

# METROPOLITAN UTILITIES DISTRICT

*Inter-Department Communication*

September 15, 2009

## METROPOLITAN UTILITIES DISTRICT OF OMAHA

### RESPONSE TO STATE AUDITOR'S ATTESTATION REVIEW

#### EXECUTIVE SUMMARY

As noted on Page 3 of the APA's report, the mission of the Metropolitan Utilities District of Omaha (District) is to provide customers low-cost, high-quality natural gas and safe drinking water at a cost consistent with sound management practices. Evidence that the recommendations and the decisions that have been made by the District's Senior Management and Board of the Directors (Board) have supported that mission is found in the 2009 Utility Bill Comparisons for Selected U.S. Cities survey conducted by the Memphis Light, Gas and Water Division of Memphis, Tennessee.

The survey compared the rates of 54 U.S. Cities as of January 1, 2009. The survey found that the District's residential gas charges were the fourth lowest when looking at an average use of 200 ccf (each ccf equals 100 cubic feet of usage). For water, the District's residential water charges were the ninth lowest when looking at 5 ccf of consumption.

The District constantly strives to improve the services it provides to its customers while still maintaining the low rates noted above. All potential options for system improvements, equipment upgrades, and the addition of personnel are weighed against their potential costs and the related need to increase the rates we charge our customers. If the District's Senior Management and Board are not convinced that the cost of any changes will be at least equal to the benefit to the District's customers, proposals for changes are not approved.

While the District will specifically address each of the APA's recommendations, it is worth noting that no fraud or illegal acts were found in the Review. In addition the APA notes in their cover letter that they found no deficiencies in internal control, violations of provisions of contracts or grant agreements, or abuse that were material to the District's customer accounts that required reporting under *Government Auditing Standards*. A number of the Review's recommendations would require the addition of personnel at the District that its Senior Management does not feel is warranted at this time due to the related costs. In addition, many of the APA's conclusions are based upon inadequate and/or invalid information which will be shown in more detail in the following pages.

Finally, the District felt compelled to compile this complete response versus attempting to address the APA's recommendations by supplying comments to be included in the APA's Review for a number of reasons.

First of all, the APA informed the District that it reserved the right to edit any comments provided by the District down to “two or three sentences per finding.” Inasmuch as the APA’s Review is over 20 pages long the District felt it was unfair for the APA to mandate such an unreasonable limitation on the District’s potential response. Secondly, in addition to the limit imposed by the APA on the length of the potential response, the APA reserved the right to edit the District’s response, even if the responses were within the two or three sentences allowed.

Finally, due to the significant deficiencies the District found in the APA’s Review, and two failed attempts to resolve them through open dialog with the APA, it was apparent that a full explanation of the District’s positions could not be addressed within two or three sentences per finding.

## **1. Accounts Receivable**

### **Timely Reporting of Customer Accounts to Collection Agencies**

The APA’s Staff were told during their on-site field work that our existing procedures were out of date due to changes that have been made to the business processes involving outside collection agencies. Therefore, the “60-day goal” is no longer in practice. This was clearly stated to the APA Staff during interviews. The primary reason for not updating formal procedures is because the functions performed by the Collections Specialist are still evolving due to changes in techniques (secondary agency introduced in late 2008); catch up work; and the implementation of other reports, etc.

The APA review indicates on Page 5, 121 accounts were analyzed. The specific accounts have not been included in the report, so the information they have reported cannot be validated. It is important to note that the staff from the APA office did their own research and did not validate their specific findings with the District’s personnel. While this is not necessary, it is highly recommended due to the varied nature of collection activities. Even District personnel from other departments verify their information with Collections personnel due to the complexity of each situation. In addition, the APA acknowledged they “judgmentally” chose only the higher dollar accounts for their review. This is a statistically flawed sampling method. It is obvious that higher dollar accounts would entail more in-house work to determine if there was collection potential without passing the accounts on to a collection agency. Instead the APA should have conducted a more random sampling of accounts that would have included lower dollar accounts as well as higher dollar accounts. Such a biased sampling methodology voids their conclusions and represents a significant deficiency in the APA’s analysis.

The comparison between the regularity of submissions to the collection agencies prior to 2004 and after 2004 is inaccurate due to the timing of reports generated by the collection agencies. Due to the delay between our submission and the input of those files at the collection agency, the months showing zero dollars submitted is misleading. A more accurate test would be to track the dates the files were created and sent to the agencies and compare the number of days between files that were sent. According to our records, the frequency of reporting to agencies after 2006 – when the Collection Specialist position was created – is 83% (or 25 out of 30 months). For the period from 2004 through 2008, the percentage since 2004 should be 67% (or 40 out of 60 months) rather than the 50% stated in the APA’s Review.

Throughout our discussions with the APA's Staff it was emphasized that we were aware of the outstanding work left to be done with regard to the bad debt process(s) at the time we went live with our new system ("Banner"). Senior management was aware of this and a commitment was made to go forward with the implementation with plans to phase in improvements to bad debt after the new system was stable. Costs associated with further delaying the implementation were weighed against the potential **additional** loss in recoveries and the soundest decision was made at the time. Our measure of the success of that decision is how the District compares with other gas utilities with regard to write-off percentages which as the APA concedes is within industry norms. Throughout this five-year period, our statistics have measured up with our counterparts and are projected to decrease with the write-off at the end of 2009. (See comments about the graphs on page 11 and 12.) It is the District's position the APA's analysis does not give sufficient weight to the fact that the District's write-offs compare favorable with the gas industry. This will be addressed later in this response.

Prior to the implementation of Banner, transferring accounts to a collection agency was a manual process that was done by clerical staff in the Collections Division as part of their daily work. Before Banner, there was little or no work done to skim off the accounts that could be collected "in-house" prior to sending them to a collection agency. This is why they made it to the agencies faster. After a few stops and starts, the District decided that doing more skip-tracing prior to sending accounts to the collection agencies would net more recoveries overall. Below, you can see a more accurate analysis of the accounts reported and recovered during the past 10 years. This analysis begins with the APA's figures but then incorporates the substantial positive impact the creation of the Collections Specialist position has had.

	Reported to C. Agency	Collected from C. Agency	Operating Revenues by Year	Collections as a % of Reported	Reported as a % of Revenues
1999	670,274	85,839	162,212,208	12.81	0.41
2000	597,415	78,541	231,039,634	13.15	0.26
2001	1,633,343	202,647	258,683,775	12.41	0.63
2002	1,581,305	133,056	210,165,003	8.41	0.75
2003	1,173,197	114,541	278,981,163	9.76	0.42
2004	1,755,731	86,889	289,719,957	4.95	0.61
2005	2,040,361	103,595	363,564,498	5.08	0.56
2006	4,691,189	211,737	337,011,792	4.51	1.39
2007	2,353,654	56,516	370,446,356	2.40	0.64
2008	4,263,800	185,640	410,136,239	4.35	1.04
6 mos. 2009	2,250,038	136,334	170,180,100	6.06	1.32

**In-house collections work done by Collections Specialist for 2007 and 2008:**

2007	payments	100,396	2008	payments	53,770
	transfers	123,715		transfers	396,040
	total	224,111		total	449,810
6 mos. 2009	payments	18,847			
	transfers	338,333			
	total	357,180			

**Adding payments and transfers to reported and collected (above) for 2007 and 2008:**

	Reported to C. Agency	Collected from C. Agency	Operating Revenues by Year	Collections as a % of Reported	Reported as a % of Revenues
2007	2,577,765	280,627	370,446,356	10.89	0.70
2008	4,713,610	635,450	410,136,239	13.48	1.15
6 mos. 2009	2,607,218	493,514	170,180,100	18.93	1.53

**Adjusting collections for 35% fees paid to collection agencies:**

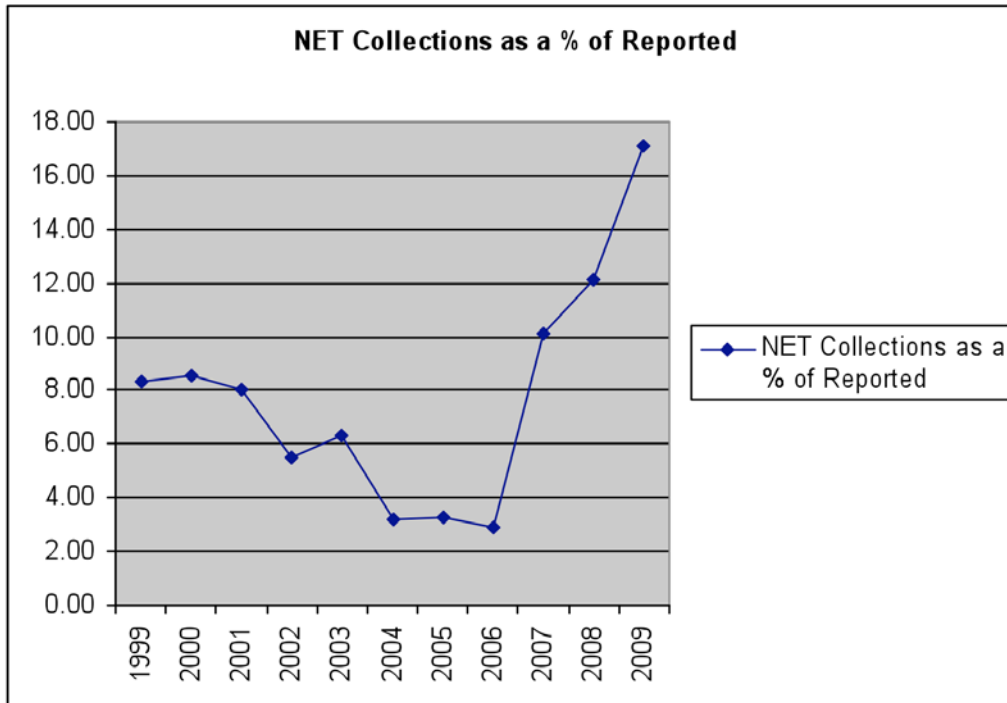
	Reported to C. Agency	Collected from C. Agency	Agency fee of 35%	Net Amount Collected from C. Agency	Operating Revenues by Year	NET Collections as a % of Reported	Reported as a % of Revenues
1999	670,274	85,839	-30,044	55,795	162,212,208	8.32	0.41
2000	597,415	78,541	-27,489	51,052	231,039,634	8.55	0.26
2001	1,633,343	202,647	-70,926	131,721	258,683,775	8.06	0.63
2002	1,581,305	133,056	-46,570	86,486	210,165,003	5.47	0.75
2003	1,173,197	114,541	-40,089	74,452	278,981,163	6.35	0.42
2004	1,755,731	86,889	-30,411	56,478	289,719,957	3.22	0.61
2005	2,040,361	103,595	-36,258	67,337	363,564,498	3.30	0.56
2006	4,691,189	211,737	-74,108	137,629	337,011,792	2.93	1.39
2007	2,353,654	56,516	-19,781	36,735	370,446,356	1.56	0.64
2008	4,263,800	185,640	-64,974	120,666	410,136,239	2.83	1.04
6 mo '09	2,250,038	136,334	-47,717	88,617	170,180,100	3.94	1.32

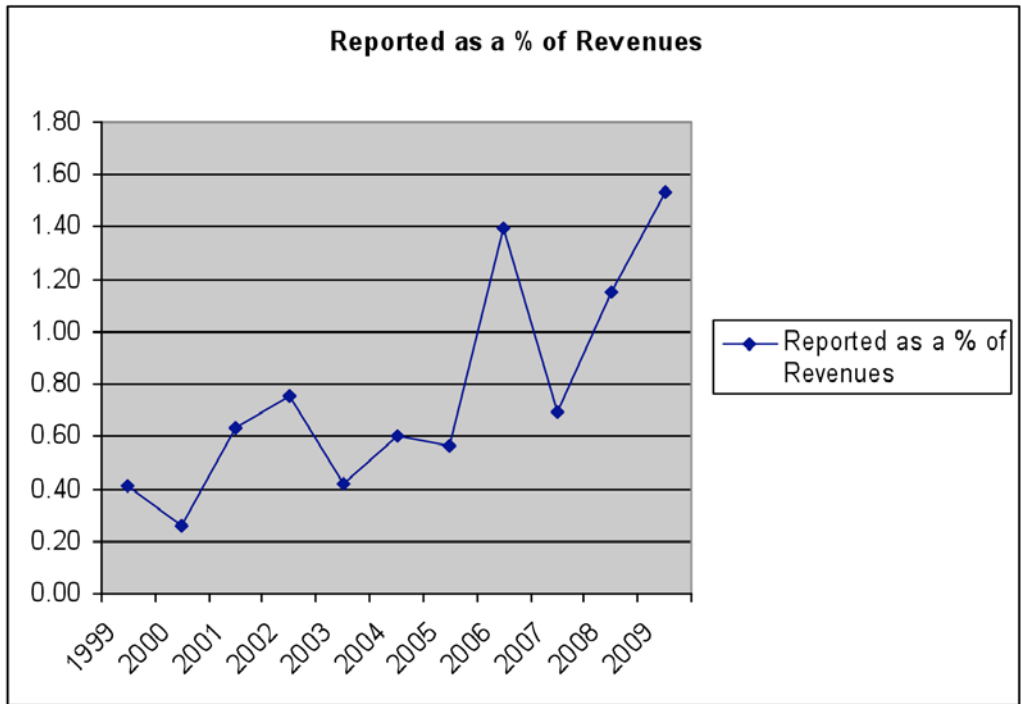
**Adding payments and transfers to reported and collected (above) for 2007 and 2008:**

	Reported to C. Agency	Collected from C. Agency	Agency fee of 35%	Net Amount Collected from C. Agency	Operating Revenues by Year	NET Collections as a % of Reported	Reported as a % of Revenues
2007	2,577,765	280,627	-19,781	260,846	370,446,356	10.12	0.70
2008	4,713,610	635,450	-64,974	570,476	410,136,239	12.10	1.15
6 mo '09	2,607,218	493,514	-47,717	445,797	170,180,100	17.10	1.53

**Collection Statistics that reflect in-house activities:**

	Reported to C. Agency	Net Amount Collected from C. Agency	NET Collections as a % of Reported	Reported as a % of Revenues
1999	670,274	55,795	8.32	0.41
2000	597,415	51,052	8.55	0.26
2001	1,633,343	131,721	8.06	0.63
2002	1,581,305	86,486	5.47	0.75
2003	1,173,197	74,452	6.35	0.42
2004	1,755,731	56,478	3.22	0.61
2005	2,040,361	67,337	3.30	0.56
2006	4,691,189	137,629	2.93	1.39
2007	2,353,654	260,846	10.12	0.70
2008	4,263,800	570,476	12.10	1.15
6 mo '09	2,250,038	445,797	17.10	1.53





As you can see, the period of decreased overall recoveries lasted for approximately two years. Since the Collections Specialist position was created, net collections are now above where we were prior to the implementation of Banner.

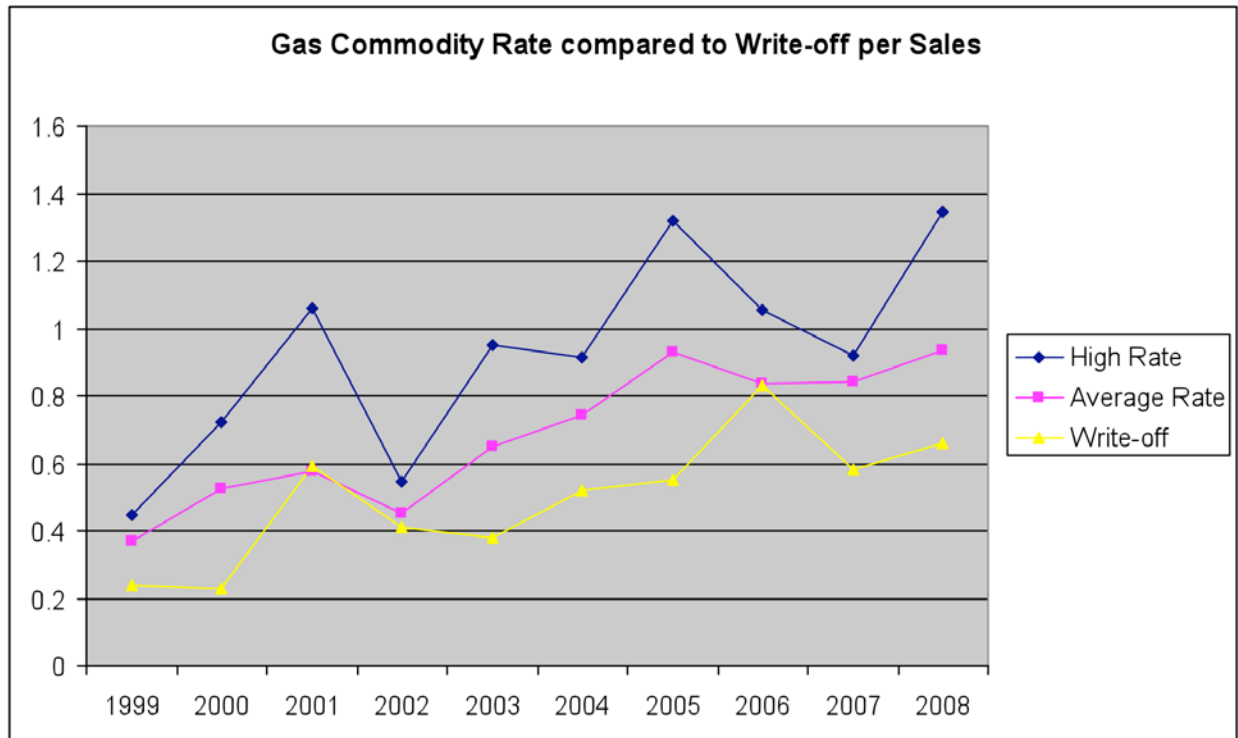
**(Graphs – Pages 11 and 12)**

The APA’s graph for accounts written off from 1999 through 2008 is accurate through the year 2006. Since the District officially “writes-off” accounts once they are two years old, the values for 2007 and 2008 are overstated. Basing our calculations on historical data for collections made in the past five years, we estimate the write-off for 2007 to be approximately \$2,240,000 – or about \$200,000 less than what the APA graph states. Our calculation of the estimated 2008 write-off is also less than what is stated by the APA. At the time the APA initially reviewed the balance of the 2008 final bill receivables, the total amount was \$3,150,098. In less than six months’ time, at the time of the first exit meeting with the APA to review their first draft report, that balance has already decreased by over \$300,000! Two months later, at the time of the second exit meeting with the APA to review their second draft report, the balance had declined by an additional \$66,000. Again, based on our calculations, the write-off for 2008 (which will be written off at the end of 2010) is estimated to be approximately \$2,400,000.

Using the District’s analysis (above), the APA’s ESTIMATED write-offs as a percentage of revenues are also overstated for 2007 and 2008. Rather than .66% and .71%, our estimates of those figures are .605% and .585% respectively. Again, this is taking into consideration our historical analysis of collections made during the five-year period after the issuance of a final bill. It is important to note that while in accordance with District policy uncollected accounts are written off after two years, collection efforts continue for three more years until the applicable Statute of Limitations has expired. Since the District

actively pursues payment for delinquent final bills and collects roughly 10% of those charges, the APA's claim that the current balance of all unpaid final bills for 2007 and 2008 will not be collected is grossly inaccurate.

Due to the fluctuations in the price of natural gas, it is also important to consider gas rates when comparing annual write-offs. As you can see in the graph on Page 13 of the APA's Review, gas prices spiked in 2000 and 2001, which caused a similar increase in the write-off for that year (APA Review Pages 11 and 12). Likewise, our estimated write-off percentage for 2008 will be higher than 2007 due to the spike in gas prices in 2008. This is evident in the graph and table below:



	Highest Monthly Gas Rate	Average Annual Gas Rate	Write-off (taken from Page 12 of APA report)
1999	0.449	0.367	0.240
2000	0.722	0.526	0.230
2001	1.059	0.577	0.590
2002	0.546	0.453	0.410
2003	0.953	0.647	0.380
2004	0.914	0.741	0.520
2005	1.318	0.931	0.550
2006	1.057	0.836	0.830
2007	0.917	0.840	0.580
2008	1.343	0.937	0.660

Thus it is clear that any increase in write offs the District has incurred has much more to do with spikes in natural gas prices than with the change in customer information systems since the 2001 increase predates the move to Banner and any alleged consequential delay

in sending accounts to collection agencies. While finally after two prior drafts the APA provides some acknowledgement that spikes in natural gas prices contribute to increased write off figures, the APA still ignores the significance of that impact in their analysis.

The nonsensical nature of the APA's deemphasizing the significant spikes in natural gas prices is further illustrated by their acknowledging the District's write-off percentages are within industry norms. Having said that but then going on to attribute higher write-off percentages when comparing 1999-2003 with 2004-2008 to any alleged delay in forwarding accounts to collection agencies would only lead one to conclude all gas companies must have simultaneously incurred a delay in forwarding accounts to collection agencies. After all, if that were not the case, then the District's figures should not be within industry norms. The APA cannot point to any specific statistical data that ties an increase in write-offs with when accounts are sent to collection agencies.

Instead, it is abundantly clear that spikes in natural gas prices are more directly correlated with higher write off figures as we've illustrated in the graph and chart on Page 7 of this response. Using the APA's two comparison periods, the average gas rate for 1999-2003 was .514. For the 2004-2008 period the average rate was .857, a 67% increase. Again despite relaying this information to the APA numerous times they've chosen to deemphasize the significance of such an increase on the ability of the District's customers to keep up with their utility bills. The dramatic increase in gas prices is illustrated on Page 13 of the APA's Review where every data point for 2004-2008 is higher than for 1999-2003.

The decision to downplay the spikes in natural gas prices, both before and after the implementation of the Banner system in 2004 is a second significant deficiency in the APA's analysis in that it clearly creates not just a "remote" likelihood but a strong likelihood that their analysis misstates the subject matter data to a degree that is more than inconsequential.

Regarding Estate accounts, the District has a formal procedure for the few estate accounts that are created. Generally, the death of a customer does not result in a separate estate account, nor does it create a payment issue. An account is generally kept in the name of the deceased and paid by interested parties until a new customer requests service. Occasionally, though not often, an Estate will set up an account in the Estate's name. The Estate then pays and there is generally no issue regarding payment. There are a few occasions when an Estate will give the District notice to file a claim, which requires the District to file a formal claim for services rendered. The Collections Department has a procedure and the forms necessary to file such a claim. The APA's suggestion that a death certificate or personal representative letter should be included in the file is form over substance and is not necessary to pursue a claim against an estate. Many lower income customers do not have an estate filed at their death due to the lack of any assets.

The APA's recommendation that additional staff be hired to assist with in-house collection activities is something that is reviewed annually. A thorough cost-benefit analysis will be done as part of the District's budgeting process to determine if any additions to staff will be made for 2010. It is important to remember that, as a public utility that provides essential services to our community, the District will always have bad debt. As a public utility, the District makes every effort to work with delinquent customers to find an agreeable solution with a shut off of services being the last resort. With regard to hiring additional staff, there

is a point of diminishing returns. The District does all it can to minimize bad debt without overspending on those efforts.

### **Documentation of “Collect-Off” Selection Criteria**

The APA staff spent approximately 30 minutes discussing and observing this process with District personnel. This time was insufficient to fully understand the complexity of the process used to select accounts for disconnection. Listed below are the criteria used to select accounts for shut-off:

- Geographic location
- Weather/temperature restrictions
- Date since last payment
- Payment history
- Amount past due
- Deposit balance
- Type of account (business or residential)
- Service order history
- Special instructions (access key required, follow up order, etc)

Finally, there is oversight of this process by many levels of management. The Division Supervisor monitors the selection of work on a daily basis either by reports or actual review of the system. The Vice President, Customer Services, reviews the delinquency summary report daily. The Sr. Vice President, Collections Specialist and the Supervisor, Collections, are also involved in this oversight process.

The APA report recommends that the District develop and document clearly defined selection criteria. It is our contention that such criteria already exists.

### **Comparison to Industry Standards**

Both the District as a Gas/Water utility and Gas/Electric combined utilities are utility companies that provide a necessary resource that is metered and billed monthly. Beyond those similarities, these two categories of utilities cannot be compared. Meter accessibility is a key difference that can have a tremendous impact on successful collection activity. Most electric meters are located outside for easy access to shut off or restore service by their technicians. Contrarily, most of the District’s water meters and a high percentage of its gas meters are located inside which limits access by our technicians. As a result, terminating services for nonpayment is much more difficult for the District. In addition, unlike electric utility service, when the natural gas service is terminated an appointment must be made with the customer before service can be restored to re-light pilot lights, etc. This adds an additional layer to the District’s process that electric utilities can avoid.

The District provided the APA with statistical data that showed an average write-off percentage of total revenues for a “water only” utility was 1.1% for the 2006 business year which was substantially higher than the District’s figure. So contrary to the APA’s inference that the District’s water utility should help lower the overall write-offs, the District’s water portion of its combined natural gas and water utility would actually raise the combined write-off percentage. The main reason for this is the previously discussed

access to the meter. In Nebraska's climate, most water meters have to be located inside the premises making it more difficult to terminate the service for nonpayment.

On average, 86% of the District's total write-off amount is attributable to gas bills and only 14% to water. As a result, it is abundantly clear the only industry to compare the District to is other gas utilities. The APA concedes the District compares favorably to that industry. Any efforts by the APA to compare the District to other industries are strained and illogical and can only be interpreted as an effort by the APA to present the District in a negative light.

Also, as previously mentioned, the spikes in natural gas prices since the beginning of this decade have had a more significant impact to the District's delinquencies than to electric utilities. As noted earlier, the APA does not significantly consider this in their analysis.

The fact that the District's write-off percentages compare favorably with the natural gas industry illustrates that any alleged delay in sending accounts to collection agencies had little, if any effect overall.

## **2. Customer Account Meter Data**

The District has implemented controls to verify that correct meter data are being entered into the District's customer information system (CIS). Those controls will continue. The District is preparing to install a new CIS and additional controls will be implemented to further improve the accuracy of meter data.

While the District will consider implementation of the Atmospheric Pressure Correction change when the new CIS is installed, the APA has completely misunderstood this issue as it pertains to the adjustments the District is currently making to the volumes of gas it bills to customers.

First of all, the APA failed to note in their review that the District's gas meters meet the industry standards for measurement deviation (American National Standard Spec B109.1) in that new meters may have a  $\pm 1\%$  deviation standard, and meters after accelerated life may deviate  $\pm 2\%$ .

Secondly, it should be noted that the use of Atmospheric Pressure Corrections is not universal in the gas industry due to varying opinions on the pros and cons of doing so. In cities such as Omaha that have varying topographies, it is possible that elevation variances within one residential subdivision can vary to the extent that the exact Atmospheric Pressure Correction figure for customer A in that subdivision would not be the same as it should be for customer B. Since it is impractical to have individual Atmospheric Pressure Adjustments for each natural gas customer, some gas companies apply a universal factor to smooth the variances amongst their customers. Other companies do not make any atmospheric pressure adjustments since the financial impact to customers can be negligible.

For those customers that the District does make some adjustment to the volume of gas billed, either through the meter or in the Banner system, the primary reason for the adjustment is due to the higher pressure of the gas that is being delivered to them, not for atmospheric pressure although that element is included in the calculation. The point the

APA misses is an adjustment is needed for those customers without any consideration to atmospheric pressures.

### **3. Internal Audit Function**

The District's Internal Auditor reports to the District's President and internal audits are addressed to the President. Copies of all Audits are provided to all Senior Vice Presidents. Copies of Audits are also provided to Vice Presidents and supervisors who are requested to respond to Audit findings. The District's audits are available for review by Board members.

The District's independent auditor, KPMG LLP, reviews all internal audits on an annual basis. KPMG LLP has found no basis for comment regarding any of the internal audits that it has reviewed.

The District will review the State Auditor's recommendations and consider what, if any, changes are warranted in current practices.

### **4. Customer Account Adjustments**

All financial transactions in Banner center around the open items table and these items are modified by making adjustments to those open items. A single charge displayed on the bill may consist of multiple open items. For example, a monthly gas charge will have a minimum of 12 open items depending on what day in the month the meter is read (2 for the commodity, 2 service charges, 2 infrastructure charges, and 6 sales tax items). For good reason, many of the "adjustments" performed by the District's authorized personnel are completed through a "front end" application in Banner that automatically creates the appropriate adjustments on the "back end."

The APA's report states that not all adjustment types were included in the review process for all adjustments totaling more than \$1,000. When those adjustment codes thought to be missing were reviewed with management personnel, it was explained that most did not belong on the report (see further explanation below). The two adjustment codes that were identified as missing are not frequently used for amounts over \$1,000, but have been added to the report.

The APA's report indicates that of the 36 adjustments over \$1,000 they checked, 27 of them lacked documentation of a review being made. Since the accounts referenced were not individually identified in the report, we are making the assumption that the explanation below is valid for all of those accounts.

Many transactions in Banner result in adjustment(s) to the individual open items. These transactions are restricted by the function it is intended to perform. For example, if an account clerk is cancelling and re-billing an account, they will simply identify the bill(s) they want to cancel. After cancelling, they then must either re-bill all months through this adjustment process or the system will automatically re-bill from the point in time and the reading where they left off. Another example would be the account transfer function. A balance can be transferred from one account to another, but cannot be removed from the account. Both of these "front-end" transactions in Banner create multiple lines of

adjustments within Banner each time they are performed. This is why there were 1.8 million lines of adjustments during the APA review period.

As indicated by the lack of any findings relating to billing adjustment by the APA, the District is diligent in reviewing and validating customer billing information. We believe our reviews are adequate and we are always mindful of how any changes to our billing system will affect our ability to protect, monitor and review all adjustments to customer billings. Any additional review of adjustments would require adding staff which as mentioned before, is evaluated annually by the District to determine if the benefits outweigh the costs.

#### **5. Allowance for Doubtful Accounts**

The District will review this recommendation and consider what, if any, changes are warranted in current practices.

#### **6. Uncollectible Accounts Charge**

The District will review this recommendation and consider what, if any, changes are warranted in current practices.

### **CONCLUSION**

As noted throughout this response, many of the APA's conclusions and related recommendations are invalid since they are based upon erroneous or incomplete assumptions and/or data. Many factors that should have been included in the APA's analysis that would have a significant impact were omitted. In addition, the APA has chosen to ignore information provided by the District which would impact some of their conclusions thus invalidating them entirely. Finally, many recommendations include adding manpower but there is no cost benefit analysis done to determine if such additions are warranted. The District does such a cost benefit analysis each year for not only manpower changes but also for system improvements and equipment upgrades. Unless the cost of any changes will be at least equal to the benefit expected to the District's customers, they are not approved. The positive impact of this analysis is illustrated in the survey noted in the Executive Summary of this response that notes the overall low rates the District's customers enjoy.

The other findings and/or recommendations that the District can comment on have been adequately addressed in the respective response.