



Office of the City Auditor

Date: November 18, 2010

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

Re: 2011 Rate Case Filing Review Report for Electric and Gas Rates

We have reviewed the rate cases, cost of service studies and tariffs submitted by Colorado Springs Utilities. These filings included the Electric Service Cost of Service Study, Capacity Charge and Gas Service Cost of Service Study. The filings are scheduled to be heard during a Public Hearing on November 23, 2010.

BACKGROUND AND SCOPE

The purpose of our audit was to evaluate whether Colorado Springs Utilities 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 revenue requirements for the coming year based on the budget and sales forecasts. In addition to annual operating expenses, revenue requirements included a) debt service, b) PILT transfers, c) working capital, and d) a capital improvement fund, which consists of capital expenditures to be cash funded and additional cash balances requested by Colorado Springs Utilities to meet financial metrics.

Our review for consistency compared data submitted this year with that submitted in prior years. The focus of the review was on identifying any significant changes that might have been made to the methodology used as a basis for projected revenue requirements. Our review for mathematical accuracy focused on the calculations within the cost of service studies.

Projected operations and maintenance expenses per the cost of service study were agreed to the budget submitted to Council for the coming year and to the cost of service model. The cost of service study was based on expected (budgeted rather than historical) revenues and expenses as well as cash flow needs for the coming year. It did not include a true-up of forecasted sales and costs in prior years to actual financial results.

The scope of the Office of the City Auditor (OCA) review does not extend to cost analysis or review of budget assumptions. The timing of the budget and rate case calendars did not allow for review of budget assumptions. Review of the methodology used to allocate administrative and general costs to each service was also not within the scope of this review.

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FINDINGS AND RECOMMENDATIONS

Timing of Budget Completion

Colorado Springs Utilities' Budget and Rate calendars were planned to ensure the budget process is completed prior to generating the cost of service study. This year, the budget was not finalized by the date indicated in the budget calendar and changes to the 2011 budget took place after rates were submitted to Council. Colorado Springs Utilities' elected not to resubmit rate cases based upon the finalized budget as they considered the change to not be significant. We concur that the amount is not significant.

While these final budget changes would not have had a significant impact on proposed rates, the City Auditor's Office recommends that the budget be finalized by the date in the budget calendar. This should ensure rates are based on the final approved budgets and allow time for quality assurance reviews.

OBSERVATIONS RELATED TO 2011 RATE CASES (SEE COLORADO SPRINGS UTILITIES RATE REPORT FOR MORE DETAILED INFORMATION)

Electric Rate Case Observations

- **Miscellaneous Transmission Revenues:** Similar to Wheeling Revenues, which were not included in the previous rate case, we noted miscellaneous transmission electric revenues were not included in the electric cost of service study. Although these were not a significant source of revenue (\$2.4 million in 2009), Colorado Springs Utilities should include all electric revenue sources when developing electric rates. These revenues were not budgeted. The revenues will require investigation to determine whether related expenses exist and how to appropriately handle the revenues in the cost development of customer rates. Colorado Springs Utilities has agreed to investigate these revenues and acknowledges them as study items for future filings. See item 7(b) in the 2011 Electric Service Report.
- As noted in Colorado Springs Utilities' rate report, 2011 Capital spending and Operations and Maintenance expenses are comparable to 2010 levels.
- Additionally, an increase to the Electric Capacity Charge (ECC) of between 2.6% and 5.5% depending on customer class is proposed to take effect January 1 to recover underfunded costs and recover expected increased capacity costs.
- As noted in the Colorado Springs Utilities' 2011 Rate Case Filing Report, the proposed Front Range Power (FRP) purchase is expected to reduce capacity costs significantly. Colorado Springs Utilities has proposed calculating estimated savings when FRP is purchased and returning savings, as well as, true-up of any under or over-collected electric Capacity Charge (ECC) balance to customers in 2011 through an ECC reduction. A proposed tariff change that redefines the ECC elements is proposed to take effect when FRP is purchased. Beginning in 2012, capacity costs would be included in base rates.

- An ECA refund of (.0067) per kWh is currently in place and is included in the typical customer bill. We understand that Colorado Springs Utilities' forecasts indicate that by the end of December, 2010, the ECA will be fully refunded to electric customers. The current ECA refund reduces the typical monthly customer bill by \$4.02 per for Residential customers, \$40.20 for Nonresidential customers and \$2,680.0 for Industrial customers.
- Rates for Industrial ELG, ECD and E8S rate classes did not agree to the cost of service model used to generate rate increases. As noted in Colorado Springs Utilities' Electric Service Report, item 5.(c) Rate Design, ELG, ECD, and E8T rates were adjusted from the Schedule 9 developed cost to the Schedule 10 assigned costs in the cost of service study model to smooth rates between industrial classes.
- The Streetlight tariff schedule rates for streetlight customers other than the City (SL1, SL2 and SL3) are proposed to increase by 7.9% which is comparable to the increase for the electric system increase in total. This increase was not based on a cost of service study and the City Auditor's Office was not provided data related to this increase. Colorado Springs Utilities' indicated that a full cost of service study will be done in 2011 to determine the correct cost.
- Subsequent to this Rate Filing, City Council approved a \$519,000 increase to the 2011 City Streetlight fee to turn on all residential streetlights. These amounts are therefore not included in the Electric Cost of Service and have not been reviewed by our office.

Gas Rate Case Observations

- Gas Base rates were last increased January 1, 2008. However, effective January 1, 2011, a redefinition of the Gas Cost Adjustment (GCA) will be implemented and significant costs and revenues will be reclassified from the base costs to the GCA. Costs that are now included in the GCA that were previously included in base gas rates when rates were last adjusted in 2008 total approximately \$1.8 million.
- A GCA refund of (.1499) is currently in place and significantly reduces typical gas bills. (The impact of the refund on a typical monthly customer bill is \$8.99 for residential customers, \$185.88 for nonresidential customers, and \$1,825.76 for industrial customers.) We understand that Colorado Springs Utilities anticipates the GCA will be fully refunded to customers in first quarter, 2011.

OTHER OBSERVATIONS

We want to recognize Colorado Springs Utilities' commitment to refund the over-collected Electric Cost Adjustment (ECA) and Gas Cost Adjustment (GCA) balances during 2010. The over-collected ECA balance was reduced from \$30.9 million to \$10.9 million in January through October, 2010. As gas prices were lower than forecasted, Colorado Springs Utilities increased the GCA refund three times in an effort to refund the GCA balance. The January and October, 2010 GCA over-collected balances were \$22 million and \$19.6 million, respectively, with a current \$(.1499) refund in effect as of November, 2010. The ECA and GCA Cost Adjustments represent a true-up of the base fuel related costs. These amounts are tracked separately from the non fuel costs considered in this Rate Filing.

Per Resolution 131-10, effective January 1, 2010, Council fixed electric and gas PILT rates at \$.006173 and \$.391539 per kwh and mcf delivered inside the City, respectively. The PILT rates will not be automatically adjusted when base rates change in the future.

A significant driver of proposed rate increases for 2011 is the change to a higher metrics requirement (debt coverage ratio of 2.25 in total) resulting in higher proposed cash and cash equivalent targets than in previous years. Colorado Springs Utilities' Rate Report notes this accounted for \$10.7 million of the increase in electric revenue requirements and \$8.0 million of the increase in gas revenue requirements. Colorado Springs Utilities' management provided our office with a Moody's U.S. Public Power Rating Methodology publication, which indicates 2.25 as a desirable debt service ratio.

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 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.”

OVERALL OPINION

Overall, the filing appears to meet the requirements in place through the Executive Limitations. We noted no material changes in the methodology used to support cost of service studies or in mathematical accuracy.

We noted the change in target metrics as a change in inputs compared to previous filings. We also noted the filing includes a proposed change in the electric capacity charge tariff to allow an adjustment to true-up savings from the proposed FRP purchase. Otherwise, the filing is fairly consistent with previous cost of service studies.

We thank Colorado Springs Utilities 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
Interim City Auditor

cc: Jerry Forte, Chief Executive Officer
Bill Cherrier, Chief Financial Planning and Financial Officer
Dede Jones, General Manager, Financial Services
Stella Chan, Manager, Financial Planning and Pricing
Dave Maier, Manager, Enterprise Risk Management
Henry Henderson, Principal Pricing Analyst