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**To:** Joseph Gonzales, CPA, Austin Water  
Utility Budget and Finance Manager  
**From:** Rick Giardina, RFC Project Manager  
**Date:** October 17, 2016  
**Re:** Revenue Requirement Methodology – Cash vs. Utility Basis

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This memorandum summarizes Raftelis Financial Consultants, Inc. (RFC) recommendation regarding the use of the Cash or Utility Basis for determining the water and wastewater revenue requirements for the City's service to wholesale and outside City retail customers. In this memorandum these customers are collectively referred to "O/C" while inside City retail customers are referred to as "I/C".

Attachment A to this memorandum provides a side-by-side comparison of the pros and cons of the two revenue requirements methodologies. At the second meetings of the Public Involvement Committee (PIC) and the Wholesale Involvement Committee (WIC), RFC presented information on both these methods.

Austin Water (AW) has long used the Cash Basis in determining revenue requirements for all its customers. Perhaps the most significant advantages of this methodology is its alignment or consistency with the City's budget approach, its simplicity and lastly, its consistency in terms of "treating" all customers alike.

That said, the Utility Basis provides benefits to both I/C and O/C customers that, at the present time, cannot be achieved under the Cash Basis, i.e., the Cash Basis shortcomings noted in Attachment A are addressed or remedied with use of the Utility Basis. These include:

1. Providing an explicit return on investment to AW's I/C customer-owners for the investments made in utility assets serving O/C customers.
2. Fairness and equity in terms of the return provided to I/C customers. Compensating AW's I/C customer-owners for a variety of risks including the risk that O/C customers may leave the AW system.
3. Enhancing rate stability for AW's O/C customers, who, regardless of the capital financing decisions made by AW, will only pay for assets when they are placed in service and then continue to pay for such assets only over their useful, beneficial life.
4. The Utility Basis is fully understood by the Public Utility Commission of Texas (PUCT) due to its use in investor-owned utility rate cases.
5. The Utility Basis is widely used by municipal utilities who provide O/C service and is an industry standard approach fully supported by the American Water Works Association and the Water Environment Federation.

For these reasons, RFC recommends the use of the Utility Basis in the determination of revenue requirements for wholesale customers and outside City retail customers.

At the third meetings of the PIC and WIC, RFC will present this recommendation, its supporting rationale and facilitate Committee discussion on this topic.

**ATTACHMENT A**

<b>Wholesale and Outside City Retail: Revenue Requirement Methodology</b>	<b>Pros</b>	<b>Cons</b>
<b>Cash Basis</b>	<ol style="list-style-type: none"> <li>1. Historically used – “generally” accepted by all customers</li> <li>2. Simple, easy to understand and determine, update and administer</li> <li>3. All customers treated the same; same methodology used for everyone</li> <li>4. Match City’s budget and accounting methodology, i.e., cash method</li> </ol>	<ol style="list-style-type: none"> <li>1. O/C start paying for assets before placed into service</li> <li>2. No explicit return to I/C customers for investment and risk to serve O/C customers</li> <li>3. Potential for material rate changes based on capital financing decisions, e.g., debt vs. cash funding</li> <li>4. Determination of used and useful assets for capital revenue requirement</li> </ol>
<b>Utility Basis</b>	<ol style="list-style-type: none"> <li>1. Provide explicit return to I/C customers for investment and risk to serve O/C customers</li> <li>2. Fairness and equity in terms of return provided to I/C customers</li> <li>3. Fairness and equity in terms of elimination of subjective decisions by AW regarding method of capital financing</li> <li>4. Enhanced level of rate stability for O/C customers</li> <li>5. O/C customer do not pay a return on or of assets until assets are in service</li> <li>6. Consistent with methodology used by PUCT in the regulation of investor owned utilities</li> <li>7. Widely used by other local government utility providers across the US in O/C service arrangements</li> </ol>	<ol style="list-style-type: none"> <li>1. New approach for customers to understand</li> <li>2. Absent an agreed upon methodology or risk premium, potential exists for extensive debate regarding determination of the cost of equity capital</li> <li>3. Requires the determination of the used and useful rate base – potential for debate regarding in-service date for assets under construction</li> <li>4. Represents costs in a manner different than the City’s current cash budget methodology</li> </ol>