

March 2012



Special Request Results

Why We Did This Report

This memo responds to a request from Mayor Leffingwell to identify criteria the Office of the City Auditor (OCA) used in comparing Austin Energy's (AE) reserve fund targets to comparable reserve funds maintained by peer utilities. In addition, the Mayor asked that OCA work with AE to obtain concurrence on the comparison results.

What We Did

To complete this special request, we:

- Reviewed AE's utility reserves comparison, dated February 21, 2012.
- Interviewed AE personnel and reviewed supporting documents provided.
- Analyzed audited financial statements for peer utilities and contacted utilities for additional information.
- Prepared comparison based on the new set of peer utilities proposed by AE.



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SPECIAL REQUEST REPORT ON ELECTRIC UTILITIES RESERVE FUNDS COMPARISON

Mayor and Council,

I am pleased to present this special request report on Electric Utilities Reserve Funds Comparison.

Background

- On January 25, 2012, the Office of the City Auditor (OCA) presented the audit report of Austin Energy (AE) Rate Proposal. The report included a comparison of the reserve funds proposed by AE to existing reserve funds of peer utilities.
- AE prepared and presented an alternative comparison of the proposed reserve funds against peer utilities to Council on January 31, 2012.
- For this report, we based our analysis on AE's Proposed Comparison, provided to OCA on February 21, 2012 (see Attachment B).

What We Found

OCA's objective for this analysis was to fulfill Council's request to determine the reasonableness of reserve funds included in AE's current rate proposal. We accomplished this through a comparison of AE's proposed reserves to those for similar utilities, and by removing reserves that are not comparable to those in AE's proposal to determine the reasonableness of the requested reserves.

The analysis AE prepared focused on comparing AE's overall liquidity levels against its peer utilities. While similar, these comparisons are not the same. Therefore, OCA recommends that Council take into account the results from both analyses when considering the current rate proposal.

Targeted levels for reserve funds in AE's current rate proposal are higher than levels for comparable reserves maintained by the utility's peers, when measured as a ratio of reserves to revenues, as depicted by the following table (see Attachment A, Section IV for more details):

Ratio	Source	AE (Proposed)	Range for Peer Utilities	Weighted Average for Peer Utilities
Cash & Adjusted Reserves to Revenues	AE	38%	13% to 103%	35%
Comparable Reserves to Revenues	OCA	35%	2% to 22%	10%

As stated in our January 2012 audit report, the measure of reserves to revenues is not common in the industry. We selected this approach to level the field among various utilities while comparing reserve levels. Please see Attachment A, Sections I through III for OCA's full analysis.

There is no uniform standard or approach for how utilities establish and account for reserves. Reserve names and designations depend on management's intent, constraints related to bond issues, or legal requirements. Some utilities do not maintain reserve funds, while others label funds with ambiguous names.

Additionally, Council also asked for debt and liquidity measures for AE and similar utilities. OCA included January 2012 measures from FitchRatings for *Debt Service Coverage*, *Debt Ratio*, and *Days Cash on Hand* in our analysis (see Attachment A, Section V). In addition, we included the bond ratings for each utility.


Kenneth J. Mory, City Auditor

ATTACHMENT A

Electric Utilities Reserve Funds Comparison - Including Liquidity Measures

in (\$000s)

Comparable Community-Owned Utilities (Source: FY 2010 Audited Financial Statements)

Line #	Austin Energy (Proposed)	L.A. Dept. of Water and Power	City Public Service (San Antonio)	Sacramento Municipal Utility District	JEA (Jacksonville)	Memphis Light, Gas and Water Division	Seattle City Light	NES (Nashville)	Omaha Public Power District	OUC (Orlando)	Tacoma Public Utilities	Nebraska Public Power District	Clark Public Utilities	
I. Revenue Reconciliation														
1	Operating Revenues Reported by AE	\$ 1,145,071	\$ 3,235,193	\$ 1,930,875 ¹	\$ 1,323,288	\$ 1,909,776	\$ 1,705,513	\$ 732,978	\$ 1,063,155	\$ 986,350	\$ 863,814	\$ 366,853	\$ 925,141	\$ 497,468 ¹
2	Less: Other Utility Services (Water, Sewer, Gas)	-	-	-	303,241	424,028	-	-	-	-	-	-	-	-
3	Adjusted Revenues Per OCA	<u>1,145,071</u>	<u>3,235,193</u>	<u>1,930,875</u>	<u>1,323,288</u>	<u>1,606,535</u>	<u>1,281,485</u>	<u>732,978</u>	<u>1,063,155</u>	<u>986,350</u>	<u>863,814</u>	<u>366,853</u>	<u>925,141</u>	<u>497,468</u>
II. Reserve Reconciliation														
4	Cash & Adjusted Reserves Reported by AE	432,793	930,056	828,715	551,882	676,018	354,521	197,115	142,480	327,222	529,512	377,091	472,885	85,869
5	Less: Cash, Cash Equivalents and	80,077 ²	423,855	401,814	371,090	338,312	286,501	56,932	106,097	35,505	54,715	213,046	176,473	85,869
6	Adjusted Reserves	352,716	506,201	426,901	180,792	337,706	68,020	140,183	36,383	291,717	474,797	164,045	296,412	-
7	Add: Working Capital Reserve ³	51,668	162,175	101,195	111,056	95,122 ⁴	24,997	52,322	25,416	52,816	49,164	28,451	64,416	27,648
8	Adjusted Reserves with Working Capital included	404,384	668,376	528,096	291,848	432,828	93,017	192,505	61,799	344,533	523,961	192,496	360,828	27,648
Less : Reserve fund types not included in AE proposal:														
9	Capital Projects / Construction Funds	-	360,047	87,620	138,571	85,255	1,100	56,981	36,383	207,128	155,242	161,669	286,997	-
10	Employee Benefit	-	-	-	-	-	7,484	-	-	23,202	-	-	9,415	-
11	Self - Insurance	-	107,884	-	-	-	37,861	-	-	4,872	30,498	-	-	-
12	Customer Deposits	-	-	-	-	-	21,575	-	-	-	58,698	-	-	-
13	Rate Stabilization Fund with Offsetting Liabilities	-	-	-	-	90,000	-	-	-	-	164,564	-	-	-
14	Other	-	-	7,673 ⁵	-	111,014 ⁶	-	-	-	24,515 ⁷	14,700 ⁸	-	-	-
15	Adjusted Reserve Funds Per OCA	<u>\$ 404,384</u>	<u>\$ 200,445</u>	<u>\$ 432,803</u>	<u>\$ 153,277</u>	<u>\$ 146,559</u>	<u>\$ 24,997</u>	<u>\$ 135,524</u>	<u>\$ 25,416</u>	<u>\$ 84,816</u>	<u>\$ 100,259</u>	<u>\$ 30,827</u>	<u>\$ 64,416</u>	<u>\$ 27,648</u>
III. Summary of Adjusted Reserve Funds per OCA [AE's proposed reserves with comparable reserves maintained by peer utilities]														
16	Working Capital Reserve Fund	51,668	162,175	101,195	111,056	95,122	24,997	52,322	25,416	52,816	49,164	28,451	64,416	27,648
17	Contingency Reserve Fund	68,891	-	-	-	-	-	-	-	-	-	-	-	-
18	Emergency Reserve Fund	68,891	-	-	-	-	-	-	-	-	-	-	-	-
19	Rate Stabilization Fund	98,158	33,430	-	41,471	-	79,266	-	32,000	-	-	-	-	-
20	Repair & Replacement Fund	61,198	-	331,608	-	51,437	-	-	-	51,095	-	-	-	-
21	Non-Nuclear Decommissioning Reserve Fund	55,578	2,140	-	-	-	-	-	-	-	-	-	-	-
22	Other Comparable Reserve Funds	-	2,700	-	750	-	3,936	-	-	-	2,376	-	-	-
23	Adjusted Reserve Funds per OCA	<u>\$ 404,384</u>	<u>\$ 200,445</u>	<u>\$ 432,803</u>	<u>\$ 153,277</u>	<u>\$ 146,559</u>	<u>\$ 24,997</u>	<u>\$ 135,524</u>	<u>\$ 25,416</u>	<u>\$ 84,816</u>	<u>\$ 100,259</u>	<u>\$ 30,827</u>	<u>\$ 64,416</u>	<u>\$ 27,648</u>

IV. Calculated Ratios Against Revenues														Weighted Average	Median	
24	Cash & Adjusted Reserves to Revenues (Reported by AE) [line 4/line 1]	38%	29%	43%	42%	35%	21%	27%	13%	33%	61%	103%	51%	17%	35%	34%
25	Ratio of Adjusted Reserves to Revenues (Per OCA) [line 15/line 3]	35%	6%	22%	12%	9%	2%	18%	2%	9%	12%	8%	7%	6%	10%	9%

V. Liquidity Measures:*														Average	Median	
26	Debt Service Coverage	1.62	2.05	2.28	1.53	3.34	1.92	N/A	3.01	N/A	1.83	1.87	N/A	1.49	2.15	1.92
27	Debt Ratio	46.8%	57.5%	58.6%	84.7%	86.2%	44.9%	N/A	47.6%	N/A	63.4%	45.0%	N/A	55.2%	60.3%	57.5%
28	Days Cash on Hand	55	167	121	158	77	49	N/A	54	N/A	182	283	N/A	11	122	121
29	Bond Rating	AA-	AA-	AA+	A+	AA-	AA+	N/A	AA+	N/A	AA	AA-	N/A	A+		
* Source :Fitch Ratings, US Public Power Peer Study, Jan 2012																

Footnotes

- ¹ Revenues for CPS and Clark Public Utility included revenues for other services. Because OCA was unable to separate out the electric reserves, we did not remove the related revenues.
- ² The AE balance of cash, cash equivalents, and investments includes cash working capital plus FY 2011 unaudited customer and escrow deposits.
- ³ AE's rate proposal included a working capital reserve fund with a target balance of \$51,668. The target is based on 45 days of operations & maintenance costs, less fuel & purchased power. OCA used the same formula to estimate working capital reserves for the peer utilities.
- ⁴ OCA computed working capital for JEA based on total operating expenses due to not being able to remove water and sewer related portions.
- ⁵ OCA did not include reserves set aside for Project Warm, a utility assistance program established by CPS which is restricted to low income customers.
- ⁶ OCA did not include adjustment to fair value of investments, water reserves, or a revenue fund. The revenue fund has restrictions related to bond and commercial paper indentures.
- ⁷ OCA did not include the NC2 separate electric system revenue fund, which is for operating activities of the NC2 electric system. The reserve is similar to a working capital reserve.
- ⁸ OCA did not include the Capital Reserve fund that Orlando Utilities established to fund capital projects.

ATTACHMENT B

Austin Energy Proposed Comparison as Provided to the Office of the City Auditor

On February 21, 2012, Austin Energy (AE) provided the Office of the City Auditor (OCA) with a memorandum on reserve funding in AE's rate review. The memorandum included the following Proposed Comparison. AE also provided supporting documentation to OCA for the values in their comparison. OCA was able to validate the values in the following table, except for the instances described in the footnotes below.

Utility	Generation	Operating Revenue	Cash & Adjusted Reserves	Percent of Revenues
Austin Energy (AE) – Proposed	Generating	\$ 1,145,071,134	\$ 432,792,984	38%
Austin Energy (AE) – FY 2010	Generating	1,147,676,000	344,999,000	30%
Tacoma Public Utilities	Generating	366,853,260	377,090,585	103%
Snohomish Public Utility District ¹	Generating	572,930,000	558,213,000	97%
Imperial Irrigation District (IID) ²	Generating	499,998,553	398,891,208	80%
Orlando Utilities Commission	Generating	863,814,000	529,512,000	61%
Nebraska Public Power District (NPPD)	Generating	925,141,000	472,885,000	51%
Santee Cooper ³	Generating	1,894,902,000	967,780,000	51%
Salt River Project (SRP) ⁴	Generating	2,701,613,000	1,169,834,000	43%
CPS Energy	Generating	1,930,875,000	828,715,000	43%
Sacramento Municipal Utility District (SMUD)	Generating	1,323,288,000	551,882,000	42%
Jacksonville Electric Authority (JEA)	Generating	1,909,776,000	676,018,000	35%
Omaha Public Power District	Generating	986,350,000	327,222,000	33%
Los Angeles Department of Water & Power	Generating	3,235,193,000	930,056,000	29%
Seattle City Light	Generating	732,977,819	197,115,141	27%
Memphis Light, Gas and Water Division	Non-generating	1,705,513,000	354,521,000	21%
Clark Public Utility District	Generating	497,468,000	85,869,000	17%
Nashville Electric Service	Non-generating	1,063,155,000	142,480,000	13%

Source: Austin Energy

¹ OCA was unable to verify adjusted reserves for Snohomish Public Utility District and did not include the utility in the analysis presented in Attachment A.

² OCA was unable to verify adjusted reserves for the Imperial Irrigation District and did not include the utility in the analysis presented in Attachment A.

³ OCA contacted Santee Cooper to obtain additional information or clarification. The utility did not respond in time to include them in the analysis presented in Attachment A.

⁴ OCA contacted the Salt River Project to obtain additional information or clarification. The utility did not respond in time to include them in the analysis presented in Attachment A.