

Surface Water Management Service Charges

Report No. 93-10

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INTRODUCTION AND BACKGROUND

The audit of the Surface Water Management (SWM) Program was initiated at the request of the King County Council. Expressed concerns included the substantial rate increase in SWM service charges, equity of service charge to ratepayers, and the capacity of the SWM Division to manage and complete an expanded and accelerated Capital Improvement Program (CIP).

The SWM Program addresses controlling and reducing surface water runoff, which creates

urban drainage problems, and protecting water resources in the SWM Service Area, which is the western, urbanized one-third of unincorporated King County. SWM Program elements include planning, land use controls, construction, operation and maintenance of facilities, and public education.

The most recent enhancement of the SWM Program became effective with the adoption of Ordinance 10187 in December 1991. The SWM Program was expanded to address water quality problems and to deal with off-road drainage systems. Furthermore, to meet current and future surface water problems, basin planning, CIP schedules were to be accelerated and expenditure levels expanded. This program expansion is to be financed by an increase in the annual SWM service charge from \$29.89 to \$85.02 for the residential customer class and comparable increases for non-residential customer class which are charged on a sliding scale based on contribution to the water runoff problem and acreage per parcel.

OBJECTIVE AND SCOPE

The primary objective of the audit was to review the basis of the new SWM service charges. The audit focused on the rate setting methodology and the reasonableness of the underlying data and assumptions. Additionally, the audit examined whether SWM service charges were equitably established and administered, and if the SWM Division had the capacity to manage the construction of major CIP projects.

Accordingly, audit methodology included a detailed review of the rate model devised by the SWM Division to establish current service charges. The rate model review included an analysis of key assumptions and underlying data through such procedure as statistical analysis and on-site visits to verify property characteristics. Other methodology included interviews of management and staff, review of contracts and agreements, reviews of policies and procedures, and a sample review of underlying documentations, such as interlocal agreements and project management files.

SUMMARY STATEMENT OF FINDINGS

It was concluded that the approach to the computation of the service charges and the design of the rate model were adequate. However, we noted that the procedures for periodic review and updates of underlying data and assumptions needed to be improved in order to minimize the potential for inaccuracies in rates charged to customers. The audit also concluded that the SWM service charge appeared to be equitably established for the rate payers within the SWM Service Area, as a whole, and it appeared that the SWM Division has the capacity to manage the currently mandated CIP projects.

MAJOR FINDINGS AND RECOMMENDATIONS

Finding 1. Rate model's design and fee computation appeared reasonable.

The approach to the computation of the service charge and the design of the rate model appeared reasonable. However, policies and procedures for periodic review and updates of underlying data and assumptions used in the rate model need to be improved to minimize the potential for inaccuracies in rates charged to customers. For example, SWM simply used the same 2% annual growth rate for all customer rate classes; however, subsequent actual growth for a given rate class ranged from an increase of 3% to a decrease of 18% in the number of accounts and an increase of 24% to decrease of 15% in acreage. Also, the key assumptions, that residential parcels average one-quarter acre and contain 24% impervious surface, were formulated in 1983 and the subsequent analysis and update appeared inadequate to validate the assumptions. Furthermore, audit staff found an 8% error rate in classification of non-residential accounts to the appropriate customer rate class.

The audit recommended that SWM maintain and analyze available historical data and that updated and accurate data be maintained in the rate model. Also, it was recommended that SWM develop and formalize standard procedures for the consistent collection and analysis of data, especially with respect to residential parcel assumptions. Finally, it was recommended that SWM implement procedures to conduct on-site verification of the characteristics of non-residential properties.

Finding 2. Procedures to adjust the rates to reflect actual data and actual costs incurred do not exist.

Policies and procedures to compare actual data to estimates and to review the resulting impact on service charges do not exist, resulting in the absence of a process to adjust customer rates which are based on estimates to rates recomputed to reflect actual customer data and actual costs. Generally, it is considered good practice, especially for utility-type services, to review the rates charged to customers and adjust subsequent rates to reflect the actual costs of services provided. Without such review to compare rates based on estimated costs and data and, also, the underlying rate model assumptions to subsequent actual costs and data, there are no full assurance that customers, as a whole, or certain customer class(es) were not over or under charged for the services provided.

The audit recommended that SWM improve its policies and procedures for documenting and maintaining rate model-related data. It was also recommended that SWM service charges be monitored to determine the reasonableness of its estimates compared to actual costs. Finally, it was recommended that, if data can be readily collected in a reasonable manner, actual costs and customer data be compared to estimates used in developing 1987-1991 and 1992-1994 rates and any differences be factored into the 1995-1997 rate setting process.

Finding 3. Impacts of annexations and incorporations appear to be adequately addressed.

Impacts of annexations and incorporations appear to be adequately addressed in SWM's planning process. To minimize the potential impact on the SWM ratepayers from the erosion of revenue base due to annexations and incorporations, the SWM Division appears to adequately monitor and plan for contingencies related to annexations and incorporations. This included downsizing of the bond issue (from original proposal of \$20-\$24 million to \$12 million), prioritizing the CIP projects to be funded and monitoring revenues to ensure adequacy of expected revenue to finance debt service.

A major concern was the County's lack of statutory authority to continue, upon annexation/incorporation, to levy SWM service charges to fund the retirement of debt which may have directly benefited the annexed or incorporated area. The remaining unincorporated residents would have borne the increased service charge rate to cover any shortfall. However, King County introduced legislation which was passed by the State Legislature in the 1993 Session. Thus, allowing the counties to continue to levy the debt service portion of SWM-type charges in areas that are subsequently annexed or incorporated.

Finding 4. Interlocal agreements appear to be well utilized by SWM.

Interlocal agreements appears to be well utilized by SWM to address cooperative arrangements. However, SWM does not have procedures to consistently and effectively monitor the terms of such contracts. SWM uses interlocal agreements primarily to formalize cost sharing arrangements with various other government entities, but may also use them for other arrangements such as the development of regulations and monitoring procedures. While audit staff found the procedures underlying the preparation and implementation of interlocal agreements were adequate, it was noted that SWM lacks formal and consistent policies and procedures to provide satisfactory assurance that the other parties to the contracts are adhering to the contract terms.

The audit recommended that SWM include more specific provisions in interlocal agreements with respect to implementation and verification of the terms of the agreements. It was also recommended that SWM prepare policies and procedures to ensure compliance with the terms of interlocal agreements, such as correctness of invoiced costs, meeting deadlines and proof of implementing laws/regulations/procedures.

Finding 5. SWM has not implemented other revenue sources.

SWM has not included any of the other revenue sources identified in its Strategic Plan and/or recommended by the Division, such as developer impact fees, in its service charge rates. In its Strategic Plan (January 1991), and other studies dating back to 1983, the SWM Division recommended reviews and potential implementation of "impact fees" on developers for necessary capital costs and a substantial fee for a "clearing permit" when undeveloped property is disturbed for any purpose. While the 1992-1994 rate amounted to an 186% increase over the

previous rate and the expected rate increase in 1995 may amount to an additional 20%, SWM has not implemented any of the supplemental revenue sources.

The audit recommended that SWM conclude its review of other revenue sources and implement such program(s) before initiating the rate setting process for the 1995-1997 rate.

Finding 6. Guidelines for the expansion of the SWM service area are not clearly defined.

Guidelines for the expansion of the SWM Service Area are not clearly defined and, also, there is a definite lack of guidelines for the placement of various CIP projects in a given CIP fund for accounting and investment purposes. SWM recently acted to expand the SWM Service Area to include the Middle Cedar River Basin. Furthermore, the funding for activities in the area was transferred from the River Improvement Fund, which deals primarily with flooding of major rivers, to the Surface Water Management Fund, which addresses urban drainage problems. SWM staff were not able to provide audit staff with clear guidelines and specific criteria, such as population level/density, level of development and percentage of impervious surface, under which a given area would be included in the SWM Service Area and expenses to fund the activities in the same area would be switched from one fund to another with clearly distinctive revenue sources and underlying mandates. Additionally, it was found that a number of CIP projects which appear to address major river problems were located in the "Surface and Storm Water Construction Fund" and a number of CIP projects addressing urban drainage problems were located in the "River and Flood Control Construction Fund," and vice versa. Thus, interest earnings of the funds allocable to the misassigned projects may be used for inappropriate purposes.

The audit recommended that SWM establish clearly defined and measurable guidelines under which a given area is included into the SWM Service Area and clearer guidelines be established to distinguish the type of service to be provided under the two major funding sources. Moreover, the audit recommended that clear guidelines for assigning CIP projects to CIP Funds be established and the accounting practices for interest earnings on funds available for projects be reviewed and, if needed, earnings be restored to the correct CIP fund.

Finding 7. SWM's project management process appears adequate, but CIP write-ups need improvements.

SWM's project management process appears adequate to handle the CIP projects envisioned in the Strategic Plan. However, SWM CIP write-up needs to be improved to clarify the status of projects and to note the involvement of other governmental entities in the CIP Projects.

The audit recommended for the latter funding, that SWM clarify its procedures for CIPs and relevant data included in the CIP budget book in order to readily review and update the information on the status of the projects. Moreover, for those projects being constructed/funded in conjunction with other governmental entities, it was recommended that SWM provide additional information, such as jurisdictional entities involved and total project costs, to disclose

the full scope of the project.

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