

STATE AUDITOR'S OFFICE PERFORMANCE AUDIT

Seattle City Light

March 16, 2010

Report No. 1002122



WASHINGTON
BRIAN SONNTAG
STATE AUDITOR

EXECUTIVE SUMMARY AND ATTACHMENTS

Seattle City Light

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Why we did this audit

We conducted a performance audit of Seattle City Light to determine whether it could improve the efficiency of its operations, whether it could reduce costs, and whether it received the full value of the services it provided and received.

The audit found a number of opportunities for the Utility to reduce duplication of efforts, reduce costs, and enhance revenues.

We also found the City of Seattle's cost allocation practices impact the operating costs of the Utility, which in turn affects the rates charged to utility customers. This may cause Utility customers to pay more than their share of the City's general government budget.

We provided a draft of this report to Utility management and City management for review and comment. Their comments are included in Ernst and Young's report contained in Attachment 1.

Scope and objectives

Seattle City Light was the subject of the audit. We conducted the audit to answer the following questions:

- Does the Utility operate in the most efficient and economical manner possible?
- Are administrative staffing levels and related expenses limited to those reasonable and necessary to help ensure the safe and efficient operation of the Utility?
- Do the Utility and the City allocate overhead in accordance with statutes, ordinances and federal regulations and are allocated amounts reasonable and necessary?
- Does the Utility fully recover the cost of services provided to other City departments?

Records for the three-year period from 2006 to 2008 were reviewed. If available, more current data and reports were used.

We conducted this audit in accordance with Generally Accepted Government Auditing Standards, prescribed by the U.S. Government Accountability Office. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We also conducted this audit in accordance with the required elements of Initiative 900.

What we found

Non-standard practices contribute to higher operating costs

City Light has opportunities to reduce operating costs, increase operational efficiencies and increase revenue.

Incorporating cable injection technology into its cable maintenance practices can provide significant cost savings for City Light. Cable injection is a minimally invasive and cost-effective way to repair and increase the life of older underground cables. In addition, we noted staff assigned to test the reliability of new transformers. New transformers are already tested and certified by the manufacturers. This redundant testing unnecessarily increases the operating costs of the utility.

Costs to maintain electrical system capacity could be reduced if techniques to optimize capacity were implemented across all City Light service areas. Currently City Light uses this technique in limited areas but not widespread across the utility's service areas.

City Light could increase its revenues by improving its systems of tracking and billing customer requested services. Under current practice, many service requests are billed based on estimates. We found indications that estimates were consistently less than actual costs of services and indications that not all billable costs were identified.

These issues are discussed in audit issues 1, 2, 3 and 4.

City Light is charged questionable general government costs

City Light appears to be paying more than its fair share of the City's overhead costs.

Overhead costs are calculated by the City and include expenses that do not clearly support the City Light's operations, such as the Mayor, City Council and City Clerk departments. This may shift general government costs onto City Light and its customers.

Overhead costs are also based on budgeted information and not adjusted when actual information is known. Lastly, the overall share of general government allocations paid by City Light is higher than it would be if all general government departments paid a share of the City's overhead costs.

These issues are discussed in audit issues 5 and 6.

Opportunities exist to reduce costs and increase revenue

City Light jointly shares in the operating costs of a financial management system and a Customer Call Center with Seattle Public Utilities. Improvements in the methods used to determine the appropriate share of costs could result in cost savings for City Light. We also noted City Light may be renting out warehouse and parking lot spaces for below market rates. Analysis of current market rates and competitive bidding may increase revenues from these properties.

These issues are discussed in audit issues 7, 8, 9 and 10.

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Financial impacts for issues identified are explained within the body of the audit report. Please refer to the individual issue areas for an explanation of the issue and any related cost savings or financial impacts. The performance audit report is in Attachment 1.

Commendations

The purpose of a performance audit is to identify opportunities to improve organizational economy and efficiency. As such, the emphasis is on reporting gaps between current performance and what could be accomplished by implementing the best practices of other comparable organizations. In the interest of balance, we call the reader's attention to the following.

Seattle City Light is the ninth-largest public power company in the nation and provides reliable electric services to more than 380,000 customers. It has been recognized in years past for its strong commitment to environmental impact reductions through its use of wind power and energy conservation programs. The Officers in charge were highly qualified individuals and highly concerned about providing reliable services to their customers.

We also appreciated the professionalism and responsiveness of individuals we interacted with throughout the audit process. City Light and City of Seattle employees were helpful and available to auditors and provided rich insights into the utility's operations. We also appreciated the high level of cooperation and participation in the audit provided by employees and managers, including the necessary feedback on the draft results and recommendations.

Other information

In addition to our performance audit results, the Seattle City Light provided us with a list of several accomplishments. These accomplishments are listed in Attachment 2 and were not audited by Ernst and Young or the State Auditor's Office .

AUDIT RESULTS

AUDIT ISSUE: BLUE

RECOMMENDATIONS: TAN

Non-standard operating practices contribute to higher operating costs

Extending Life of Electrical Cable: Seattle City Light could save millions by using proven methods to extend the life of underground electrical cable.

- City Light should pursue cable injection as a cost-effective way to repair and extend the life of older underground cables.
- City Light should also research and adopt leading practices related to underground cable maintenance and installation practices to facilitate future cable injections.

Testing Electrical Transformers: City Light unnecessarily spends nearly \$500,000 each year to test electrical transformers the manufacturers already test.

- We recommend it update its policy and provide examples of risks that could trigger testing of new transformers.
- We also recommend City Light familiarize itself with suppliers' quality control processes and procedures to aid in the development of its policy. If testing is performed, the results of testing should be maintained.

Excess electrical system capacity: City Light spends more than necessary to add and maintain unneeded electrical system capacity.

- City Light has unnecessary capacity in its existing feeder system and should not spend additional funds to further increase capacity.
- Feeder capacity projects previously approved should be revisited to determine if they are truly necessary for the safe and reliable operation for the utility.

Billings for Customers' Special Orders: City Light ratepayers collectively may be subsidizing the cost of installing and updating electrical service that should be charged to individual customers.

- Institute procedures to analyze actual project costs, estimated costs and customer billings and use the results to improve its processes.
- Update its processes and tools to collect a reasonable level of detail to compare estimated project costs versus actual billable costs.
- Implement processes to verify that all recoverable costs including costs of engineers are recorded to customer work orders.
- Establish performance goals to track how closely cost estimates compare to actual project costs as well as the percentage of billable installation costs recovered from new customers.
- Follow the Seattle Municipal code regarding cost recovery.
- Consider changing the threshold from \$35,000 outside the downtown core to \$5,000 so that any job estimated to be higher can be billed as time and materials. As City Light improves its estimating process, the threshold may be increased as necessary.

Questionable overhead cost allocations

City Allocations of Indirect Costs : City allocations, based on budgeted information, are not adjusted to reflect actual costs and levels of service and certain allocation factors are questionable.

- We recommend the City update its cost allocation policy to require adjustments when significant differences between actual costs and service levels are identified. A comprehensive analysis should be done in the beginning of each year to verify the accuracy of prior year allocations.
- We recommend the City revisit its allocation methodology for the departments of Emergency Management and Information Technology to develop an allocation methodology that bases the cost of services on the benefits to be received.

City Allocations of Indirect Costs : Some City departments are not charged their fair share for City services and some City services charged to City Light are questionable. Both conditions cause City Light to pay more general government expenses than it should.

- We recommend the City update its cost allocation policy to clearly define costs that should not be allocated or charged directly to non-general fund departments.
- We recommend the City revisit its central service allocation methodology. The methodology should be based on a current analysis of the relationship between central service costs and the amount of benefit received by the departments that pay these service costs. Departments that are considered too small to make the effort cost-beneficial should be clearly identified.
- We recommend the City discontinue overcharging the Utilities more than their share of pooled costs and other questionable costs.
- We recommend the City reimburse City Light the amounts paid for the support of the Mayor's office by the Office of Policy and Management in 2009 from the time the position was vacated through the end of the year and any amounts paid in 2010.

Opportunity for decreased operation costs and increased revenue

Joint operations: City Light may not be paying an accurate share of costs to jointly operate a customer service center with Seattle Public Utilities.

- We recommend future agreements base cost splits on analysis which includes all forms of customer inquiries.
- The analysis of customer inquiries should occur more regularly and cover a longer period of time.

Joint operations: City Light does not charge Seattle Public Utilities enough to cover the operating costs of the financial management system they jointly use.

- City Light should review prior year actual costs and verify Seattle Public Utilities was billed for all allowable costs.
- The agreement between City Light and Seattle Public Utilities should contain language that supports the full recovery of costs each year.
- The agreement should take into account all cost information and should factor in actual usage of the system.

Accounts Receivable: City Light does not receive the information necessary to evaluate the cost effectiveness of its revenue collection practices.

- City Light should conduct an analysis of customer payment trends by type and by region. This will provide management with key information necessary to evaluate the optimal mix of customer service options.
- Where it is found that the overall cost per transaction is not optimal, City Light could encourage customers to use less costly payment methods such as electronic or mail-in remittances.

Rental Properties: City Light does not charge market rates for use of warehouse and parking properties it owns.

- City Light should perform a market rate analysis to determine the appropriate rates to charge its tenants.
- City Light should begin discussions with its tenants to update the lease agreements immediately.

WHAT'S NEXT?

Initiative 900 requires the legislative bodies for the government agencies in this report hold at least one public hearing to consider the audit findings and to receive comments from the public within 30 days of this report's issue.

The corresponding legislative body must consider this report in connection with its spending practices. A report must be submitted by the legislative body by July 1 each year detailing the status of the legislative implementation of the State Auditor's recommendations. Justification must be provided for recommendations not implemented. Details of other corrective action must be provided as well.

The state Legislature's Joint Legislative Audit and Review Committee (JLARC) will summarize any statewide issues that require action from the Legislature and will notify the appropriate fiscal and policy committees of public hearing agendas.

Initiative 900 provides no penalties for audited entities that do not follow recommendations in performance audit reports.

Follow-up performance audits of any state or local government entity or program may be conducted when determined necessary by the State Auditor.

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The State Auditor's Office independently serves the citizens of Washington by promoting accountability, fiscal integrity and openness in state and local government. Working with these governments and with citizens, we strive to ensure the efficient and effective use of public resources.

ATTACHMENT 1: CONTRACTOR'S FULL REPORT


Seattle City Light

WHAT'S INSIDE

- Contractor's submittal letter
- Report table of contents
- Report
- Seattle City Light's Response
- Ernst & Young's Rejoinder to Management Responses



WASHINGTON
BRIAN SONNTAG
STATE AUDITOR



Performance audit report for Seattle City Light

February 15, 2010

Mr. Brian Sonntag
Washington State Auditor
Washington State Auditor's Office
3200 Capitol Boulevard S.W.
P.O. Box 40031
Olympia, Washington 98504-0031

February 15, 2010

Dear Mr. Sonntag:

We have completed Phase III of the performance audit of Seattle City Light (City Light). Our engagement was performed in accordance with our Contract No. 0608-C-K50, dated September 29, 2008. Our procedures were limited to those described in that letter.

Background

In 2005, the voters of Washington state passed Initiative 900 (I-900) authorizing the Washington State Auditor's Office (SAO) to begin conducting performance audits of various Washington state and local government entities. The purpose of these performance audits is to promote accountability and cost-effective uses of public resources through identification of opportunities for potential cost savings.

Scope of our work

The SAO engaged Ernst & Young to complete the City Light performance audit in accordance with Generally Accepted Government Auditing Standards. As part of the audit, Ernst & Young reviewed data and records for the three-year period from 2006 to 2008. If available, more current reports and data were used. The audit was designed to address the following objectives from the request for proposal (RFP):

- Is City Light achieving the most cost-effective balance of resources used versus services provided?
- Is City Light effectively limiting salaries and other administrative expenses as well as limiting staffing levels to those necessary for the legal, reliable and safe operations of the utility?
- Is City Light effectively limiting overhead allocations and other expenditures charged against the utility to those that are allowed by state law and municipal code, and are reasonable and necessary? This includes, but is not limited to, central service allocations and charges from other city general government departments.
- Is City Light fully recovering the costs of light utility services provided to other city departments?

The performance audit also addressed the following I-900 objectives:

- Identifying cost savings.
- Identifying services that can be reduced or eliminated.
- Identifying programs or services that can be transferred to the private sector.
- Analyzing gaps or overlaps in programs or services and recommendations to correct them.
- Assessing the feasibility of pooling the entity's information technology systems.
- Analyzing the roles and functions of the entity and recommendations to change or eliminate roles or functions.
- Recommending statutory or regulatory changes that may be necessary for the entity to properly carry out its functions.
- Analyzing the entity's performance data, performance measures and self-assessment systems.
- Identifying leading practices.

The performance audit was delivered in four phases: diagnose current state, define and design audit plan, execute audit plan and summarize communication and report results.

Results of our work

From March 2008 to June 2009, Ernst & Young executed the audit plan designed for the selected list of risk areas in Phase II of the performance audit. Based on information gathered using data analytics, flow charts, interviews, testing and benchmarking, we identified findings and leveraged our subject matter resources to provide leading practices recommendations to City Light.

The draft performance audit report was delivered to the SAO on June 18, 2009.

Restrictions on the use of our report

Ernst & Young assumes no responsibility to any user of the report other than the SAO. Any other persons who choose to rely on our report do so entirely at their own risk.

We appreciate the cooperation and assistance provided to us during the course of our work. If you have any questions, please call Michael Kucha at +1 206 654 7741.

Very truly yours,

Ernst & Young LLP

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Introduction

Background

This audit of City Light was conducted under the SAO's performance audit authority granted by I-900, which was approved by citizens statewide in the November 2005 election. The initiative, in part, called for the SAO to examine the "largest, costliest governmental entities first." With about \$870 million in operating revenues and 380,000 residential and business customers, City Light fit that category. To conduct this audit, the Auditor's Office SAO with Ernst & Young.

Objectives

In planning and performing the audit, we considered these nine elements stipulated by I-900:

- Identification of cost savings
- Identification of services that can be reduced or eliminated
- Identification of programs or services that can be transferred to the private sector
- Analysis of gaps or overlaps in programs or services and recommendations to correct gaps or overlaps
- Feasibility of pooling the entity's information technology systems.
- Analysis of the roles and functions of the entity and recommendations to change or eliminate roles or functions
- Recommendations for statutory or regulatory changes that may be necessary for the entity to properly carry out its functions
- Analysis of entity performance data, performance measures and self-assessment systems
- Identification of leading practices

In addition, the SAO set the following objectives for us to pursue in this audit:

- Is City Light achieving the most cost-effective balance of resources used versus services provided?
- Is City Light effectively limiting salaries and other administrative expenses as well as limiting staffing levels to those necessary for the legal, reliable and safe operations of the utility?
- Is City Light effectively limiting overhead allocations and other expenditures charged against the utility to those that are allowed by state law and municipal code, and are reasonable and necessary? This includes, but is not limited to, central service allocations and charges from other city general government departments.
- Is City Light fully recovering the costs of light utility services provided to other city departments?

Methodology

Ernst & Young conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our own audit objectives. These were our objectives:

- Obtain an understanding of the area being audited
- Consider legal and regulatory requirements
- Identify and review management controls applicable to the area
- Identify criteria needed to evaluate matter subject to the audit
- Identify and examine sufficient, appropriate sources of evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives
- Determine the need for technical professional assistance

Our work included:

- Conducting interviews with managers and staff
- Validating our understanding of processes and controls by interviewing process owners
- Performing a benchmarking analysis to determine how City Light compared to peers
- Testing transactions and records for effectiveness of controls and adherence to policy
- Reviewing policies and procedures
- Reviewing reports
- Analyzing processes to identify potential cost savings or efficiencies

We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Scope

The scope of the audit included performing a broad, independent performance audit of City Light, in the state of Washington, in accordance with Government Auditing Standards.

As noted above, we considered the elements of I-900 as part of the planning and performance of the audit.

Ernst & Young tested data and records for the three-year period from 2006 to 2008. If available, more current data and reports were used. Ernst & Young began the performance audit in October 2008 and completed fieldwork in June 2009.

Ernst & Young recognizes that implementation of the recommendations will require resources. Although this performance audit was not structured to include detailed implementation plans and related expenses, Ernst & Young estimates that City Light has the experience and expertise to develop the specific steps necessary to implement the recommendations, and that the cost savings gained through the recommended efficiencies will more than offset the costs of implementation.

Cost savings as used in this report represent the difference between costs associated with current practices and the lower costs associated with recommended practices. In some instances these savings represent the estimated result from improved efficiencies.

City Light background

Brief history of City Light

City Light is a municipally owned public power system that is governed by elected Seattle officials and supported by customer revenues.

In 1902, the citizens of Seattle voted to build a hydroelectric power plant on the Cedar River watershed. The Cedar Falls dam, which is now the oldest hydroelectric plant in the nation, generated the first electricity City Light delivered to its customers in 1905.

Guided by the vision of J.D. Ross, often referred to as the “Father of Light”, City Light built three dams on the Skagit River: the Gorge Dam in 1924, the Diablo Dam in 1930 and the Ross Dam in 1951. In 1967, the Boundary Dam and powerhouse was built in the northeastern part of Washington on the Pend Oreille River. The Boundary Dam is City Light’s largest generating facility.

City Light’s current Federal Energy Regulatory Commission (FERC) contract for the operation of the Boundary Dam expires in 2011. The utility is currently in negotiations to renew the license.

As of the end of 2007, City Light provided power to approximately 383,127 people in the city of Seattle and neighboring suburbs. City Light ranked as the ninth largest public power system in the nation. City Light’s fuel mix consists of the following:

| Generation Type | Percentage |
|-----------------|------------|
| Hydro | 90.61% |
| Nuclear | 4.83% |
| Wind | 3.25% |
| Coal | 0.85% |
| Natural gas | 0.37% |
| Other | 0.09% |

The findings and recommendations of the performance audit are listed below. For further details on City Light's management responses and Ernst & Young's rejoinder please review Appendix B on page 22 and Appendix C on page 32.

Findings and recommendations

Non-standard operating practices

1. City Light could save millions of dollars by using proven methods of extending the life of existing underground electrical cable.

Background

City Light has 2,500 miles of power lines of which an estimated 100 to 500 miles are underground. Underground electrical lines have multiple insulating layers to protect them from corrosion. Over time, the internal insulation breaks down and allows moisture to come in contact with the cables, which in turn ruins the cables.

Condition

When underground lines reach the end of their life cycle, City Light repairs or replaces them. Replacement can cost between \$75 and \$150 a foot. In urban areas, where asphalt and/or concrete must be removed in order to replace them, the costs may reach up to \$350 per foot.

A less costly method to maintain underground lines is available. Injecting new insulation into underground lines at an approximate cost of \$20 a foot can extend a cable's life between 20 and 40 years.

Criteria

Cable injection technology has been in commercial use since 1987 and has been a proven and reliable method of maintaining existing cable at considerably less cost than replacement. Based on our experience, we consider injection technology a leading practice.

Cause

Historically, City Light has not used this technology. However, the utility recently conducted a cable injection pilot project and, based on the results, is planning to perform more injections.

Effect

If the utility was to replace 100 miles of its underground lines it could cost between \$39 million and \$79 million. If the same 100 miles were injected, the cost would be approximately \$10.56 million.

Recommendation

City Light should pursue cable injection as a cost-effective way to repair and extend the life of older underground cables. City Light should also research and adopt leading practices related to underground cable maintenance and installation practices to facilitate future cable injections.

2. City Light unnecessarily spends nearly \$500,000 each year to test electrical transformers already tested by their manufacturers.

Background

The transmission and distribution systems used to deliver electricity to businesses and households rely on transformers to adjust electricity from high voltage to low voltage. Electrical transformers come in a range of sizes and can be either pole mounted or pad mounted. A pole type transformer is usually mounted high atop an electrical service pole but can also be mounted at ground level. A pad-mounted transformer is mounted at ground level.

City Light reported it spent nearly \$10 million in 2008 to buy 1,265 transformers and nearly \$10 million in 2007 for 1,505 transformers.

Condition

In 2008, the Utility spent nearly \$500,000 to test 10 % of smaller utility pole-mounted transformers and 100 % of all other types of non-transformers. This duplicates work done by transformer manufacturers, which must do tests to certify transformers meet national industry standards before they are sold.

Criteria

Transformer manufacturers perform tests in accordance with applicable standards set by the Institute of Electrical and Electronics Engineers and the National Electric Manufacturers Association. Those standards are approved by the American National Standards Institute. The manufacturer provides the results of the transformer tests to City Light and certifies that each transformer is in compliance with standards.

Cause

City Light's Materials Standards Policy requires the transformer testing. City Light officials were unable to explain why the policy required the tests and our review of testing results did not support such an extensive testing policy.

Effect or potential effect

By discontinuing the redundant testing of non-network transformers, City Light can avoid or redirect approximately \$494,000 per year toward other value-added activities. Over five years, the benefit to the utility could be more than \$2.47 million.

Recommendation

City Light agrees with our conclusion that redundant transformer testing is not necessary unless utility management identifies a significant benefit or risk. We recommend that City Light update its policy to reflect this and provide examples of risks that could trigger testing of new transformers.

We also recommend City Light familiarize itself with suppliers' quality control processes and procedures to aid in the development of its policy. If testing is performed, the results of testing should be maintained.

3. City Light spends more than necessary to add and maintain unneeded electrical system capacity.

Background

City Light uses feeder lines to carry power from substations to transformers that connect to individual homes and businesses. City Light builds in additional feeder line capacity to make sure it can deliver sufficient power during peak use times and to prevent service interruptions caused by equipment failure.

Condition

City Light is paying for feeder line capacity that is unnecessary and not based on normal electricity use patterns. In the downtown area, City Light uses what is known as a load model approach to plan its system capacity. This approach analyzes electricity use based on the time of day, the seasons of the year, historical use and other factors to determine how much feeder line capacity is needed. This approach is not used in non-network areas.

For all non-network areas, City Light builds and maintains feeder lines to handle at least 50 % more electricity than is regularly needed. The use of load modeling would allow City Light to determine the right amount of capacity needed without paying for unnecessary capacity.

Criteria

Utilities typically add capacity to feeder systems based on load modeling techniques to avoid excessive costs related to overcapacity. This type of analysis takes into account the amount of electricity a feeder system will need to carry. Planning in this way allows for more precise determinations of how much additional capacity is needed.

Cause

City Light management was not able to explain why the load model approach is not used in all areas of the city. Its practice of 50 % excess capacity in non-network areas has been standard practice for many years.

Effect

City Light's practice of maintaining 50 % additional capacity in non-network areas adds unnecessary operating costs that ultimately are borne by its ratepayers. Between 2009 and 2014, City Light plans to spend an estimated \$476 million on capacity projects. Feeder line enhancement projects are not tracked separately but are a portion of this budget.

Information on past enhancement project spending was not readily available but documentation supports a conservative estimate of approximately \$1.3 million a year. If City Light began using load modeling to guide its capacity decisions, it could save \$6.5 million over the next five years.

Recommendation

City Light has unnecessary capacity in its existing feeder system and should not spend additional funds to further increase capacity. Feeder capacity projects previously approved should be revisited to determine if they are truly necessary for the safe and reliable operation for the utility.

- 4. City Light ratepayers collectively may be subsidizing the cost of installing and updating electrical service that should be charged to individual customers.**

Background

The utility has two main service areas: the downtown business core and all other neighborhoods and business districts. Under City Light's business practices, new customer installations and customer-requested upgrades to existing electrical services are frequently billed based on estimated costs. Only customers with projects expected to exceed \$75,000 in the downtown core and \$35,000 outside the core are billed for all project costs. Customers with projects expected to be under these thresholds are only billed the estimated amount. Actual costs which exceed the estimate are absorbed by City Light.

For example, if an out-of-network upgrade or installation project was estimated to cost \$15,000 but the actual costs were \$20,000, the customer would not be billed for the \$5,000 difference. If a project was estimated to cost \$35,000 or more, the actual cost would be billed to the individual customer who requested the work.

Seattle City ordinance requires the utility to bill individual customers for labor and materials of customer-requested service upgrades and new meter installations. The reason is to have only customers who directly benefit pay the cost rather than every customer who covers utility operating costs through the electrical rates they pay.

Condition

City Light does not bill in accordance with city ordinance. We reviewed work orders for individual projects and found more than \$21 million was not billed to individual residential and business customers from 2006 to 2008. Instead, these costs were absorbed in utility operating costs and thus spread across all ratepayers. There was no documentation to explain what portion of the project costs were the responsibility of the customer. Per conversations with City Light, some of these costs were billable.

Specifically, we examined 542 work orders completed during the three-year period. The actual costs of 497 work orders, exceeded the invoiced amounts by approximately \$8 million.

Some additional unbilled costs result from engineering work completed before project work orders have been set up. So some engineering costs are not reflected in the work orders – the primary instrument to track project costs. Those engineering costs are charged to what is called standing work orders and are not assigned to specific projects. Some of these costs were not billed to customers.

We identified \$13 million in unbilled costs coded to standing work orders with no documentation explaining why these were not billed to customers.

Criteria

Seattle Municipal Code, Chapter 21.49, requires City Light to recover specific customer costs related to installations or upgrades.

Cause

City Light does not have adequate procedures in place to make sure all appropriate project costs are identified and billed to the customer.

Project activities can be a mix of work that is the responsibility of the utility and work that should be paid for by the customer. Although the utility collects cost information, the codes used to account for costs are not detailed enough to distinguish billable amounts. A reconciliation between the total project costs, the estimated costs and the portion billed to the customer is not performed to support the accuracy of amounts billed.

Effect

Existing customers may be subsidizing installation and upgrade services through the utility rates they pay.

Between 2006 and 2008, we estimated that about \$21 million in customer-requested project costs were not billed to customers. When these costs were reviewed with City Light, the utility suggested that some of the costs may not actually have been billable. However, documentation was not available to support the unbillable amounts.

Recommendation

City Light needs to institute procedures to analyze its actual project costs, estimated costs and customer billings and use the results to improve its processes.

The utility can make the following changes to improve its billing and cost recovery process:

- Update its processes and tools to collect a reasonable level of detail that will allow it to compare estimated project costs versus actual billable costs.
- Implement processes to verify that all recoverable costs, including engineering costs, are recorded to customer work orders.
- Establish performance goals to track how closely cost estimates compare to actual project costs as well as the percentage of billable installation costs recovered from new customers (e.g., 95% of new customer installation costs recovered).
- City Light should follow the Seattle Municipal Code regarding cost recovery.

We recommend City Light consider changing the threshold from \$35,000 outside the downtown core to \$5,000 so that any job estimated to be more than that can be billed as time and materials. As City Light improves its estimating process, the threshold may be increased as necessary.

Questionable overhead cost allocations

5. City allocations, based on budgeted information, are not adjusted to reflect actual costs and levels of service and certain allocation factors were questionable.

Background

City Light pays for services provided by other city departments, such as human resources, information technology and emergency management. The amount paid is based on the total cost of providing the services (known as pooled costs) and on allocation factors indicating how much each department uses those services.

The adequacy of the cost allocations depend on:

- An accurate identification of total support service costs and the correct exclusion of certain costs. Typically state and federal requirements are the basis for excluding certain costs. For example, public utilities cannot pay for costs that should be exclusively paid by the general government.
- The identification of allocation factors that accurately reflect the level of service received. For example, if City Light employees receive 20 % of the benefits of the city's information technology system, then City Light should pay for 20 % of the costs to operate the City's information technology department.

Cost allocations are typically estimated at the beginning of each budget period. These costs are estimates of future expenses and levels of service. But once actual costs are known, usually at the end of the year, cities must compare what was allocated to what should have been allocated. If significant over allocations or under allocation are noted they should be corrected.

In 2008, the city of Seattle allocated just over \$86.8 million in general government costs among City Light and other departments. City Light's share was approximately \$10.4 million. City Light also received just over \$38.9 million in direct allocations from other departments in the same period.

Condition

City Light was overcharged for some city-allocated costs and may have been overcharged for others. Two reasons were noted – lack of adjusting budgeted information to actual information as well as using questionable allocation bases.

Adjusting for actual expenses and actual allocation factors

The city allocates its costs based on budget estimates. The majority of these costs are not reconciled to actual costs and service levels. The city has not performed a comprehensive reconciliation since 2004. Two of the city's many allocation factors were reviewed as part of this report.

One of the allocation factors is the amount of staff time spent on projects. Approximately 24 % of City Light's central service allocations are based on this factor. City Light also receives many direct allocations from other departments based on the factor. We found that some department managers estimate the amount of time staff will spend on City Light projects without a process in place to verify the accuracy of the estimates. In some cases, employees are directed to code their time based on fixed percentages regardless of the actual time spent. In addition, employees are not required to maintain support for actual time spent on projects. This makes it impossible for management to evaluate the accuracy of their estimates.

Another allocation factor is based on the number of employees in each department. Approximately 17 % of City Light's central service allocations are based on this factor. We estimate that City Light paid nearly \$660,000 more between 2006 and 2008 than its share of general government costs because the city did not adjust budget estimates to reflect actual costs and headcounts.

Questionable allocation factors

Certain allocation factors are used by the city that do not have a clear connection between the amounts allocated and the benefits received. Two examples include the Emergency Management and Information Technology departments.

Emergency management

Budgeted costs of the city's Emergency Management Division are allocated to 22 City departments based on the size of each department's operating budget. Since City Light's operating budget accounts for over one-third of the participating departments' combined budgets, City Light pays over one-third of the Emergency Management Division's operating costs. This equated to nearly \$438,000 in 2008. Including Seattle Public Utilities, both utilities pay over 58 % of the Division's budgeted operating costs.

However, the size of a department's operating budget has little connection with the number of individuals employed at the department or their level of participation in emergency management efforts. In recent years, City Light has also developed its own emergency management program that is operated and funded internally. This may mitigate some of its reliance on the city's program. This has not been considered when determining the amount City Light should pay toward the city's Emergency Management program.

Information technology

Certain budgeted costs of the city's Department of Information Technology are also allocated based on the size of participating departments' operating budgets. Specifically, City Light paid nearly \$2 million (over 35 %) of the city-wide web support and data backbone service operating costs in 2008. These payments may not be representative of the benefits received by City Light.

Again, the size of a department's operating budget has little connection with the level of benefit received from the Department of Information Technology. Alternative methodologies may be used to distribute expenses in a more equitable fashion. For example, data backbone expenses are often allocated on a per-port basis (a port is used by individuals to connect to the city system) and, depending on the complexity, may include different rates depending on the type of port used.

Criteria

State law (RCW 43.09.210) prohibits a department from benefiting financially at the expense of another department within the same agency. It states in part:

"All service rendered by, or property transferred from, one department, public improvement, undertaking, institution, or public service industry to another, shall be paid for at its true and full value by the department, public improvement, undertaking, institution, or public service industry receiving the same, and no department, public improvement, undertaking, institution, or public service industry shall benefit in any financial manner whatever by an appropriation or fund made for the support of another."

The city receives federal grants. Grant money must be spent in accordance with federal guidelines outlined in the Office of Management and Budget's (OMB) Circular A-87, Attachment A, which states in part:

Section F1 "To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect costs within a governmental unit department or in other agencies providing services to a governmental unit department. Indirect cost pools should be distributed to benefited cost objectives on bases that will produce an equitable result in consideration of relative benefits derived."

Section C3(a) "A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received."

The OMB Circular, Attachment C, section G4, also states:

"A comparison of the revenue generated by each billed service (including total revenues whether or not billed or collected) to the actual allowable costs of the service will be made at least annually, and an adjustment will be made for the difference between the revenue and the allowable costs."

Cause

Current city of Seattle policy does not require routine adjustments to budgeted cost allocations to reflect actual costs and allocation factors except under unusual circumstances. The city believes the effort would not result in significant adjustments. The city performs such adjustments on a discretionary basis.

The allocation bases for Emergency Management and certain Information Technology expenses were originally established using a method of total adopted budget dollars, which does not accurately reflect the benefits received. This methodology has not been revisited.

Effect

For illustrative purposes, we conducted selective recalculations using actual costs and allocation factors which demonstrate a closer relationship between the costs and the amount of benefits received. We did not conduct a complete analysis as this is the responsibility of city management. The city may find additional differences after conducting a full analysis of its allocation methodology.

Adjusting for actual costs and number of employees:

Approximately 17 % of the total general government allocations charged to City Light are based on budgeted employee counts. Between 2006 through 2008, we estimate City Light paid nearly \$660,000 more than it would have if budgeted costs and budgeted employee counts were adjusted to actual. Assuming spending patterns are similar, City Light would pay approximately \$1.1 million less in general government allocations over the next five years if the city changes its cost allocation practices. Calculations are based on actual costs and average annual FTE counts.

Performing the same calculation for Seattle Public Utilities over the same three-year period, we estimated the utility paid \$219,000 more in general government allocations than it would have if budgeted costs and budgeted employee counts had been adjusted for actual.

Change factor from budgeted costs to number of employees – Emergency Management:

We recalculated City Light's Emergency Management allocations for the years 2007 and 2008. We used actual headcounts instead of operating budgets and compared the results to what had been allocated. This analysis resulted in approximately a 45 % reduction in the amount of Emergency Management costs that City Light paid each year. Over five years, this equates to savings of \$1.2 million.

Headcount was selected because one could reasonably assume that more employees within a department equates to more employees to be mobilized in the event of an emergency. Although our limited analysis indicates headcount may be a reasonable allocation factor, we acknowledge there may be other appropriate allocation factors. It is up to the city to determine which factor best represents the benefits received by departments.

Estimated change in factor from budgeted costs to number of employees – Information Technology:

Between 2006 and 2008 City Light paid just under \$4.9 million in allocations from the Department of Information Technology related to three activities – citywide web services, data backbone services, and internet and security services. Costs for the three activities are allocated based on the size of department operating budgets. Although a detailed recalculation was not performed, we illustrate the potential effect by showing the impact of a 5 % change in the amount allocated.

Currently, City Light pays 35.56 % of the operating costs for these three activities. In 2008, this amounted to over \$1.85 million. For illustrative purposes, if City Light paid 5 % less (30.56 %), it would pay just under \$1,595,000. If City Light paid 5 % more (40.56 %), it would pay just over \$2,116,600. The difference between these two amounts and what it currently pays is either +/- \$260,900.

Although our limited analysis indicates headcount may be a reasonable allocation factor, we acknowledge there may be other appropriate allocation factors. It is up to the City to determine which factor best represents the benefits received by departments.

Recommendation

We recommend the city:

- Update its cost allocation policy to require adjustments when significant differences between actual costs and service levels are identified. At a minimum, a comprehensive analysis should be done in the beginning of each year to verify the accuracy of prior year allocations.
- Revisit its allocation methodology for the city’s departments of Emergency Management, Information Technology and other departments that pay allocations based on the size of their operating budget. Allocation factors should provide a reasonable connection between the amounts allocated and the amount of services or benefits received by the department.

6. Some city departments are not charged their fair share for city services and some city services charged to City Light are questionable. Both conditions cause City Light to pay more general government expenses than it should.

Background

Like other City departments, City Light pays for using central service support, such as human resources, payroll, accounting and others, which support its operations. Central service costs should be allocated across all departments that use their services.

As an example, if 10 departments use the same central service equally, then each department should pay one-tenth of the its operating costs. If instead, only five departments pay, then each pays twice the amount they would have paid had the same costs been spread across the 10 departments.

Condition

City Light was charged more city-allocated costs than it should. In addition, City Light was charged for expenses that were questionable. Two reasons were noted.

First, certain departments do not have to pay their share of costs for using city services. This means the total amount of pooled central service costs is allocated over fewer departments, which results in departments such as City Light paying a larger share of the total pooled costs than they otherwise would have paid. The departments that do not pay a share of pooled costs are listed below:

General fund departments that were not charged pooled costs:

| | |
|--|--------------------------------------|
| Office of Arts and Cultural Affairs | Department of Finance |
| Civil Service Commission | Department of Information Technology |
| Executive | Fleets & Facilities Department |
| Mayor's Office | Personnel Department |
| Office for Civil Rights | City Auditor |
| Office of Intergovernmental Relations | Legislative Department |
| Office of Policy & Management | Law Department |
| Office of Economic Development | Department of Neighborhoods |
| Office of Sustainability & Environment | Other small departments |
| Department of Executive Administration | |

Instead, pooled costs are allocated entirely across the following 14 departments. These departments were allocated just over \$86.8 million in general fund costs in 2008. Of this amount, the four non-general fund departments paid over \$23 million.

Non-general fund departments that were overcharged pooled costs:

| | |
|--------------------------------|--------------------------------------|
| Seattle City Light | Department of Planning & Development |
| Seattle Public Utilities-Water | Employees' Retirement System |

Other general fund departments that were overcharged pooled costs:

| | |
|----------------------------------|---------------------------|
| Department of Transportation | Seattle Center |
| Fire Department | Human Services Department |
| Police Department | Municipal Court |
| Library | Office of Housing |
| Department of Parks & Recreation | Other small departments |

Secondly, City Light paid certain general government costs that were questionable, and in at least one instance did not correspond with any service or benefit received. Some general government costs are to be exclusively funded by the general government and not allocated or otherwise charged to city departments. These types of costs are related to the management of the city as a whole.

We noted City Light paid general government costs that included operating expenses of the council, city clerk and legislative departments as well as support for the Mayor’s Office. Mayor’s Office support included a full-time policy advisor on energy issues, part-time administrative support, consulting services and a contingency amount for sundries, report writing and temporary employee services. A recent court decision ruled that similar costs should be charged only to the general fund.

Although the city has stopped charging the salary and benefit costs of the city council to City Light, other operating costs related to the council, city clerk¹ and legislative departments were included in City Light’s overhead allocations. Between 2006 and 2008 the amounts paid by City Light were \$389,257, \$400,926 and \$351,858 respectively. Performing the same calculation for Seattle Public Utilities over the same three-year period, the amounts paid by the utility were \$491,015, \$505,936 and \$450,790 respectively. Federal guidance on uses of federal funds mentions similar categories of costs and calls them unallowable because they are general government expenses. Based on a recent court case, state law does not allow enterprise activities, such as City Light, to pay for general government expenses.

In addition, the staff support for the Mayor’s Office was based on a contractual agreement with the Office of Policy and Management (OPM). The agreement specified the type of OPM support and the maximum amount that would be charged. Between 2006 and 2010, the maximum charges were to be \$320,000, \$200,000, \$207,000, \$215,000 and \$224,000, respectively. In 2009, the individual providing policy advice left employment with the OPM and the position is not expected to be refilled.

Criteria

State law (RCW 43.09.210) prohibits a department from benefiting financially at the expense of another department within the same agency. It states in part:

“All service rendered by, or property transferred from, one department, public improvement, undertaking, institution, or public service industry to another, shall be paid for at its true and full value by the department, public improvement, undertaking, institution, or public service industry receiving the same, and no department, public improvement, undertaking, institution, or public service industry shall benefit in any financial manner whatever by an appropriation or fund made for the support of another.”

¹The city clerk’s duties include providing support for the legislative process of the city council.

The city receives federal grants. Grant money must be spent in accordance with federal guidelines outlined in OMB Circular A-87, Attachment A, section C(3). It states in part:

Section F1. "To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect costs within a governmental unit department or in other agencies providing services to a governmental unit department. Indirect cost pools should be distributed to benefited cost objectives on bases that will produce an equitable result in consideration of relative benefits derived."

Section C3(a) "A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received."

Attachment B, section 23(a) states in part:

"The general costs of government are unallowable. These include:

"Salaries and expenses of the Office of the Governor of a State or the chief executive of a political subdivision... Salaries and other expenses of State legislature, tribal councils, or similar local governmental bodies, such as county supervisors, city councils, school boards, etc., whether incurred for purposes of legislation or executive direction."

The city received the results of a 2004 class action lawsuit in which a judge ruled that certain general government expenses cannot be paid with money collected through utility fees. The court ruling was specific to certain types of general government expenses. We believe the logic of this ruling may extend to the council, city clerk and legislative department expenses included in this finding, although the ruling doesn't specifically mention them.

Specifically, the court documents recognize that staff in the Mayor's Office "have provided analysis on power purchases and sales decisions, licensing applications, superintendent confirmations, the California energy crisis, and billing errors. The staff also works with other utilities across the country to develop energy policy. The Mayor's Office staff spends approximately 20% of its time on utility oversight, of which a significant percentage is oversight of City Light."

It further states, "The Superintendent of City Light is its Chief Executive Officer. The Mayor and his staff serve a general governmental function of oversight and coordination with other Seattle departments. While this activity may benefit City Light, it is of a general administrative nature and facilitates the Mayor's performance of his duties. The work of the Mayor's office is governmental rather than proprietary in nature."

It concludes, "Consequently the expenses of the Mayor's Office...may not be allocated to City Light, and Seattle's General Fund must refund to City Light all such expenses charged to and paid by City Light since January 1, 2000."

Cause

The conditions noted and their related causes are noted below:

Excluded departments

Current city of Seattle policy does not require a share of central services costs to be assigned to all general government departments that use the services. The city believes allocating across general government departments that would subsequently reallocate the expenses unnecessarily complicates the allocation process. For example, several departments, such as the Department of Information Technology and Personnel, would simply include these allocations in the amounts they charged other departments. While this is true for some departments, it would not apply to the remaining departments.

Questionable costs

The city interpreted the court's ruling narrowly. Although it eliminated the costs of salaries, benefit and other operating costs of the Mayor's Office, the city only eliminated the salary and benefit costs of the city council. It did not eliminate other operating costs of the city council. Further, the city did not apply the court ruling to other general government operations such as the city clerk and legislative departments' costs.

Effect

Adjust for inclusion of currently excluded departments in overhead allocations:

There are more than 19 general government departments that do not pay a share of the costs for using city services. This results in the remaining city departments paying a larger share of the general government costs. Some of the remaining departments receive federal funding. This increases the risk of non-compliance with federal requirements, which could result in loss of eligibility for future federal awards.

To show the potential effect of this condition, we selected three city general government departments exempt from allocations – the Mayor’s Office, the Office of Arts and Cultural Affairs, and Legislative Department. We did not conduct a complete analysis as this is the responsibility of city management.

Using the current city allocation factors, we recalculated the 2007 through 2009 allocations. By including just 3 of the 19 departments, our calculation shows over \$7.3 million in general government expenses were not allocated that should have been. Of this amount, City Light’s portion was over \$2.3 million and Seattle Public Utilities portion was over \$1.5 million. These are the amounts the utilities would not have paid had the three departments been included in the general government allocations. The city may find additional overcharges after conducting a full analysis of all exempt agencies.

Support of general government administrative activities

Between 2007 and 2009, approximately \$6.8 million in operating costs of council staff, the city clerk and legislative assistants was allocated across city departments. Of this amount, City Light paid just over \$1.1 million and Seattle Public Utilities paid just over \$1.4 million.

The allowability of these allocations is questionable.

Support of Mayor’s Office through the OPM

Between 2005 and 2008, City Light paid the OPM \$1,036,000 in support services for the Mayor’s Office. In 2009, City Light’s contractual obligation for this support was \$215,000. Its obligation for 2010 was increased 4 % to \$224,000.

The allowability of these allocations appears to be questionable. In addition, the policy advisor position supporting the Mayor’s Office was vacant for a portion of 2009 and not expected to be refilled. City Light should be reimbursed amounts paid from the time the position was vacated through the end of 2009 and any amounts paid in 2010.

Recommendation

We recommend the city:

Update its cost allocation policy to clearly define general government activities whose costs should not be allocated or charged directly to non-general fund departments. Updates should be made with consideration of the 2004 court ruling.

Revisit its central service allocation methodology. The methodology should be based on a current analysis of the relationship between central service costs and the amount of benefit received by the departments that pay these service costs. Departments that are considered too small to make the effort cost-beneficial should be clearly identified.

Discontinue overcharging the utilities more than their share of pooled costs and for other questionable costs that cannot be supported with further legal analysis by the city’s attorney.

Reimburse City Light the amounts paid for the support of the Mayor’s Office by OPM in 2009 from the time the position was vacated through the end of the year and any amounts paid in 2010.

Opportunity for decreased operating costs and increased revenues

7. City Light may not be paying an accurate share of costs to jointly operate a customer service center with Seattle Public Utilities.

Background

City Light and Seattle Public Utilities share the cost of operating call centers which handle customer inquiries. Seattle Public Utilities operates the center, and City Light currently pays 60 % of the budgeted costs based on its share of about 40,000 calls the center answers each month. To determine the portion of customer calls specifically relating to City Light services, once every two years, Seattle Public Utilities selects a short period of time to analyze the number and type of calls handled by customer service representatives.

Condition

City Light may not pay an accurate share of the center’s operating costs because of an incomplete analysis of the volume of customer activity. The analysis does not include walk-in customer visits or other queries handled electronically. Electronic inquiries encompass most of the customer contacts.

Without an analysis of all customer inquiries, we could not determine whether City Light has been paying more or less than its fair share of the costs. An accurate accounting of customer service calls is significant because City Light’s costs are passed on to customers in electrical rates. The same condition exists at Seattle Public Utilities, which generally operates separately from City Light in providing water, wastewater and refuse collection services.

Criteria

RCW 43.09.210 prohibits a department from benefiting financially at the expense of another department within the same agency. The RCW states in part:

“All service rendered by, or property transferred from, one department, public improvement, undertaking, institution, or public service industry to another, shall be paid for at its true and full value by the department, public improvement, undertaking, institution, or public service industry receiving the same, and no department, public improvement, undertaking, institution, or public service industry shall benefit in any financial manner whatever by an appropriation or fund made for the support of another.”

RCW 43.09.200 requires adequate records be maintained to show how revenues and expenses served a public purpose. It states in part:

“...all receipts, vouchers, and other documents kept, or required to be kept, necessary to isolate and prove the validity of every transaction.”

Cause

The cost split between City Light and Seattle Public Utilities may not be accurate because it does not include all types of inquiries. Increased usage of existing technology should facilitate its ability to gather information on other types of customer inquiries.

Effect

City Light does not have adequate support to show it is paying its fair share of the operating cost. Our own calculation showed that if the cost allocation was to swing by +5 % or -5 %, City Light’s share of the costs would change by approximately \$429,000 per year. We base this calculation on the inter-agency agreement stipulating how the utilities allocate the costs.

The ultimate effect on most individual customers may be minimal because many use services provided by both City Light and Seattle Public Utilities.

Recommendation

We recommend a new agreement between the utilities to reflect:

- Use of all forms of customer inquiries in the analysis that determines cost allocations.
- The analysis of customer inquiries should occur more regularly and cover a longer period of time.

8. **City Light does not charge Seattle Public Utilities enough to cover the operating costs of the financial management system they jointly use to maintain customer accounts.**

Background

City Light manages the Consolidated Customer Service System that electronically processes and tracks billing, accounts receivable and other financial activities of its customers as well as those served by Seattle Public Utilities. In return for City Light's management of the system, Seattle Public Utilities agreed to share equally in the operating costs.

Condition

We determined City Light was underpaid \$186,068 in 2006 and \$280,688 in 2007 because it failed to fully charge Seattle Public Utilities its share of operating the system. The amount City Light billed Seattle Public Utilities was based on incomplete year-end cost information.

Criteria

RCW 43.09.210 prohibits a department from benefiting financially at the expense of another department within the same agency. The RCW states in part:

"All service rendered by, or property transferred from, one department, public improvement, undertaking, institution, or public service industry to another, shall be paid for at its true and full value by the department, public improvement, undertaking, institution, or public service industry receiving the same, and no department, public improvement, undertaking, institution, or public service industry shall benefit in any financial manner whatever by an appropriation or fund made for the support of another."

RCW 43.09.200 requires adequate records be maintained to show how revenues and expense served a public purpose. It states in part:

"...all receipts, vouchers, and other documents kept, or required to be kept, necessary to isolate and prove the validity of every transaction."

Cause

City Light failed to charge the appropriate amount to Seattle Public Utilities because the reports used to prepare billings did not capture all system expenses that occurred prior to the end of the year. A year-end reconciliation to verify Seattle Public Utilities is not being over or under charged is not occurring.

Effect

City Light is not allocating a fair share of the system operating costs. City Light and its customers are ultimately paying those charges through rates they pay to support the utility's operation.

In most cases, the impact on individuals and businesses is minimal because they are customers of both City Light and Seattle Public Utilities.

Recommendation

City Light should incorporate the review of prior year actual costs in its financial reconciliation meetings at the beginning of each year. In addition, the agreement between City Light and Seattle Public Utilities should contain language that supports the full recovery of costs each year and explains the potential delay in closing periods. The agreement should take into account all cost information and should factor in actual usage of the system.

9. City Light does not receive the information necessary to evaluate the cost effectiveness of its revenue collection practices.

Condition

City Light does not have a process in place to evaluate its revenue collection practices. City Light customers can choose to pay their bills by mail, electronically or in person at one of 11 payment centers across the city. The cost to process a customer transaction by credit card or at a payment center is considerably higher than other forms of payment. For example, payments received by mail cost \$0.15 per item. Cash payments received electronically cost \$0.57 per item. Credit card payments cost \$3.24 per item and in-person payments cost \$7.71 per item².

Criteria

Call centers and contract centers (in-person payment centers) can be measured for cost effectiveness in a number of manners. One of the more commonly used measures is the average “cost per transaction”. Although City Light receives enough information to determine its average cost per transaction, it has not used this information to analyze its transaction costs and identify savings opportunities.

The Washington State Department of Licensing encourages citizens to use online or mail-in tab renewal services instead of in-person locations. If citizens choose to renew in person, they may have to pay applicable services fees based on the location or sub-agent they go to.

Cause

Seven of the payment centers used by City Light are operated by the city’s Department of Neighborhoods. City Light’s fee for using the centers is based on the number of City Light transactions processed without regard to the type of transaction processed. City Light does not receive information on the number of transactions by type.

Effect

City Light is unable to effectively evaluate the cost effectiveness of its customer payment options.

Recommendation

City Light should conduct an analysis of customer payment trends by type and by region. This will provide management with key information necessary to evaluate the optimal mix of customer service options. We recommend City Light look first at the two payment processing locations within the Seattle Municipal Tower as a consolidation opportunity.

Where it is found that the overall cost per transaction is not optimal, City Light could encourage customers to use less costly payment methods, such as electronic or mail-in remittances. In addition, having customers share in the cost of credit card payments and payments at walk-in centers, as well as discontinuing use of certain walk-in centers, should be included in the considerations.

² These costs were calculated using data that was provided from the city’s Consolidated Customer Service System. We did not perform tests to assess the reliability of the system or the information it generates.

10. City Light does not charge market rates for use of warehouse and parking properties it owns.

Background

City Light owns property with a warehouse and adjacent parking spaces. The utility uses a portion of the warehouse for its own storage and leases the remaining space to a motorcycle shop and a homeless shelter funded by another city department. Surrounding parking spaces are also leased to a private vendor. On average, City Light receives \$52,000 a year from its three tenants in rent, related costs of utility usage and leasehold taxes. The city of Seattle pays approximately \$6,800 of that amount to rent space for its homeless shelter.

Condition

City Light is not collecting as much revenue as it could because its lease rates for warehouse space are below market rates. Although City Light believes it would pay between \$11 and \$13 a square foot annually to find comparable storage space, it charges the motorcycle shop \$3.82 and the City \$1.20 per square foot. In addition, it has leased parking spaces to a private parking vendor without asking for proposals from similar vendors. Such competition would likely generate increased lease revenues.

In order to verify City Light is not subsidizing the costs of private vendors and other city departments, it should charge its tenants based on comparable market rates.

Criteria

The Municipal Research and Services Center of Washington, a nonprofit organization that primarily serves local governments, organization provides guidance to local governments, such as the following guidance on use of public funds:

“A city or county is often asked to use its funds, property, or borrowing power (credit) to subsidize or assist endeavors by individuals or private organizations, such as the construction or operation of recreational facilities, economic development, or tourist promotion, and other civic or charitable works. However, the Washington State Supreme Court has long held that no matter how public the purpose may be, it may not be accomplished by public gifts or loans to private persons or organizations (except certain aid to the poor and infirm).” <http://www.mrsc.org/Subjects/Governance/publicfunds.aspx#subsidize>

Article 8, Section 7 of the Washington state constitution states in part:

“No county, city, town or other municipal corporation shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company or corporation, except for the necessary support of the poor and infirm...”

In addition, RCW 43.09.210 prohibits a department from benefiting financially at the expense of another department within the same agency. The RCW states in part:

“All service rendered by, or property transferred from, one department, public improvement, undertaking, institution, or public service industry to another, shall be paid for at its true and full value by the department, public improvement, undertaking, institution, or public service industry receiving the same, and no department, public improvement, undertaking, institution, or public service industry shall benefit in any financial manner whatever by an appropriation or fund made for the support of another.”

Lastly, two other warehouse properties were identified in a nearby area that advertised annual rates of \$10.50 and \$12 per square foot.

Cause

An analysis of market rates for warehouse and parking space has not been performed. City Light uses the property primarily for storage and considers additional income from renting the excess property as a secondary priority.

Effect

Based on the city's estimate of \$11 a square foot for market rate for comparable warehouse space, we calculate that City Light could receive up to \$35,900 in additional funds each year from the motorcycle shop and another \$49,000 from the city.

Data to compare potential rates per parking stall were not readily available.

Recommendation

We recommend City Light perform a market rate analysis to determine the appropriate rates to charge its tenants. The agreements with its tenants are on a month-to-month basis. City Light should begin discussions with its tenants to update the agreements immediately.

Other observations

City Light may have opportunities to streamline its Accounts Payable and Human Resource Departments and save on operating costs.

The Accounts Payable and Human Resource Departments have more employees than comparable departments, a condition that points to possible overstaffing, process inefficiencies and duties that could be done more efficiently by other departments.

The Accounts Payable Department currently has 11 full-time employees and 4 half-time employees. It also plans to fill an opening for a full-time accounting supervisor. According to City Light, the department's staffing includes eight full-time employees directly involved in the daily processing of invoices, a central function of the operation. Other staff positions include a manager, a full-time accountant, four half-time accountants and an office aide.

During our audit, we compared the department's invoice processing staff levels with average staffing in benchmark organizations. Our analysis concluded the department's staff of eight exceeds some benchmarked departments which perform the same level of work with 3.6 employees. A comparison of the department's other seven employees was not performed.

We encourage the Department to continue its evaluations of current operations and implement changes to reduce efforts that may no longer be required.

Similarly, the Human Resources Department has 40 individuals which serve 1,792 City Light employees. This calculates to roughly 45 City Light employees served for every human resource employee. We compared the Department's ratio of staff served with average benchmarked departments and noted other departments serve 52 employees for every human resource employee.

The departments were compared to benchmarks which included both public and private organizations. The departments perform additional over-sight duties that some private companies do not perform. For example, a comparison of the department's accounts payable staffing to the benchmark of 3.6 employees must consider that some private companies may not review every voucher as state law requires municipalities to do. Similar considerations must be made when comparing operating costs of City Light's Human Resource Department to benchmarks.

Audit procedures were not performed to quantify expected savings as detailed studies of both Departments' operations would have been required. We also did not evaluate the departments' ratios of support staff to total staff. Although some support staff is necessary, a high ratio is another indicator of possible inefficiencies and duties that could be performed by other departments. But raising these issues presents the utility with an opportunity to evaluate job duties and establish its own benchmarks to increase efficiencies, avoid duplications of effort and reduce costs where possible.

Appendix A – Initiative-900 Elements

Appendix A provides a chart showing each I-900 element and where each is addressed in the performance audit issue areas.

| I-900 Element | | Extending life of electric cable | Testing of electrical transformers | Excess electrical system capacity | Billing for customer special orders | City allocation of indirect costs | Joint operations | Accounts receivable | Rental properties |
|---------------|---|----------------------------------|------------------------------------|-----------------------------------|-------------------------------------|-----------------------------------|------------------|---------------------|-------------------|
| 1 | Identification of cost savings | X | X | X | X | X | X | X | |
| 2 | Identification of services that can be reduced or eliminated | | X | | | | | | |
| 3 | Identification of programs or services that can be transferred to the private sector | | | | | | | | |
| 4 | Analysis of gaps or overlaps in programs or services and recommendations to correct gaps or overlaps | | X | X | X | | | | |
| 5 | Feasibility of pooling information technology systems within the department | | | | | | | | |
| 6 | Analysis of the roles and functions of the department, and recommendations to change or eliminate departmental roles or functions | | X | | | | | | |
| 7 | Recommendations for statutory or regulatory changes that may be necessary for the department to properly carry out its functions | | X | | | X | | | |
| 8 | Analysis of departmental performance data, performance measures and self-assessment systems | | | | X | X | X | X | X |
| 9 | Identification of leading practices | X | | X | | | | | X |

Appendix B – Management responses



City of Seattle

February 5, 2010

Brian Sonntag, State Auditor
Washington State Auditor's Office
Sunset Building
3200 Capitol Boulevard
P.O. Box 40031
Olympia, WA 98504-0031

Dear Mr. Sonntag:

In response to the State's Performance Audit of Seattle City Light performed in 2009, the City of Seattle is pleased to offer the following comments. Since 2004 Seattle City Light (City Light) has been engaged in an effort to deliver the best customer service experience of any utility in the nation. City Light's mission as a publicly owned electric utility is dedicated to exceeding its customers' expectations in producing and delivering environmentally responsible, safe, low cost and reliable power. As the utility strives for excellence in operations and customer service, City Light has undertaken multiple initiatives to improve productivity and cost effectiveness, to measure and improve performance, and to manage rates for the long term. City Light and the City have welcomed the opportunity to work with your office over the past year to identify additional areas where further improvements can be made.

As City Light staff have worked with Ernst and Young (EY), the firm retained by your office to perform the audit, and as issues were raised, City Light initiated work to address them.

The City of Seattle and City Light greatly appreciate the value that your audit team has provided and, equally importantly, the collaborative approach used by them. Our staff have been true partners with EY and the State Auditor's Office (SAO) throughout the audit process. This approach has allowed ongoing open and professional interactions between all of the parties and transparent communications to occur.

Responses to the findings in the Audit Report follow.

1. Cable Injection

City Light agrees that injecting a cable can extend the life substantially (15-20 years) and is a lower cost option. In fact, City Light initiated a cable injection program through a trial project in 2008 prior to the State Auditor beginning the performance audit and expanded it in 2009. City Light expects to inject around 20 miles of cable in 2010 and replace around 350 cable sections that are expected to be in poor condition. A prioritized list of future projects has been assembled and 2010 Cable Injection goals established.

City Light has an estimated 535 miles of underground cable. Over time, the insulation of this older cable will degrade and allow moisture to intrude into the cable, eventually creating faults, forcing the cable to be replaced. As the auditors noted, replacing cable is very expensive. The order of magnitude depends on whether the cable is direct buried or under asphalt.

City Light estimates that the cable replacement cost per mile can range between \$500,000 and \$2,000,000 depending on initial conditions of installation. If injected it should cost around \$100,000 to \$150,000 per mile. Accordingly, City Light agrees that a cable injection program offers significant cost savings opportunities, and will continue to pursue this approach.

2. Transformer Testing

City Light agrees that there should be a review of transformer testing processes for other than pole top single phase transformers. City Light will review the transformer testing processes for other types of transformers in 2010 and will adjust testing practices as appropriate. City Light will also review charging practices with employees to ensure that only the cost associated with testing transformers is charged to these activities.

On the other hand, City Light notes that the testing in place at the utility for pole top single phase transformers is very low cost when compared with the equipment purchase cost, is in-line with manufacturer recommendations and the practices at other local and national peer utilities, aids the utility in recovering revenue, and helps the utility guard against significant risks.

Further, the majority of the units that Seattle City Light purchases each year are overhead single-phase transformers. This testing program related to this class of equipment was recently reviewed internally with the following findings.

1. Very little time (15 minutes per each OH transformer test) is spent testing these transformers. Less than 60 hours annually should be charged to test overhead pole-mounted transformers.
2. A majority of peer utilities (in the region, in the state, and nationally) perform testing.
3. The brief tests performed are used to help recover revenue from the manufacturer in two ways.
 - Failed units can be returned to the manufacturer for a replacement or credit.
 - Units that are revealed through testing to be not efficient enough (called "losses"- wasting electricity instead of converting it to lower-voltage electricity) are charged a penalty that is passed back to the manufacturer for payment.

Finally, City Light respectfully notes that manufacturers perform some tests at the factory on each new "design" of transformer, but very few on each individual transformer. In the controlled factory environment, a loose connection might not present itself.

Manufacturers recommend inspection and testing by utilities to ensure transformers make the long trip from factory to utility without damage to the delicate internal components and connections.

Briefly testing a limited number of transformers can shield the utility from several forms of risk.

- Personnel risk- crews energize overhead transformers in close proximity to the unit. An eventful failure could cause serious injuries.
- Financial risk (material) - the warranty period for transformers is very short (12-18 months). If a failure is not found within that time, the utility has no ability to recover the equipment cost from the manufacturer.
- Financial risk (labor) - the labor cost of installing an untested transformer that fails and must be replaced and installed a second time by the crew can far outweigh the cost of the transformer itself.
- System reliability risk- other than random accidents (for example, a vehicle impacting a pole and dislodging a transformer). Most transformer failures happen at the very beginning of their life (a missed or loose connection, low oil, etc) or at the very end of their life (wear out of paper insulation or similar). Testing can reduce the risk of an early-life failure and help protect system reliability.

3. Distribution Capacity

Feeder Line capacity is designed to carry load during peak use time. Previously, City Light design criteria was conservative to enable switching flexibility to transfer load during outages. City Light officially changed the 50% normal capacity loading assumption in the 2009 capacity plan, which was completed prior to the conclusion of this audit, to be more in line with industry norms.

In non-network areas, City Light determined that the 50% loading criteria was no longer accurate as loads have grown through the years, and construction has not kept up with the growth as indicated from load data from the Energy Management System. In fact, several projects were proposed in the 2009 budget during planning stages to reconductor to maintain the 50% capacity assumption and were postponed based upon implementation of new design criteria.

City Light presently does not have a working load modeling software for the radial system. However, in 2010 City Light system planning engineers will implement a more accurate tool for review of how the feeders are loaded during normal and emergency conditions. City Light may make further revisions to design assumptions after this analysis.

Load modeling will occur when Geographic Information System data is transferred to the newly acquired distribution analysis software (ETAP) by August of 2010. The planning process will become more integrated as a result.

Due to changes in planning assumptions and modeling software implementation, City Light recognizes that past assumptions on capacity projects are no longer accurate and will be revised in the 2011-12 budget cycle as the 6-year CIP plan is updated.

4. Billings

City Light agrees that all billable costs should be recovered from customers. The practice of billing actual costs for only those jobs that are over \$35,000 was a long standing practice and adopted business policy at City Light. Historically, City Light has had a good track record of producing valid estimates that matched final costs for these sized jobs.

Nevertheless, City Light began an overall billing process improvement effort in 2009 and will begin an additional effort in 2010 focused more specifically on billing for customer work. All jobs over \$5,000 will be billed as time and material. In addition progress billings will be implemented and metrics established to ensure performance goals are being met. This process improvement effort will be completed early in 2010.

In addition, City Light is currently implementing process changes in engineering and operations to put in place standard procedures, materials, and methods (compatible units) though currently many jobs are uniquely designed.

As part of the 2010 process improvement efforts, City Light will analyze the work orders and amounts estimated by the auditor as unbilled to determine whether these amounts are accurate.

City Light will also review and attempt to recover outstanding costs associated with any projects where the analysis shows that the customers can be billed in accordance with the Seattle Municipal Code.

5. Cost Allocations

This response is provided by the City's Department of Finance.

As part of the 2010 budget, City Light worked with the City of Seattle's Department of Finance, the Mayor's Office, and the City Council to eliminate many of the utility's vacant positions. The utility has improved its hiring processes and thus expects to maintain lower vacancy rates in the future. Because these lower rates are more consistent with the vacancy rates used by other departments, the cost allocation problems that resulted from

using budgeted instead of actual positions should be reduced or eliminated beginning in 2010.

The City is committed to reviewing many cost allocations as part of the development of the 2011-2012 biennial budget. Based on the results of the audit, we will include emergency management and information technology functions in this review. The City will also examine the possibility of "truing up" budgeted values for allocated costs and allocation factors with actual results at the end of each year or biennium.

Identifying the appropriate allocation factors for the emergency management function is difficult. Much of the benefit of the citywide emergency operations center (EOC) and program is the opportunity for immediate inter-departmental cooperation, which is of significant value to City Light. In an emergency, City Light often needs to get assistance from the Police Department, Fire Department, Seattle Public Utilities, or other agencies, and the co-located EOC facilitates this. It is also worth noting that most of the activations of the EOC in recent years have been for storm events, which typically most affect the utilities and the Seattle Department of Transportation. It is thus reasonable that those departments bear a substantial share of emergency management costs.

6. General Government Costs

This response is provided by the City's Department of Finance.

The City does not agree with the audit recommendation that central service departments such as the Law Department and Personnel Department should allocate costs to each other. This would simply create another layer of complexity and, on average; any savings to the utilities due to these internal allocations would be balanced by higher charges to the utilities to recover the reallocated costs. The City therefore does not agree with the figures of potential overcharges to the utilities included in the audit.

However, the audit does point out one change that should be made. The City revised its cost allocation processes in 2005 in response to the Superior Court's decision in the Okeson case. This decision upheld the vast majority of cost allocations challenged by the plaintiffs but did identify a few categories of costs, such as costs for the Mayor's Office, which should not be charged to City Light. In making these adjustments, the City inadvertently failed to recognize the indirect costs that are associated with the internal services provided to the Mayor's Office, the City Council's portion of the Legislative Department, the portion of the Office of Arts and Cultural Affairs that is not involved in the 1% for Art program, and the portion of the Department of Neighborhoods other than the neighborhood payment centers. This oversight results in small excess charges to City Light and will be corrected in the 2011-2012 budget.

The City does not agree with the audit's view that it is inappropriate to allocate most Legislative Department costs, including the City Clerk's Office and the Council's central staff, to City Light. These units provide services to City Light including processing legislation, maintaining public records, and reviewing rate proposals. If City Light were not

part of City government, the costs of these Legislative Department functions would be lower, so City Light appropriately bears these costs. By way of analogy, if City Light were a privately-owned utility, it would be required to pay the costs of its regulatory agency. Therefore, it seems appropriate that City Light pay these Legislative Department costs. It is also worth noting that the Okeson decision allowed these costs to be charged to City Light.

The energy advisor position in the Office of Policy and Management was discontinued in mid-2009. City Light received a refund for all unspent funds for 2009 and was not allocated costs for this position or related functions for 2010.

7. Joint Operations-Call Center

City Light and SPU agree that the allocation of costs for the call center should be reviewed. In the fall of 2009, City Light and SPU agreed to conduct a comprehensive joint study of the call center. This would include a thorough analysis of operating costs and appropriate cost allocation. A new agreement was to be negotiated based on the study results. This study was to be completed by the end of the first quarter in 2010.

However, a new Seattle City administration was elected and sworn in 2010. One of the administration's priorities is to examine the feasibility of consolidating operations. The responsibility for this broader potential undertaking, as well as a review of the Call Center, now rests with a member of the Mayor's cabinet, and a schedule for the review is currently under development.

8. Joint Operations- CCSS Billing

City Light notes that while a validation and true up of costs did occur in the past, an examination of City Light practices revealed that the skills of the review team needed to be supplemented and that City Light may have reviewed incomplete cost data.

In 2008 as the performance audit was underway, City Light increased the focus on monthly reviews by both expanding the skills on the review team members and ensuring the correct and full data was reviewed. City Light is also putting procedures in place to ensure that all costs are fully identified and billed by February 28 of the following year in which the charges were incurred.

As a result of the auditor's recommendation, City Light also intends to pursue recovering the 2006 and 2007 under paid amounts.

9. Customer Revenue

City Light supports the goal of driving down transaction costs and generating savings for ratepayers. Therefore, City Light is conducting a review of our collection practices.

However, City Light's arrangements with the Department of Neighborhoods are governed by the Mayor and City Council, who have made a policy choice to require that City Light continue this payment option through the Neighborhood Service Centers. The Mayor and Council have stated that they believe the higher cost is justified due to the customer service benefit provided.

City Light plans to address this and other payment alternatives in the collection practices review, with work to be completed in the first half of 2010. Based on the results of that study, City Light will be actively negotiating alternative pay station arrangements in 2010 to increase the options for convenient bill payment while mitigating costs to the Utility.

10. Rental Properties

City Light agrees that charging market rates for the use of parking lots and the warehouse is appropriate. City Light has already taken action to implement the audit recommendation to increase parking lot rent to market rates. Parking lots under permit or pending permitting have been rented for 65% of gross revenues (including the 12.84% Leasehold Excise Tax) for two of three pay parking lots and for 63% of gross revenues for the third property. The rental agreement for the third property also requires that certain improvements be made.

City Light has also engaged a real estate advisory firm to advise on market rental rates for the warehouse. The motorcycle dealer and the City Department operating the homeless shelter have been advised of the proposed audit finding. City Light notified these entities that City Light is obtaining an appraisal of market rates and the use permit for the motorcycle dealer and the interdepartmental rental agreement for the homeless shelter will be revised appropriately unless City Light receives approval to sell the property.

11a. Other Considerations- Human Resources

While City Light supports improving the efficiency of operations in all of its business units, it is important to note that City Light's Human Resources function operates in a unique environment that should be recognized in efforts to benchmark overall HR resources per employee. HR practices and resource levels reflect the unique needs of both a represented utility industry workforce and city civil service and other unique HR processes and requirements. Further, HR at City Light primarily relies on manual processes rather than business systems. In the absence of adequate business systems, City Light has work processes that are extremely labor intensive.

In 2009 there were 38 authorized positions in Human Resources. Two positions were cut in the 2010 budget resulting in 36 authorized positions. In 2010, the ratio will be 52.3 positions for every human resources position. It should be noted that the Human Resources business unit at City Light includes the Safety and Apprenticeship divisions in addition to recognized human resource functions.

The current HR information system was designed to meet the general needs of 22 different departments in the City of Seattle and does not adequately address the unique needs of an electric utility functioning in a highly regulated industry. If the Utility were to have funding to invest in a Talent Management System that shared a platform with the rest of the Utility's business systems, HR could further reduce support staff.

11b. Other Considerations- Accounts Payable

City Light is committed to ensuring that all functions within the Utility are performed efficiently while at the same time ensuring the effectiveness of SCL's controls to mitigate the risk of financial fraud and abuse.

The Account's Payable Unit of City Light during 2009 has been staffed with 10 full time positions and 4 part-time positions. These positions include a full time manager, a full-time accountant, eight full time accounting technicians, three part-time accounts payable technicians and a part-time office aide. This staffing will be reduced in 2010 by one position.

City Light believes the Accounts Payable function has operated efficiently for the work the group is tasked with. There are responsibilities that the Accounts Payable group is charged with that are not found in private companies, such as the responsibility for complying with not-infrequent public disclosure requests that require searches for and compilation of hundreds of invoices and voucher packages. Further, as a public entity, the level of scrutiny the Utility applies to payments is higher than at entities which do not operate in this environment. The governing structure of the City and the regulatory and administrative oversight provided by the City Council, its Energy and Technology Committee, and in particular the City and State Auditors underscore the importance of effective controls to ensure payments are accurate, timely and appropriate.

For example, payment procedures require multiple layers of review and approval as well as manual calculations to ensure expenditures are within encumbered funds and budget expenditure authority. Similarly, as the State Auditors have noted, review of staffing levels must also consider that some private companies may not review every (invoice) voucher as state law requires municipalities to do.

That said, City Light recognizes that the emphasis on strict compliance should also be tempered with a "cost-benefit" perspective. To that end, City Light conducted during 2009 a review of accounting operations, including accounts payable, and is working through a number of potential work process changes. Since the State Auditor's fieldwork, we have implemented the following changes:

- Abrogated 1 position / will not fill the open Supervisor position and
- Revised procedures for review of credit card charges to better align the default account coding which is automatically applied to each transaction to minimize the

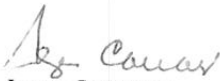
number of recoding actions that must be taken before the transactions are processed for payment.

Continued changes in A/P operations are under discussion, with the goal of identifying operational changes that are feasible and cost effective but which do not substantially increase the risk of fraud or mis-appropriation of Utility funds. Focus areas include:

- Revising procedures for review of high frequency low dollar items where invoices may be paid without time consuming routine review by field personnel (e.g. shop towels, photocopy machines, some cell phones, etc).
- Transition the preparation and filing of bankruptcy claims out of Accounts Payable and to the Legal Affairs Unit.

Thank you for this report which will allow the City to assess and implement many recommendations to improve operations.

Sincerely,


Jorge Carrasco
Superintendent
Seattle City Light


Dwight Dively
Director
Department of Finance
City of Seattle

Appendix C – Ernst & Young rejoinder to management responses

In response to City Light's Management comments, Ernst & Young offers the following rejoinders.

Finding

2. City Light unnecessarily spends nearly \$500,000 each year to test electrical transformers already tested by their manufacturers.

We thank City Light officials for reviewing their testing practices. We reaffirm our audit results. In 2008, more than 15,000 hours were charged to single-phase transformer testing. This amount is significantly more than the 60 hours City Light suggests should be incurred each year. Furthermore, we agree that other utilities may perform limited testing; however, we do not agree that it is common practice for utilities to test each and every transformer received. During the audit, we attempted to obtain records for all types of transformer testing showing the number of failed units identified, the types of failures and the number returned to the manufacturer or assessed penalties. City Light's records were inadequate to show this type of historical information; therefore, we were unable to determine the cost benefit of its testing activities.

6. Some city departments are not charged their fair share for city services and some city services charged to City Light are questionable. Both conditions cause City Light to pay more general government expenses than it should.

We concur that a complete allocation scheme among all central services departments could add an unnecessary level of complexity. But we affirm our position as our report calculations allocate expenses to three central services departments that are not reallocated. Our calculations including only the three departments are an accurate reflection of the amounts overcharged, including over \$2.3 million to City Light and over \$1.5 million to Seattle Public Utilities. Put another way, while we agree that allocating expenses to a department that subsequently reallocates all its expenses may not result in a material difference, there is definitely a significant impact when excluding departments that do not reallocate. This analysis supports the need for the city to revisit its cost allocation methodology.

Regarding legislative costs, we respectfully disagree with the City's assertion that the Okeson case allowed these costs to be charged to City Light. Our analysis indicates the decision did not specifically address Legislative expenses other than the Mayor's Office and staff. We believe it is reasonable to consider legislative activities as a general government function. This is why we recommend the city perform additional legal analysis of these expenditures before it continues to allocate them to City Light, Seattle Public Utilities and other city funds. Related to general government functions, the Okeson case noted the Mayor's Office spent approximately 20 % of its time on utility oversight, of which a significant portion was oversight of City Light. Despite the time spent on City Light activities, the court ruled that the mayor and his staff serve a general government function of oversight and coordination with other Seattle departments.

ATTACHMENT 2: SEATTLE CITY LIGHT'S ACCOMPLISHMENTS

Seattle City Light

ABOUT SEATTLE CITY LIGHT'S ACCOMPLISHMENTS

- Provided to the State Auditor by Seattle City Light
- Information is not audited



WASHINGTON
BRIAN SONNTAG
STATE AUDITOR



Seattle City Light

Noteworthy Accomplishments

- **Asset Management:** Began implementation of a comprehensive life cycle asset management program and is in the process of installing a work and asset management software solution to support this effort. Scheduled for completion in 2012, this program will allow the utility to more effectively target electrical delivery infrastructure upgrades and more improve the scheduling of work. This program will improve reliability and save costs.
- **Automated Fleet Management:** Installed an information technology system to automate the management of fleet vehicle check out and use. This allowed us to increase the effectiveness of vehicle use and retire a number of older vehicles from the fleet.
- **Benchmarking:** Participated for the past five years in American Public Power annual benchmarking studies and for the last few years in specific studies on transmission and distribution, generation, support services and customer service including the J.D. Powers survey. City Light is using the information gained from these studies to drive improvements at the utility.
- **Bonneville Power Administration Contract Re-negotiated:** The contract for power with BPA was successfully negotiated. This negotiation firmed up roughly 45% of Seattle's power supply for 17 years, 2011-2028 under terms similar to earlier agreements.
- **Boundary Relicensing:** Filed application for a new 50 year license with FERC in September 2009. Seattle City Light has been engaged in the licensing process for the Boundary Dam for over five years, including an active negotiation process involving federal, state, tribal, and other stakeholders. There were no competing proposals filed with FERC. The Utility and FERC have reached agreement in principle, and formal settlement is expected in early 2010. As part of its license application, the Department has proposed various capital improvements to the Boundary Project over the life of the new license.
- **Combined Charities:** City Light served as the departmental lead for the citywide effort to raise funds for Combined Charities Campaign. The City exceeded the goal of \$1.14 million during a historic national economic downturn. City Light raised over \$182K, more than any other department.



- **Compliance with Federal Regulations:** Built new compliance oversight function to promote compliance with new mandatory reliability standards established by the North American Electric Reliability Corporation, and met 2009 compliance requirements.
- **Conservation and Renewable Resources:** Continued to be a leader in the conservation area including developing a 5-year conservation plan to ensure annual increases in savings and as a major component of an Integrated Resource Plan. In 2008, the Department achieved 10.37 aMW (90,883 MWh) of energy savings. Total savings since the program's inception amount to 120 aMW (1,051,200 MWh), representing more than ten percent of the Department's total energy needs in 2008.
- **Current Diversion:** Revitalized this program designed to reduce energy theft. SCL is working with local law enforcement and prosecution offices to help curtail drug operations and ensure SCL recoups significant lost revenue.
- **Customer Satisfaction:** Seattle City Light's score in the JD Powers utility customer service ranking increased by 5 points, which put the utility into the top 25% of participating utilities nationwide.
- **Emergency Preparedness and Response:** Staffed an emergency preparedness and response unit, instituted an Incident Management Team, developed a Continuity of Operations plan, and provided training on emergency response to employees.
- **Enterprise Risk Management:** Prepared risk management plans for the top risks at the utility and proposed an enterprise risk management policy to the overseers of the utility.
- **Energy Risk Management:** Completed the first Wholesale Energy Risk Management Policy Review (conducted by Deloitte & Touche). No exceptions to the Utility's Energy Risk Policy were noted.
- **Environment:** Achieved zero-net greenhouse-gas emissions while providing power to its customers and has done so since 2005 as the only utility in the nation to reach this goal. Locally, the Utility's stewardship of watersheds are a priority, and tireless efforts to restore the Chinook Salmon runs on the Skagit River are getting results. The Chinook run on the Skagit this year is estimated to be 25,000, the highest level in over 20 years. It was so high that Washington opened a brief fishing season on the Skagit.
- **Finance and Budget:** Received bond rating upgrades from Standard and Poor's from A+ to AA and from Moody's Investors Service from AA3 to AA2 in December 2008. Reduced utility spending by \$64 million in 2009 in response to economic downturn and the impact on the Utility's surplus power sales. Giving continuing impact of



downturn and cost changes since 2006 when rates were last set, the Utility conducted a rate review in 2009 with citizen involvement, leading to a Council approved rate adjustment for 2010.

- **Human Resources:** Created a comprehensive workforce development plan recognizing that in 5 years 50% of our workforce will be eligible for retirement and there is currently a national shortage of personnel trained to perform specialized work in the utility industry. Trained staff are needed to fill the roles vacated by retirees and to support the utility's pursuit of new technology such as Automated Metering Infrastructure (AMI), new Conservation technology and distributed generation. Developed plan for implementing workforce reductions for 70 positions which impacted 36 employees (subsequently reduced to 60 positions). Designed plan to implement furloughs for more than 1000 represented and non represented employees.
- **IT Infrastructure:** Supported 25 facilities; 2700 computer devices; 1435 wireless devices; 10.8 terabytes of data. Logged and resolved >20,000 Service Desk Tickets. Upgraded email system to Microsoft Exchange and Outlook, implemented web filtering software, implemented over 35 enhancements to power management software.
- **Overtime:** City Light's Energy Delivery Operations division took steps to significantly reduce overtime costs (by approximately 35%, or \$4 million) after several years of exceeding budgeted amounts.
- **Outage Management System:** Began implementation of a new software application that will provide better information to customers about restoration times and will more effectively organize crew work for improved response time. Project is on time and within budget with scheduled implementation to be completed prior to 10/01/10.
- **Performance Management:** Initiated the implementation of a business intelligence system to provide data and measurements for management to improve process efficiencies and cost effectiveness of operations.
- **Purchasing and Contracting:** Implemented policies and procedures with internal controls that will be used as a model for other City departments. Consistently expanded supplier base, increasing utilization of services from historically underutilized and women/minority owned businesses from under 5% of spending in 2004 to approximately 12% in 2009.
- **Ross Generating Station - Generator Rewind Program:** Completed field construction activities associated with a rewind of the fourth of four generators at Ross. This program began in 2004 as a means of addressing operational limitations



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related to failures that were occurring with electrical features of these machines. With the completion of the final machine this year, we have essentially built four new generators that have a design life of approximately 40-years. These machines are also more efficient and more reliable as a result of this work. The work was completed with a combination of contract crews and City Light crews.

- **Strategic Plan:** Developed a strategic plan to communicate the key issues facing Seattle's electric utility, and how the Utility intends to respond to them. Conducted extensive public outreach (30 meetings and events) on the plan. City Light will update the plan in 2010.
- **Smart Grid:** Developed a Smart Grid Plan and applied for Federal Stimulus funding to begin implementation of the program. Plan provides for distribution and substation automation, and advanced metering.



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