



OFFICE OF THE DISTRICT OF COLUMBIA AUDITOR

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Deborah K. Nichols
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010:02:SDG:VDJ:VH

March 22, 2002

**Sufficiency Review of the Water and Sewer Authority's
Fiscal Year 2002 Revenue Estimate in Support of \$100,000,000
in Commercial Paper Notes**



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The Honorable Linda W. Cropp, Chairman
and Members of the Council of the District of Columbia
The John A. Wilson Building
1350 Pennsylvania Ave., N.W. Suite 504
Washington, D.C. 20004

Letter Report: Sufficiency Review of the Water and Sewer
Authority's Fiscal Year 2002 Revenue Estimate in
Support of \$100,000,000 in Commercial Paper Notes

Dear Chairman Cropp and Members of the Council of the District of Columbia:

On August 6, 2001, the Chief Financial Officer (CFO) of the District of Columbia Water and Sewer Authority (WASA) requested the District of Columbia Auditor to certify to its fiscal year 2002 revenue estimate pursuant to D.C. Code, Section 34-2202.09(h), regarding WASA's issuance of \$100,000,000 in Commercial Paper Notes. D.C. Code, Section 34-2202.09(h), provides the following regarding the Auditor's responsibilities related to the borrowing of money and issuance of bonds, notes or other obligations by WASA:

During each fiscal year in which debt service on the proposed bonds and outstanding revenue bonds issued by the Authority, and the transfer provided in Section 34-2202.07(f) becomes due and payable, the Authority may not issue bonds, notes, or other obligations or borrow money unless the Authority first certifies, to the reasonable satisfaction of the District of Columbia Auditor, that the revenues of the Authority are sufficient to pay its costs, the principal of and interest on and other requirements pertaining to the proposed bonds and outstanding revenue bonds issued by the Authority, and amounts equal to the debt service payments on District general obligation bonds issued by the District prior to October 1, 1996, which financed Department of Public Works, Water and Sewer Utility Administration capital projects, as such bonds and transfers become due and payable. The Authority's certification shall be supported by expert study and analysis.

According to information provided by WASA officials, the purpose of the commercial paper program was to provide interim financing for their \$1.6 billion capital improvement program. The Auditor reviewed WASA's fiscal year 2002 operating and capital budgets, the Comprehensive Annual Financial Reports for fiscal years 1999 and 2000, and an expert study and analysis conducted by an outside consultant retained by WASA. In addition, WASA provided such other supporting documentation as the Auditor deemed necessary.

Based upon a review of the expert study and analysis and other information provided by WASA in support of the commercial paper issuance, the District of Columbia Auditor certified to the fiscal year 2002 revenue estimate as presented in WASA's certificate. The Auditor notes that WASA's revenue estimate of \$252.1 million included approximately \$4.7 million expected to be earned from a proposed 5% rate increase that, as of the date of the Auditor's certification, had not been approved by WASA's Board of Directors.¹ Because the rate increase had not been approved, WASA's fiscal year 2002 revenue estimate of \$252.1 million was adjusted downward by \$4.7 million to \$247.4 million for the Auditor's determination of whether the revenue (without the 5%) would be sufficient to cover WASA's costs and other obligations in fiscal year 2002.² Based on the Auditor's review, it appeared that the revenue estimate of \$252.1 million with the 5% rate increase, or the alternative estimate of \$247.4 million without the 5% rate increase, would be sufficient to cover WASA's fiscal year 2002 costs. Table I presents WASA's fiscal year 2002 revenue estimate assuming the approval of the 5% rate increase and assuming the 5% rate increase would not be approved.

¹ At the time the Auditor certified to WASA's fiscal year 2002 revenue estimate, the Board of Directors had not met on the proposed 5% rate increase scheduled for April 2002. Subsequent to the Auditor's certification, but before issuance of this report, the Board met on January 10, 2002, and voted against the approval of an increase in retail rates during fiscal year 2002.

² According to WASA's CFO and information presented in WASA's fiscal year 2002 Revised Budget, operating expenditures are projected at \$238.9 million for fiscal year 2002.

TABLE I
Water and Sewer Authority's Fiscal Year 2002
Revenue Estimate

Account Type	
Residential and Commercial	
Federal Government	
District of Columbia Government	
D.C. Housing Authority	
Total Retail	\$191,172,759
IMA Wastewater Charges	
Potomac Interceptor Wastewater Charges	
Total Wholesale	49,143,099
District Stormwater Revenue	
Misc. Rev (connection fees, meter maint.)	
Washington Aqueduct Debt Service Revenue	
Interest Income	
Total Other	<u>11,759,000</u>
WASA's FY 2002 Revenue Estimate	
Including 5% Rate Increase	\$252,074,858
Adjustment for 5% Rate Increase	
Not Yet Approved by WASA's Board	<u>(4,678,000)</u>
WASA's FY 2002 Revenue Estimate	
Excluding 5% Rate Increase	<u>\$247,396,858</u>

Source: District of Columbia Water and Sewer Authority Proposed FY 2003 Operating and Capital Budgets dated October 25, 2001

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this review was to determine whether the fiscal year 2002 revenue estimate of \$252.1 million, as certified by WASA's Chief Financial Officer (CFO) in a signed certificate dated November 19, 2001, was reasonably sufficient to cover WASA's fiscal year 2002 costs, the principal of and interest on the proposed bonds and other requirements, outstanding revenue bonds, and the debt service payments on general obligation bonds issued by the District on behalf of the Department of Public Works, Water and Sewer Utility Administration, prior to October 1, 1996.

The Auditor interviewed WASA officials, including the CFO and the Director of Budget and Finance, concerning the issuance of \$100,000,000 in Commercial Paper Notes. In addition, discussions were held with PB Consult, Inc. a consulting firm retained by WASA to complete the expert study and analysis required by law.³

According to PB Consult, in conducting the expert study and analysis, they interviewed WASA's financial management and staff, reviewed financial records, conducted financial tests and analyses, and performed various other tasks. In its expert study, PB Consult reported that WASA was found to have made reasonable revenue projections in that WASA: (1) provided sufficient documentation for verification of their projections; (2) appeared to have used the most current information available to prepare the fiscal year 2002 revenue forecasts; (3) computed projections accurately; and (4) gave appropriate consideration for the risks that would affect forecasted values. PB Consult concluded that WASA's fiscal year 2002 revenue estimate had been reasonably developed and was attainable. The Auditor relied, in part, on representations contained in the expert study and analysis, as well as information obtained directly from WASA, to support the certification of revenues. PB Consult issued an initial report of its findings dated September 20, 2001, and an updated report on November 19, 2001. The Auditor reviewed both reports.

BACKGROUND

The Water and Sewer Authority was established pursuant to D.C. Law 11-111, effective April 18, 1996. Prior to the establishment of the Authority, the Water and Sewer Utility Administration, which was under the organizational umbrella of the District's Department of Public Works, managed the District's water and sewer utility operations. In accordance with D.C. Law 11-111, the Water and Sewer Utility Administration was abolished and its functions were transferred from the Department of Public Works to the Water and Sewer Authority. D.C. Law 11-111 was amended by D.C. Law 11-184 to clarify the Authority's relationship with the District government and provided for the Office of the District of Columbia Auditor's analysis of revenues certified by the Authority.

³ According to reported information, PB Consult provides management consulting services to owners, operators, developers and builders of infrastructure project systems worldwide.

The Water and Sewer Authority is governed by an 11-member board of directors. The chairperson and five members represent the District and are appointed by the Mayor of the District of Columbia with the advice and consent of the Council of the District of Columbia. The remaining five members represent Prince George's and Montgomery Counties in Maryland, and Fairfax County in Virginia. A general manager provides day-to-day management of the Authority with the assistance of a management team consisting of two deputy general managers and an assistant general manager.

WASA's Commercial Paper Program

According to WASA's CFO, the commercial paper program represents an interim financing plan that will be used by WASA to finance some of its capital construction. Commercial paper is a financing vehicle that provides flexible access to the short-term capital markets, taking advantage of lower interest rates that are typically realized in the commercial paper market. Technically, commercial paper is a short-term promissory note with a maximum maturity of not more than 270 days, with typical issuances maturing in 30 to 60 days. Commercial paper is generally backed by a letter of credit issued by a commercial bank. According to a WASA official, this is WASA's first commercial paper issuance.

FINDING

WASA's FISCAL YEAR 2002 REVENUE ESTIMATE CONTAINED REVENUE FROM A PROPOSED RATE INCREASE THAT HAD NOT BEEN APPROVED BY WASA's BOARD OF DIRECTORS

The achievement of WASA's fiscal year 2002 revenue estimate of \$252.1 million was based, in part, on an anticipated 5% retail rate increase. The retail rate increase was scheduled to be voted on by WASA's Board of Directors in January 2002 and implemented in April 2002. The rate increase was projected to generate approximately \$4.7 million in additional revenue in fiscal year 2002. At the time of our sufficiency review, the Auditor was not reasonably satisfied that \$4.7 million in revenue expected to be generated by the rate increase would be realized because the rate increase had not been approved by WASA's Board of Directors. As previously noted, subsequent to our sufficiency review, WASA's Board of Directors voted not to approve the 5% rate increase.

According to information contained in the expert study and analysis prepared by PB Consult, and a resolution passed by WASA's Board of Directors, a 5% rate increase was proposed by the retail rate committee for fiscal year 2002 to assist in supporting WASA's projected \$1.6 billion capital program over a ten-year period. The committee's resolution provided for "a rate-setting policy that calls for implementation of retail rate increases in a gradual and predictable manner, avoiding large one-time rate increases."

In view of the fact that the proposed 5% rate increase had not been approved by the Board and that the rate increase could be modified or delayed to a later period, the Auditor requested that the certificate supporting WASA's certification of revenue be modified to reflect the status of the proposed rate increase. Additionally, the Auditor's certificate was modified to include the following language regarding the proposed rate increase:

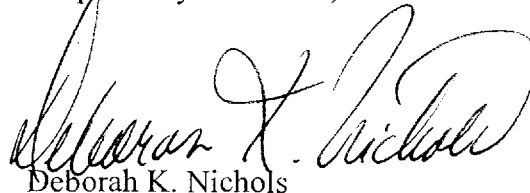
"...The Authority's estimate of \$252,075,000 assumes the approval of a five percent retail rate increase effective April 1, 2002, by the District of Columbia Water and Sewer Authority Board of Directors. If the proposed rate increase is not approved, the revenue of the Authority for the fiscal year ending September 30, 2002, is estimated to be \$247,397,000, which is estimated to be sufficient to pay the Authority's costs and principal and interest on its obligations as outlined in Paragraph 2 of the Authority's Certificate."

With the inclusion of this language in the certificates, and based upon the Auditor's review of information contained in the expert study and analysis and other critical information submitted by WASA, the Auditor was reasonably satisfied that WASA's fiscal year 2002 revenue estimate of \$252.1 million, adjusted to \$247.4 million without the 5% rate increase, was sufficient to cover WASA's fiscal year 2002 projected costs.

CONCLUSION

The Auditor certified to the sufficiency of WASA's fiscal year 2002 revenue estimate of \$252,074,858 in support of the \$100,000,000 Commercial Paper Notes, Series A and Series B. The Auditor notes that WASA's achievement of the \$252,074,858 was contingent upon the Board of Directors approval of a proposed 5% retail rate increase. Although the Board did not approve the proposed rate increase, the fiscal year 2002 revenue estimate adjusted downward by \$4.7 million should still be sufficient to cover WASA's fiscal year 2002 costs. Based on the Auditor's analysis of all information presented by WASA, the revenue estimate of \$247,396,858, which excludes the 5% rate increase, should be sufficient to cover WASA's projected fiscal year 2002 expenses.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Deborah K. Nichols", is written over a horizontal line.

Deborah K. Nichols

District of Columbia Auditor