the recently adopted policy related to ECA and GCA should be consistently applied going forward and significant changes in the composition of the ECA and GCA are not anticipated.

OVERALL OPINION

Overall, the filing appears to be in line with the direction provided by the Executive Limitations and is fairly consistent with prior filings.

We thank CSU and especially the Pricing and Forecasting Department for their cooperation during this review.

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

Sincerely,



Denny L. Nester
Assistant City Auditor

cc: Jerry Forte, Chief Executive Officer
Stella Chan, Manager, Pricing and Forecasting
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