

Sewage Facilities Capacity Charge

Report No. 95-03 -- Report Summary

Mac Fletcher, Principal Financial Auditor
Paul Walker, Financial Auditor

TABLE OF CONTENTS

▶ [Introduction and Background](#)

▶ [Objective and Scope](#)

▶ [Summary Statement of Findings](#)

▶ Major Findings:

- ▶ [Finding](#) - Assurances that Metro's capacity charge rate meet the state mandate did not exist.
 - ▶ [Finding](#) - Metro collected two elements of capacity charge revenue in accordance with existing mandates.
 - ▶ [Finding](#) - Capacity charge revenues are not used for any specific purpose.
 - ▶ [Finding](#) - Capacity charge revenues could be enhanced by adjusting the discount rate offered in the early payoff program.
 - ▶ [Finding](#) - The current billing system does not guarantee that all customers subject to the capacity charge are identified and billed.
-

INTRODUCTION AND BACKGROUND

The financial audit of the sewage facilities capacity charge was authorized by the Metropolitan King County Council in the 1995 Auditor's Office work program. The audit was requested by the Regional Water Quality Committee to review the collection and use of the capacity charge.

The statutory authority to impose a capacity charge is provided through RCW 35.58.570. The capacity charge is imposed on users of sewage facilities when the user connects, reconnects, or establishes new service. The purpose of the capacity charge is to recover costs already paid by present and past customers for building enough sewage treatment capacity to serve newly connected customers. The responsibility for the capacity charge currently resides with the Water Pollution Control Division.

OBJECTIVE AND SCOPE

The overall objective of the audit was to determine whether Metro's sewer capacity charge complied with the legislative mandates expressed in the State statute and any relevant County ordinances or METRO resolutions. The audit focused primarily on the underlying data determining the monthly capacity charge. Additionally, the audit reviewed the amount and the use of capacity charge revenues and Metro's capacity charge billing system.

SUMMARY STATEMENT OF FINDINGS

The general conclusion of the audit was that the Metro capacity charge rate may not be in compliance with the legislative mandate expressed in the State statute. The audit found that costs

included in the capacity charge rate may be overstated through errors, overstatement of recoverable costs, and inclusion of facilities which may not have excess capacity designed into them. Additionally, the audit found that the documentation to support the current charge is no longer available and, thus, not verifiable.

Furthermore, while Metro conducted an annual review of the capacity charge rate, the audit found that the underlying assumptions are unclear and the data used appear to be erroneous and/or outdated. The audit also found that capacity charge revenues are not used for any specific purpose which may not be in accordance with the original intent of the program. Finally, the audit found that Metro's billing system did not provide assurance that all customers subject to the capacity charge are identified and billed.

MAJOR FINDINGS AND RECOMMENDATIONS

Finding II-1. Underlying assumptions and data to ensure that Metro's capacity charge rate met legislative mandates were not documented or clearly defined; thus, compliance to the mandate is not assured.

Audit staff found that documentation for any Metro staff work conducted in support of capacity charge legislation (RCW 35.58.570) was not available. The statute is specific as to eligible sewage facilities and the excess capacity portion(s) of such facilities. However, documentation of any work which may have been done to arrive at the capacity charge specified in the statute or to ensure that eligible capital costs would not have resulted in a rate less than the statutory limit was not retained by Metro.

Subsequent to the initiation of the capacity charge, Metro has conducted an annual review of the rate. However, audit staff found that the analysis' underlying assumptions are unclear and the data used in the annual review were erroneous and/or outdated. For example, it was found that the basis for "excess capacity" and its applicability to the facilities used in the calculation of the capacity charge have not been adequately defined or documented.

In addition, the project descriptions in Metro's capital budget book indicate that excess capacity may not have been designed into all the facilities used in the analysis. The audit also found that "actual" costs used in the analysis do not reconcile to Metro's accounting records, included grant funds provided by other governments, and some of the supporting data such as the estimate of new customers, appear outdated. Finally, similar to the staff analysis for the capacity charge legislation, the original documentation for the annual rate review process was not retained by Metro and, therefore, was no longer verifiable.

The audit recommended that the Water Pollution Control Division should conduct a detailed review of assumptions and data underlying the capacity charge, select one approach to compute and/or test the reasonableness of the rate, and present the results of the review to the Metropolitan King County Council for its review. It was also recommended that the Water Pollution Control Division should retain all key documentation which support charges to customers as long as such charges are effective.

Finding II-2. Metro collected two elements of capacity charge revenue -- direct charges to new customers and capacity charge benefit payments by the City of Seattle -- in accordance with the existing mandates.

Metro collected capacity charges from new customers after they connect, reconnect, or otherwise establish new service. Metro also received capacity charge benefit payments from the City of Seattle. This was proposed by Rate Structure Advisory Committee to pay for the costs of capital improvement projects for the combined sewer overflow (CSO) control program which intended to deal with inflows of surface and stormwater into the sanitary wastewater system in Seattle. The City has accepted the capacity charge benefit payment through an amendment to the Agreement for sewage disposal.

The audit found that Seattle capacity charge benefit payments are made in accordance with the

existing terms of agreement. The audit further noted that under the current rate of payments, it will take 225 years or more for Seattle to pay off the CSO control projects thus far identified by Metro staff.

Finding II-3. Capacity charge revenues are not used for any specific purpose, which may not be in accordance with the intent of those who proposed the rate.

The audit found that capacity charge revenues, including both customer charges and the Seattle capacity charge benefit, are not used for any specific purpose. Both revenues are commingled with other operating revenues of the water quality program and used primarily for operating expenses and debt service requirements.

Audit staff found no language in the existing mandates that require the capacity charge revenues to be used for any specific purpose. However, audit staff has found some indication that the capacity charge proceeds should be used for specific purposes. It appears that the Rate Structure Advisory Committee intended to address this issue. Furthermore, the amendment to the Agreement for Sewage Disposal with the City of Seattle requires that capacity charge revenues be used only for capital expenditures or early defeasance of outstanding revenue bonds.

The audit recommended that the Water Pollution Control Division should review the underlying intent of capacity charge revenues and the intended use of such revenues. The result of such review and determination as to specific use should be presented to the Metropolitan King County Council for review and approval.

Finding II-4. Capacity charge revenues could be enhanced by adjusting the discount rate offered in the early payoff program.

Under authority granted by Ordinance No. 11780, the capacity charge customer is allowed to pay off the sum of any remaining payments at any given time. The audit found that such payments are discounted at the rate of 8%, which is higher than the interest rate paid by Metro on its long-term borrowed funds, currently in the 6-7% range. Audit staff noted that, by lowering the discount rate to 6%, Metro could enhance the capacity charge revenue by, at minimum, \$41,500.

The audit recommended that the Water Pollution Control Division should consider a proposal to revise the discount rate language of the early payment provision to more flexible language tying the discount rate to the long-term interest rate. Such rate should be set annually in order for customers to determine the amount payable under the early payment option.

Finding II-5. With the current billing system, there is no assurance that all customers subject to the capacity charge are identified and billed; thus, potentially reducing the revenues available to the program.

Under the current system, the capacity charge was billed directly by Metro to its customers. However, Metro relied on the component sewer agencies to identify and report new customers who are subject to the capacity charge. Also, under interlocal agreements, the component agencies are to request that customers complete capacity charge forms and determine the accuracy of the information submitted by the customers.

Metro Audit Services (MAS) recently initiated a review of the capacity charge program, in conjunction with the review of other customer statistics reported to Metro by the agencies. Based on the MAS work thus far completed, it was found that as many as 8.3% of new customers subject to the capacity charge were not being reported to Metro. MAS also found that some of the component agencies were not verifying the accuracy of the information submitted by the customers.

The audit recommended that the Water Pollution Control Division should prepare a cost-effective solution to ensure that all new customers subject to the capacity charge are reported and billed in accordance with statutory authority and existing County ordinance.

Updated: 06/24/02