

SPENDING UTILITY RATEPAYER MONEY:

Not always linked to services,
decision process inconsistent

March 2011

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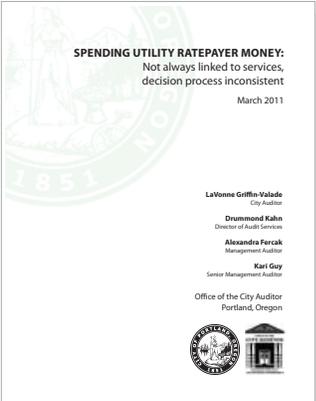
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CITY OF PORTLAND

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March 30, 2011

TO: Mayor Sam Adams
Commissioner Nick Fish
Commissioner Amanda Fritz
Commissioner Randy Leonard
Commissioner Dan Saltzman
Dean Marriott, Director, Bureau of Environmental Services
David Shaff, Administrator, Portland Water Bureau

SUBJECT: Audit Report – *Spending Utility Ratepayer Money: Not always linked to services, decision process inconsistent* (#398)

The attached report contains the results of our audit of the City's spending of utility ratepayer money. Our work focused on whether spending by the Bureau of Environmental Services (BES) and the Water Bureau was related to providing utility services. We very much appreciate the cooperation and assistance we received from the involved bureaus and other City staff throughout this audit.

The budgets of the Water Bureau and BES are almost entirely supported by utility rates, fees, and bond proceeds. The combined capital and operating spending of the two bureaus will be approximately \$478 million in FY 2010-11. The Water Bureau supplies domestic water to residents of the Portland area and serves approximately 900,000 people. BES provides sanitary sewer service to approximately 576,000 residents, numerous commercial and industrial facilities, and several wholesale contract customers.

While the vast majority of spending is directly related to water and sewer services, the audit found that some spending of ratepayer money is not consistent with the planning, budget, and rate setting process, and it is not always clear how these items are directly related to providing water and sewer services. Without following the rigorous and comprehensive public budget process required of all City bureaus, the use of ratepayer money may not be transparent to the public or support utility-related purposes. The City's budget process is designed to allow open discussion of spending priorities, and in doing so, it creates a public record of City decisions, helps to hold decision-makers accountable, and fosters the public's confidence in City government.

The audit also shows that the funding of some non-utility related programs has increased over the past five years. Although these projects may have civic importance and laudable goals, there are risks associated with such spending decisions. State law, City Code, and bond covenants require that utility ratepayer money be spent for utilities. For example, Council is granted authority to collect fees for utility services under state law, but spending the money on services not related to the utility could lead to this revenue being classified as an unauthorized tax.

Reasonable people may disagree about how to most efficiently operate a water or sewer system. Some may prioritize maintenance over new construction or rank conservation over new treatment facilities. While there may be disagreement, the budget decisions made by City Council should be made with clear rationale and consistent with constraints. The report recommends that the City demonstrate how future budget items would support the costs of providing water and sewer services and show the impact on utility rates. Further, we recommend not using ratepayer money for items that don't follow the budget and Council approval process.

Better Council oversight is needed to ensure that water and sewer ratepayers only pay for water and sewer service. We expect this audit report will be an important step in restoring control over how the City spends ratepayer money. We ask BES and the Water Bureau to provide us with a status report in one year, detailing steps taken to address our recommendations.



LaVonne Griffin-Valade
City Auditor

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Attachment

SPENDING UTILITY RATEPAYER MONEY:

Not always linked to services, decision process inconsistent

Summary The City of Portland operates water and sewer utilities, and is required by City Charter to spend ratepayer money from water and sewer operations on these utilities. Recent concerns about the use of utility ratepayer money for non-utility purposes led us to conduct this audit. Our objectives were to determine whether utility ratepayer money is used for non-utility purposes, and whether the decision-making process and uses of ratepayer money are transparent to the public. The audit scope included utility ratepayer money spent by the Bureau of Environmental Services (which operates the sewer system) and the Water Bureau.

Most City spending of ratepayer money was both related to providing a utility service and approved through the complete public budget process. However, we identified other examples where this was not the case. We found that ratepayer money spent by the City falls into three categories:

1. Ratepayer money spent for purposes **directly linked** to providing water and sewer services that also **followed** the City's complete financial planning and budget process.
2. Ratepayer money spent for purposes **not directly linked** to providing water and sewer services, but **followed** the City's complete financial planning and budget process.
3. Ratepayer money spent for purposes **not directly linked** to providing water and sewer services, and **did not follow** the City's complete financial planning and budget process.

The first category includes water and sewer spending that was directly linked to the cost of providing sewer and water services and followed the complete financial planning and budget process. This includes major projects such as maintaining pipes for the water distribution system and operating the sewage treatment plant. Most water and sewer spending falls into this category.

The second category includes spending where the link to providing water and sewer services was not clearly explained and justified, but where the spending followed the complete financial planning and budget process. While the total dollar amounts in this category are relatively small, we found an increasing number of Council policy choices to spend ratepayer money where the benefits and costs to ratepayers were not well defined. This category includes several examples of spending for such items as sustainability programs, Parks Bureau arborists, and dog park enforcement. In these cases, Council's policy direction in approving the spending was clear, but the connection to utility services was not clearly explained.

The third category includes ratepayer money spent without a clear explanation of how the use of money benefits water and sewer ratepayers and where the City's complete financial planning and budget process was not followed. Spending items in this category included remodeling a building for the Rose Festival Foundation's use, building an environmental demonstration house, and funding community college scholarships. While these projects may have civic importance, they do not appear directly linked to providing utility service to ratepayers.

Without following the complete public budget process, City use of ratepayer money may not be transparent to the public and may not support utility-related purposes. Following the complete public budget process and providing rationale for budget decisions helps determine spending priorities and holds City government accountable.

The constraints to consider when the City makes decisions to spend ratepayer money include the question of whether the revenue is used on utility-related purposes, and whether the utility system is operated in an efficient and effective manner. We recommend that the City

always spend water and sewer ratepayer money following the complete financial planning and budget process. To do this, we further recommend that bureaus develop a utility rate impact statement for each new significant expenditure funded by ratepayer money. This will help to clarify how the expenditure is related to the cost of providing utility services to ratepayers, and how the new expenditure affects utility rates.

Finally, we found that Utility License Fees (to cover the benefit of using the City's rights-of-way) are authorized by City Charter, but those fees are not as clear to customers as they could be. We recommend the bureaus separate their Utility License Fees from the base rates charged on water and sewer bills. Doing so will help ratepayers clearly identify the fees used to support General Fund services.

Background **Utility rates support water and sewer services**

The budgets of the Bureau of Environmental Services (BES) and the Water Bureau are almost entirely supported by utility rates, fees, and bond proceeds. The bureaus' combined capital and operating spending will be approximately \$478 million for Fiscal Year (FY) 2010-11.

BES provides sanitary sewer service to approximately 576,000 residents, numerous commercial and industrial facilities, and several wholesale contract customers. The majority of the BES budget goes to the Engineering (71%) and Wastewater (14%) Programs. The Engineering Program manages the planning, design, and construction of all BES public improvements, including wastewater and stormwater facilities. The Wastewater Program operates and maintains the wastewater and stormwater facilities.

The Water Bureau supplies domestic water to residents of the Portland area and serves approximately 900,000 people. The Water Bureau manages the core functions of operating and maintaining the Bull Run watershed, water mains, storage facilities, meters, hydrants, decorative fountains, and drinking fountains. The Regulatory Compliance Program is responsible for water quality sampling and Endangered Species Act compliance. Together, these programs constitute almost 70% of the Water Bureau's FY 2010-11 budget.

Transparency of City budget process and utility rate setting

The City budget process starts with Council reviewing overall goals, establishing priorities, and providing direction to bureaus. This process includes a public information component to obtain direct public input on City service priorities, and bureaus include key stakeholders when developing their budget requests.

The Water Bureau and BES develop financial plans and capital improvement plans, and they submit those to Council before submitting their requested budgets. The financial and capital improvement plans and the adopted budgets are used to determine the total revenue required from utility rates to fund bureau operations. The total revenue amount needed from customers is used to calculate water and sewer utility rates. Using cost-of-service principles, the bureaus complete an annual utility rate calculation, which plays a central role in determining how the bureaus' budgeted services and programs will be funded. The City Charter authorizes the Council to establish fees and charges for the use of the water and sewer systems. Other than City Council, there is no government approval required to adopt fees and charges.

After reviewing the bureaus' requested budgets, City Council as the budget committee considers input from bureaus and testimony from the community. The Mayor can add or alter programs and projects when submitting the Mayor's Proposed Budget. After the Mayor's Proposed Budget is issued, the City Council can alter the bureaus' budgets as part of the City's Approved and Adopted Budgets. In 1994, the City established the Portland Utility Review Board (PURB), which consists of nine appointed volunteer residents. The PURB provides independent and representative customer review of the financial plans, budgets, and customer rates related to water, sewer, stormwater and solid waste. The PURB operates in an advisory capacity to provide input to City Council.

An open and inclusive city government promotes efficiency and effectiveness in City services. Access to information enables the public to participate in the City's decisions and to help determine the spending of ratepayer money. A complete public budget process allows the open discussion of spending priorities, creates a public record of City decisions, helps to hold decision-makers accountable, and fosters the public's confidence in City government.

Constraints on sewer and water uses of ratepayer money

Various restrictions and requirements, including State law, City Code and bond covenants, limit how the Water Bureau and BES may spend ratepayer money. In order to understand the guidance on how the City can spend ratepayer money, it is also necessary to review guidance on how utility rates are established. The items to consider when making decisions regarding the spending of ratepayer money are whether the utility charges are just and equitable and based on reasonable cost-of-service principles, whether the revenue is spent on utility service related purposes, and whether the utility system is operated in an efficient and effective manner.

State law authorizes the City to set sewer service charges that are “just and equitable,” which determines the rate setting philosophy and methodology. Sewer charges should be based on reasonable cost-of-service utility ratemaking principles. This means the charges should not materially exceed the costs of providing the utility service, and the money collected must be spent to finance the service. The City Attorney interprets the State law as saying that sewer rates can only be collected to pay for activities or projects related to the City sewer system. In other words, customers are to pay rates tied to sewer services actually provided in return.

State law also gives Council the authority to collect fees for utility services. However, collecting money under this authority and then spending the money on services not related to the utility could lead to this revenue being classified as an unauthorized tax. According to the City Attorney, this classification could result in the requirement for repayment of ratepayer dollars.

City Charter authorizes the City to set sewer user fees only for the charges related to “design, construction, acquisition, operation, maintenance and contract requirements of sewage treatment or purification and related facilities.” City Charter also limits the City in how it spends sewer ratepayers’ money. The City is to spend the money for any matter connected with the sewer disposal or treatment system, and the bond debt service related to the sewer system. According to the City Attorney, these City Charter provisions authorize the collection and the expenditure of ratepayer money for purposes directly related to operation of the sewer utility.

City Charter also requires that funds and accounts of the Water Bureau related to the water system are separated from other accounts and funds of the City and treated as separate municipal operations. In addition, money in the Water Fund and the Water Construction Fund cannot be transferred to the City's General Fund or to special funds that are not related to the water system and related bond debt service. Although these provisions address transfers among city funds, the City Attorney's Office interprets the Charter to constrain indirect transfers of Water Bureau funds to support purposes not related to water services.

According to the City Attorney, the Charter's limitations are intended to "prevent the City Council from using the City's water revenues to carry out General Fund projects." The City Attorney indicated that Water Bureau money "cannot be spent on matters unrelated to the water system." In order to determine whether an expenditure is related to the system, the City Attorney considers whether the expenditure's primary purpose is to promote the objectives of the City's water services, and whether the expenditure is reasonably calculated to promote those objectives.

In addition to State statute and the City Charter, bond covenants also place restrictions on how utility rates are set and how ratepayer dollars are spent. Bonds require that the City establish rates in connection with the operation of the sewer and water system that are sufficient to pay all operating expenses and all lawful charges. In addition, it requires that spending of ratepayer money is prioritized from the highest priority (operating expenses of the utility systems) to the lowest priority (all other lawful purposes), and only after all higher priority expenditures have been covered. According to the City Attorney and City Treasurer's Office, this spending prioritization applies only when revenues are not sufficient to cover all bureau operating, debt and capital requirements.

Bond covenants further require that the City operate the water and sewer systems in a safe, sound, efficient, and economic manner in compliance with all regulations and laws. According to the City Treasurer's Office, this covenant was added in order to strengthen the focus on operations and to prevent the Water Bureau and BES from drifting away from their core missions of providing utility services.

According to the City Attorney, this bond requirement can lead to questions about whether water and sewer expenditures would be viewed by bondholders as sound, efficient, and economic costs for a municipal utility. The City Attorney stated that one way to meet this covenant requirement is to ensure that water and sewer funds are spent only for water and sewer related services.

State law, the City Charter, and bond covenants each contain requirements and restrictions over the use of ratepayer money, summarized in Figure 1. While each specific requirement is different, we found that overall, the legal, charter, and bond requirements share some important similarities. Specifically, each requires a connection or relationship between the use of ratepayer money and the utility that is being paid for.

Figure 1 Does the use of utility ratepayer money meet the following requirements?

| | |
|----------------|---|
| State Law | <ul style="list-style-type: none"> - Based on reasonable cost-of-service principles - Related to sewer system |
| City Charter | <ul style="list-style-type: none"> - Connected with the sewer system - Related to water works or service |
| Bond Covenants | <ul style="list-style-type: none"> - Supports sound, efficient and economic operations of utility |

Source: Audit Services Division developed this list of requirements based on input from the City Attorney's office.

Reasonable people may disagree about how to most efficiently operate a water or sewer system – for example, some may prioritize maintenance over new construction, or rank conservation over new treatment facilities. While there may be disagreement, the budget decisions made by the City Council should be made with clear rationale, so that utility ratepayers understand how spending decisions are consistent with the requirements in State law and the City Charter. It is the role of City Council to determine through the budget process that spending priorities are consistent with these constraints.

Audit Results

Decisions on spending ratepayer money are not always transparent or directly linked to water and sewer services

Although most bureau expenditures support the cost of providing water and sewer services and follow the budget process, utility ratepayers are assuming an increasing burden of costs for other City programs where the benefits to ratepayers and the connection to providing water or sewer services are not well defined. These City program costs added to various bureau budgets do not represent a significant share of those budgets. However, these increasing costs were not always directly linked to the cost of water and sewer services, and they did not always follow a transparent budget process.

For this audit, we collected and reviewed questionable expenditures by both the Water Bureau and BES. We focused on the financial planning and budget process that affects rate revenue and on the uses of ratepayer money questioned by a number of interested residents and stakeholders. Our review looked primarily at items that were new or had increased over the last five years.

Some spending items were adopted through the complete budget process, but ratepayer benefits and costs are not clear

Some of the spending items we reviewed were approved by Council and followed the financial planning, budget, and rate setting process, yet the link to utility services was not clear to the public and other stakeholders. Expenditures in this category represent policy choices made by Council. However, due to the lack of transparency in determining how and whether questionable spending is related to the utility service, the public and other stakeholders may disagree as to whether these expenditures are related to providing water and sewer services.

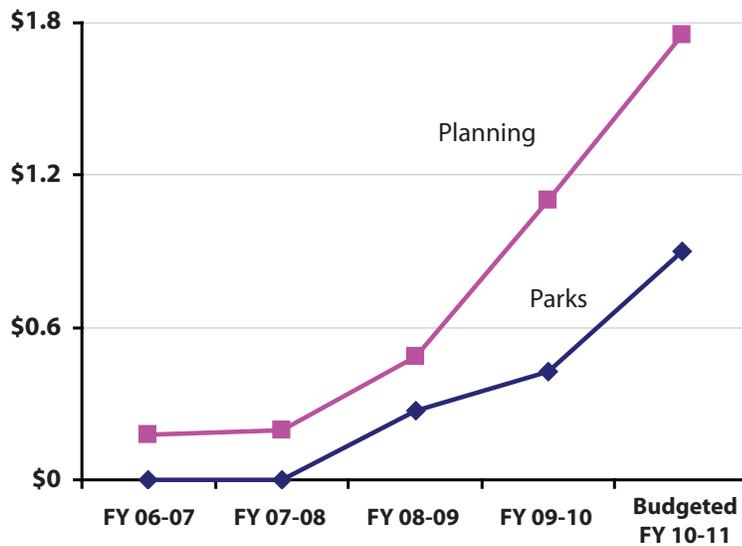
For example, we found an increase in the number of parks and planning programs funded with sewer ratepayer money. The most recent parks items added through the budget process include a tree inspector, fungicide to protect elm trees, invasive species control, and enforcement of dog rules in natural areas. BES management stated that it is more cost effective to manage stormwater before it reaches the stormwater system, and maintaining both tree canopy and natural areas helps prevent rainwater from reaching the storm-

water system. The City's response to the Federal Endangered Species Act was initially funded jointly with sewer funds, water funds, and the City General Fund. In FY 2009-10, the general funding was eliminated, and sewer ratepayer funds to the program were increased by almost \$270,000. The program is now funded almost entirely by sewer and water rates.

Water ratepayers have also assumed increasing expenses for parks and planning programs. These include the cost of maintaining the City's decorative fountains for the Parks Bureau and contributing to a number of sustainability programs through the Bureau of Planning and Sustainability. Parks and Planning items funded with water ratepayer money totaled over \$1.3 million in the current fiscal year.

These types of programs have purposes deemed valuable by Council and were added through the normal financial planning and budget process. However, the rationale for spending ratepayer money on these programs may not be evident to the public and other stakeholders. Following a process for describing how the items are related to the provision of utility services would help to explain the uses of money to ratepayers.

Figure 2 Growth in BES-funded Planning and Parks-related programs not directly related to utility service (millions)



Source: Audit Services Division analysis

Figure 2 shows the growth in parks and planning programs funded with sewer ratepayer money. Five years ago, sewer ratepayers funded less than \$200,000 in parks and planning programs not directly linked to utility services. This year, the City expects to spend over \$2.5 million of ratepayer money for these programs.

Some spending did not follow the complete financial planning and budget process, and it is not clear how these items are directly related to utilities

We found that some spending of ratepayer money is not consistent with the City's planning, budget, and rate setting process, and it is not clear how these items are directly related to providing water and sewer services. We identified a number of projects that were not included in the bureau financial planning process. We also identified two funded projects, the Yeon Building and the Water House, which Council discussed, but never explicitly approved or added to the Water Bureaus' adopted budgets. The following are examples of ratepayer spending not directly related to water and sewer services and where the spending appears not to have followed either the financial planning and budgeting process and/or the Council approval process.

River Programs: In the FY 2010-11 budget, the Bureau of Planning and Sustainability (BPS) requested City General Fund dollars to continue working on the River Plan. The project would include recommendations for zoning code amendments, prioritized investments, and programs to implement the City's river strategy. Early versions of the City budget included general tax dollars to fund the program. However, in the final budget adopted by Council, sewer ratepayer money was provided to fund the river planning activities in BPS. Because this shift to sewer ratepayer funds occurred so late in the budget process, the budget advisory and review committees did not have sufficient opportunity to provide input on the new use of ratepayer funds.

The Office of Healthy Working Rivers (OHWR) was created in 2009 to protect and restore the ecological, transportation, and recreational roles of the Willamette and Columbia Rivers. During that same year two positions from the Bureau of Planning's River Renaissance Office were moved to the OHWR, an additional four positions were

created, and the OWHR was included in the BES FY 2009-10 budget. Funding for the OHWR was not included in the BES budget request, and was not reviewed by the budget advisory and review committees. Ratepayer funding for OHWR was added to BES budget in the Mayor's proposed budget. According to Commissioner staff, the River Renaissance office advanced from the planning phase to the implementation phase and became the OHWR. The Commissioner staff also stated that OHWR is related to implementing water quality programs and consequently should be funded by sewer ratepayer funds.

Yeon Building in Waterfront Park: The Yeon Building, now owned by the Water Bureau, was remodeled for the use of the Rose Festival Foundation. In February 2009, Council approved the transfer of land between the Parks Bureau and Water Bureau to allow the Rose Festival Foundation to "make more strategic use of its limited revenues and reduce ongoing maintenance costs of the space to the City." During hearings on this proposal in April 2009, the Council had extensive discussion about whether water ratepayer money would be used to renovate the building. The legislative intent, as stated by the Mayor, was for the building's capital costs to "be reimbursed by the Rose Festival or donated or fundraised some other way." In a subsequent hearing, one Council member stated the understanding reached among Council members was that "at most, we might front the improvement costs somewhere in the \$100,000 range." The same Council member also added the understanding that any additional building improvements will "be subject to the Water Bureau's budget process...and those improvements will have to fare with the other things that are competing with ratepayers' dollars."

Ratepayer-funded improvement costs on the building totaled over \$1.5 million, including labor costs for existing staff and capitalized overhead. The project was never included in the Water Bureau capital improvement plan or budget. In May 2010, the Water Bureau signed a 25-year lease with the Rose Festival Foundation for the use of the Yeon Building, with the base rent for the property of \$1 per month. There is also a remodel payment of \$200,000 to be paid by the Rose Festival Foundation in increments of at least \$666.67 each month for the term of the lease. However, ratepayer money will continue to be spent to maintain the building.

Water House: The Water Bureau's energy efficient demonstration project, also known as the Water House, located at 1616 NE 140th, was not included in the bureau's budget. In October 2009, Council passed an ordinance to allow donations of services and products for the construction of an energy efficient home. Bureau management explained that rather than sell an unused piece of property, they opted to develop the property, then sell it and fully recover the value of the land and the Water Bureau costs. At the Council hearing for this project, Water Bureau staff estimated the building cost at \$200,000, and the land value at \$150,000. The goal was to sell the house for \$400,000. As of January 2011, the Water Bureau had spent over \$700,000 of ratepayer funds, including capitalized overhead charges for bureau administration, on the Water House project.

Scholarships: In the FY 2010-11 budget process, the Mayor's Proposed Budget added a program to provide scholarship grants for the first two years of study at Portland or Mt. Hood Community Colleges. The \$500,000 program cost is divided between the City's general fund, and water and sewer ratepayer funds. The scholarship program was not included in the financial planning for either water or sewer rates, but was added by Council after bureau budget requests were finalized.

Green Street Facilities: In March 2010, City Council directed the BES to include \$20 million in its capital improvement plan over the next three years for Green Streets projects on bike boulevards. Green Streets is a stormwater program intended to cost-effectively decrease stormwater flow into the City's sewer pipes. This proposal linked the Green Streets developments to boulevards in the Portland Bicycle Plan for 2030. The Council action took place outside of the complete budget process, so the expenditure was not included in the bureau's financial planning and budgeting process.

Figure 3 shows representative examples of three types of expenditures funded by ratepayer money, including items that were added late in the budget process.

Figure 3 Examples of three types of expenses funded by ratepayer money

| Examples of expenses funded by ratepayer money | Bureau funding the expenses | Directly related to provision of water or sewer service | In bureau budget request <i>(includes review by budget advisory committees and PURB)</i> | In Council adopted budget |
|---|-----------------------------|---|---|---------------------------|
| Expense directly related to utility services and complete budget process followed | | | | |
| Wastewater treatment plant operations | BES | Yes | Yes | Yes |
| Maintenance of distribution mains | Water | Yes | Yes | Yes |
| Expense not directly related to utility services and complete budget process followed | | | | |
| Parks aborists and invasive species control | BES | <i>Council policy choice</i> | Yes | Yes |
| Drinking fountains and decorative fountains | Water | <i>Council policy choice</i> | Yes | Yes |
| Enforcement of dog park rules | BES | <i>Council policy choice</i> | Yes | Yes |
| Expense not directly related to utility services and complete budget process not followed | | | | |
| River planning | BES | <i>Council policy choice</i> | No | Yes |
| Green Street Facilities along Bike Boulevards | BES | <i>Council policy choice</i> | No | Yes |
| Community College Scholarships | Water/BES | <i>Council policy choice</i> | No | Yes |
| Yeon Building Renovation | Water | | No | No |
| Water House | Water | | No | No |

Source: Audit Services Division

Each of the projects in the last category of Figure 3 may have a public benefit. However, there was no formal process clarifying how these projects are related to the operation of water or sewer services, nor whether those benefits should be funded with water or sewer ratepayer money. Adding spending items to bureau budgets late in the budget process, or not including the items in the financial planning and budget process, goes around the formal mechanism allowing review by bureau budget advisory and review committees, and the public. Not including these stakeholders undermines the public's input on spending prioritization of ratepayer money.

Since bureaus do not plan and budget for these items added late in the budget process, it may also impact how well the City operates the water and sewer systems. Moreover, spending ratepayer money on purposes not directly related to utility services, may lead bondholders to question whether the bureaus are drifting from their core mission of providing utility services, and whether they are operating the utilities in a sound, economic and efficient manner.

**Utility license fee
not identified on
customer bill**

Portland City Code includes a license fee (to cover the benefit of using the City's rights-of-way) on various utilities doing business within the City, including electric utilities, gas utilities, and the City's own water and sewer utilities. The City Council sets the level of the fee for each utility type. Revenues from the Utility License Fees are deposited in the City's General Fund, which pays for services such as fire protection, police, and parks. General Fund dollars are not used to fund water or sewer utility services.

Various stakeholders have questioned whether Utility License Fee revenues are collected with a customer's water and sewer bill to fund non-utility purposes. We found that while this separate fee may be imposed at the discretion of the City Council to fund general City operations, the Utility License Fee is not singled out and identified on the customer bill.

When the utility bureaus calculate the revenue required to run the bureaus for the subsequent year – the basis for setting utility rates – the bureaus include the Utility License Fee payment in the General Fund as part of this revenue requirement. Similarly, the customer

bill includes the Utility License Fee amount as part of the water and sewer charges, instead of listing the fee as a separate line item. Other utilities such as cable or gas list taxes and fees as separate line items on the customer bill.

Recommendations

To improve transparency of the Water Bureau and BES budget process and to ensure that ratepayer money is spent for utility-related purposes, we recommend that the Commissioners-in-charge direct those bureaus to implement the following recommendations. Some effort will be required by the full Council to ensure the highest levels of transparency in the budget and spending processes:

1. For new significant expenditures funded by ratepayer money, develop a utility rate impact statement demonstrating how the new budget item supports the costs to provide water and sewer services and how it will affect utility rates.
2. For new significant expenditures funded by ratepayer money, ensure that the budget process and Council approval process are followed. For any items that do not follow the complete budget and Council approval process, do not use ratepayer money.
3. Separate utility license fees from base payments on water and sewer bills, so that ratepayers can clearly identify the fees used to support General Fund services.

In addition, Council should solicit from bureaus and then use in its deliberations more detailed reviews of new significant expenditures of ratepayer money, examining whether budgets were met, and whether the results of the projects matched their intent. For example, Council could consider whether an approved ratepayer-funded project was completed within its budget and matched the intent of Council when it approved the project.

Objectives, scope and methodology

The objectives of this audit were to determine whether ratepayer money is used for non-utility purposes, and whether the uses of ratepayer money and the decision-making process are transparent to the public. We focused our audit on the spending of ratepayer

money by the Bureau of Environmental Services (BES) and the Water Bureau. We focused on the financial planning and budget process that affects rate revenue and on uses of ratepayer money questioned by a number of interested residents and stakeholders.

To determine constraints on the use of water and sewer revenue by the City, we studied the Oregon Revised Statute, the City of Portland Charter and Code, and the City's bond covenants. In order to interpret the legal and contractual constraints, we obtained input from the City Treasurer's Office and the City Attorney's Office.

We reviewed the Water Bureau and BES missions, goals, and strategic planning documents. To determine how bureaus develop their budget and how bureaus expend utility rate revenue, we reviewed the bureaus' budget processes and financial planning process, we reviewed bureaus' expenditures, and we interviewed bureau staff. We also reviewed utility rate studies, and we reviewed how the bureaus determine the total revenue needed from utility customers.

To gain an understanding of the public and stakeholders' concerns and questions regarding the bureaus' expenditures and use of ratepayer money, we interviewed members from the Portland Utility Review Board (PURB), staff from Office of Management and Finance, City Council staff, and we reviewed media coverage and residents' comments. Based on input from the bureaus and various stakeholders, we developed a list of bureau expenditures that were funded by ratepayer money but are questioned by various stakeholders. We focused our review on this limited number of bureau expenditures.

For this audit we did not review in detail the rate setting process. Based on PURB recommendations from 2010, the Water Bureau and BES hired an outside consultant to review the City's rate setting process and identify rate setting best practices based on a review of other cities.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. These 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 that the evidence obtained provides reasonable basis for our findings and conclusions based on our audit objectives.

RESPONSES TO THE AUDIT



CITY OF
PORTLAND, OREGON

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To: Auditor Lavonne Griffin-Valade
From: Dan Saltzman *Don*
Date: March 23, 2011
Subject: Audit Report #398: Spending Utility Ratepayer Money

Thank you for the opportunity to comment on Audit Report #398, "Spending Utility Ratepayer Money: Not always linked to services, decision process inconsistent." It is a clear, useful and thorough presentation of the issues around proper use of ratepayer funds. The distinction drawn between appropriateness of expenditure and relationship to the City's budget process is helpful.

I agree with the Report's recommendations for improving the transparency of the budget processes for Water and Environmental Services. Requiring impact statements for all budget decision packages is one way to do this, as well as including a rate impact on the Fiscal Impact Statement on City Council documents. The Bureau of Environmental Services will work with the Auditor's Office to determine a rate impact statement that is useful and clear to ratepayers. However, the bureaus can assess these impacts only with adequate lead time for analysis and agreement by City Council.

Finally, breaking out the Utility License Fee on customer bills would help customers understand the fees incurred for utility and General Fund services. Bureau of Environmental Services will work with the Water Bureau to break out that specific line item.

I am committed to working with our citizen committees and City Council to identify opportunities that will provide the transparency and linkages needed in spending ratepayer money for sewer and stormwater services.



Randy Leonard, Commissioner
David G. Shaff, Administrator

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March 23, 2011

TO: Auditor LaVonne Griffin-Valade

FR: Commissioner Randy Leonard

Water Bureau Administrator David Shaff

RE: Audit #398, Spending Utility Ratepayer Money

Thank you for the opportunity to comment on Audit #398, "Spending Utility Ratepayer Money". We acknowledge receipt and generally concur with the analysis and recommendations of the audit.

As you note in the audit, reasonable people may disagree about how to most efficiently operate a municipal water system. However, we agree that projects undertaken by the Portland Water Bureau should be done for the benefit of the ratepayer and should be undertaken in a clear and transparent process allowing for public input and comment. We believe that we have done that, including the specific projects highlighted in the audit.

One project highlighted by the audit was the Water Bureau's renovation of the historic Visitor's Center in Tom McCall Waterfront Park. The Visitors Center was a severely neglected, unusable public facility on Portland's waterfront when the Council transferred ownership of the building to the Water Bureau in 2009. In the Council discussions about the renovation of the Visitors Center, we were very clear that the labor for the renovation would be undertaken by existing employees of the Water Bureau, while additional expenses associated with converting the building into the headquarters of the Rose Festival Association would be amortized in the Rose Festival's lease payments on the renovated building. The approach described to the Council in public hearing is what occurred, and any characterization to the contrary is inaccurate.

Further, outside of the costs that were incurred and passed along to the Rose Festival for the renovation of the Visitor's Center, the Water Bureau employee labor costs should be characterized as opportunity costs because the cost of those employees would have been borne by the ratepayers regardless of whether the Visitors Center renovation occurred or not. Those employees work on an ongoing basis to maintain and repair Water Bureau facilities all over the City and in the Bull Run watershed, and no new employees were hired for the purpose of renovating the Visitors Center. Therefore, the choice to direct those employees to work on the Visitors Center should be characterized as a choice between directing those resources to that project or a project at another Water Bureau facility.

Regarding the billing recommendation, the current bill statements include the following:

"Customers of all utility services within the City of Portland pay a utility license fee that helps fund general City services including, but not limited to, fire fighting, parks and police. This fee is factored into each of the following charges"

Breaking out the ULF fee as a specific amount on each customer's bill presents some challenges, but we agree that customers would benefit from more information regarding what their money pays for. We will work with the Bureau of Environmental Services and the Office of Cable Communications and Franchise Management to explore better ways to inform our customers where their payments go and how they are used.

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Spending Utility Ratepayer Money: Not always linked to services, decision process inconsistent

Report #398, March 2011

Audit Team Members: Alexandra Fercak, Kari Guy

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LaVonne Griffin-Valade, City Auditor
Drummond Kahn, Director of Audit Services

Other recent audit reports:

Percent for Art: Progress made, but consistency can be improved (#401, February 2011)

Sewer Maintenance: BES and PBOT maintain the system together, but should consider operational changes (#365, December 2010)

City of Portland Service Efforts and Accomplishments: 2009-10, 20th Annual Report on City Government Services (#400, December 2010)

