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Cover photo by Denver Auditor’s Office staff.
AUDITOR’S LETTER

April 4, 2024

In keeping with generally accepted government auditing standards and Auditor’s Office policy, as authorized by city ordinance, we have a responsibility to monitor and follow up on audit recommendations to ensure city agencies address audit findings through appropriate corrective action and to aid us in planning future audits.

In June 2022, we audited Denver Water city services and found risks involving the processes for reviewing charges and the analysis being used to justify bringing billing services in-house. The Department of Transportation & Infrastructure and the Department of General Services agreed to implement all five recommendations we made.

We recently followed up and found all recommendations fully implemented.

Therefore, based on our follow-up work, we conclude the Department of Transportation & Infrastructure and the Department of General Services addressed all risks associated with our original findings.

We appreciate the leaders and team members in Transportation & Infrastructure and General Services who shared their time and knowledge with us throughout the audit and the follow-up process. Please contact me at 720-913-5000 with any questions.

Denver Auditor’s Office

Timothy M. O’Brien, CPA
Auditor
The city’s dependence on Denver Water’s price setting could lead to the city overpaying for services

- The city did not check whether the discounted governmental water rate charged to the city was calculated in compliance with the Denver Charter.
- The Department of General Services did not adequately review the city’s monthly water bills.
- The Wastewater Management Division did not adequately check the accuracy of Denver Water’s fees for sewer billing services, which are done on the city’s behalf.

The ongoing analysis to potentially discontinue sewer billing services through Denver Water was flawed

Transportation & Infrastructure’s analysis to bring sewer billing into its own system did not consider several factors based on government leading practices. Furthermore, its cost analysis did not include all relevant costs, the timing of cash flows, and the riskiness of cash flows.

WHY THIS MATTERS

Without adequate processes to review charges, the city could overpay Denver Water for the services it receives. Meanwhile, Transportation & Infrastructure could not be certain that switching sewer service billing to an in-house service was the best method of providing billing services to Denver customers.
April 4, 2024

Action Since Audit Report
Denver Water City Services

5 recommendations proposed in June 2022

We found the Department of Transportation & Infrastructure and the Department of General Services fully implemented all our recommendations made in the original audit report.

By improving their processes for reviewing rates and costs, the departments are better protecting the city from overpaying for services it receives.

By implementing a decision framework aligned with government best practices and through its decision to leave sanitary sewer billing with Denver water, the Wastewater Management Division has effectively addressed the risks associated with Recommendation 2.1 and Recommendation 2.2 in the original audit report.

<table>
<thead>
<tr>
<th>Fully Implemented</th>
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<tr>
<td>Partially Implemented</td>
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FINDING 1 | The city’s dependence on Denver Water’s price setting could lead to the city overpaying for services

<table>
<thead>
<tr>
<th>RECOMMENDATION</th>
<th>IMPLEMENTATION STATUS</th>
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<tbody>
<tr>
<td>1.1 Review annual discounted governmental water rate</td>
<td>FULLY IMPLEMENTED</td>
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<tr>
<td>1.2 Review water rates charged on monthly city water bills</td>
<td>FULLY IMPLEMENTED</td>
</tr>
<tr>
<td>1.3 Review Denver Water’s annual service fee cost estimate</td>
<td>FULLY IMPLEMENTED</td>
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**RECOMMENDATION 1.1**

**REVIEW ANNUAL DISCOUNTED GOVERNMENTAL WATER RATE** – The Wastewater Management Division should develop and document a process to review the annual discounted governmental water rate provided by Denver Water to ensure it aligns with the Denver Charter and excludes prohibited costs. Specifically, the review should confirm:

- The rate charged to the city does not exceed Denver Water’s cost of water furnished to the city.
- The rate charged does not include costs for debt service, betterments, additions, or extensions per city charter.¹

In the event the rate is incorrect, the Wastewater Management Division should notify city agencies that receive water bills, including the Department of General Services, Denver International Airport, and Denver Parks and Recreation.

**FULLY IMPLEMENTED**

**Agency’s original target date for completion: June 30, 2022**

**SUMMARY OF AGENCY ACTION**

The Department of Transportation & Infrastructure created and documented procedures to review the annual discounted governmental water rate to ensure the rate complies with the city charter. The charter specifies that Denver Water may not bill more than its costs to furnish water to the city and that certain other costs may not be passed on to the city, including costs for debt service, additions, extensions, or betterments.

We reviewed the Department of Transportation & Infrastructure’s written procedures and documentation of the department’s review of the 2022

¹ Denver Charter § 10.1.12.
discounted governmental water rate, which includes calculating Denver Water’s annual net operating expenses and dividing this amount by the total sales of treated water to determine the operating rate per 1,000 gallons. We compared this amount to the city’s treated water rate to determine whether the city’s rate is the same or less than Denver Water’s operating rate. We did not find any instances of the city being charged more than Denver Water’s cost to furnish water to the city, nor did we find any instances of the city being charged for prohibited costs.

Therefore, we consider this recommendation fully implemented.

**Recommendation 1.2**

**REVIEW WATER RATES CHARGED ON MONTHLY CITY WATER BILLS** – The Department of General Services should develop and document a process to review the type of service agreement on all water bills for city properties to ensure Denver Water has charged the correct discounted governmental water rate.

**FULLY IMPLEMENTED**

*Agency’s original target date for completion: July 6, 2022*

**SUMMARY OF AGENCY ACTION**

After our original audit, General Services began reviewing water rates on a monthly basis. To determine whether the department’s review procedures are documented and sufficient to detect any errors, we examined General Services’ new training documents that outline the procedure, and we interviewed the staff responsible for the review. We also observed staff members reenacting a monthly review.

We reviewed Denver Water’s billing spreadsheets for 2023 and confirmed there were no errors in the billing rate.

Therefore, we consider this recommendation fully implemented.

**Recommendation 1.3**

**REVIEW DENVER WATER’S ANNUAL SERVICE FEE COST ESTIMATE** – The Wastewater Management Division should develop and document a process to review the annual cost estimate for billing service fees that Denver Water provides to ensure no erroneous costs are present before the city agrees to the annual fee.

This review should include, at a minimum, an evaluation of the direct costs allocated to the city and the number of accounts Denver Water has for the city to ensure costs are proportioned accurately.
Agency's original target date for completion: Sept. 30, 2022

SUMMARY OF AGENCY ACTION

The Wastewater Management Division within the Department of Transportation & Infrastructure has substantially improved the quality of its review over the fee cost estimate from Denver Water.

To understand their updated procedures, we asked Wastewater Management staff to explain the changes and we examined a new template they had developed to analyze 2024 billing service costs. We also looked at training documentation and determined the review process was standardized and adequately documented.

We found Wastewater Management’s updated process to review the annual service fee cost estimate is sufficient to detect erroneous costs and ensures only direct costs are charged. It also will determine the allocation basis is correct and recalculated based on Wastewater Management’s own records.

Therefore, we consider this recommendation fully implemented.
FINDING 2 | The ongoing analysis to potentially discontinue sewer billing services through Denver Water is flawed

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<tr>
<th>RECOMMENDATION</th>
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<tr>
<td>2.1 Revise the decision analysis for sewer billing to align with governmental best practice</td>
<td>FULLY IMPLEMENTED</td>
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<tr>
<td>2.2 RImprove upon the net present value analysis tool</td>
<td>FULLY IMPLEMENTED</td>
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**Recommendation 2.1 REVISIE THE DECISION ANALYSIS FOR SEWER BILLING TO ALIGN WITH GOVERNMENTAL BEST PRACTICE** – The Wastewater Management Division's analysis to move sewer billing in-house should align with city and county government best practice. At a minimum, this should include the consideration of the following:

1. Strong executive direction.
2. Stakeholder input.
3. Service requirements.
4. Flexibility of the arrangement to bill in-house.
5. Reversibility of the arrangement to bill in-house.
6. Transition costs.
7. Communication.
8. Cost and service quality (consideration of qualitative as well as quantitative factors).

Agency's original target date for completion: Dec. 31, 2022

**SUMMARY OF AGENCY ACTION**

At the time of our original audit in 2022, the Wastewater Management Division was considering moving sanitary sewer billing operations from Denver Water to the city. Recommendation 2.1 was intended to address the limited and inaccurate analysis the division had done regarding its decision to move sanitary sewer billing in-house.

During our follow-up review, Wastewater Management leaders said they had decided to keep sanitary sewer billing with Denver Water, and they provided documentation on how they reached their decision. Based on our
review of the documentation, we found this decision framework aligns with government best practices and incorporates all eight of the considerations noted in our recommendation. The division also included an assessment on how this decision aligned with the agency's priorities.

As such, we consider this recommendation fully implemented.

**Recommendation 2.2**

**IMPROVE UPON THE NET PRESENT VALUE ANALYSIS TOOL** – In addition to Recommendation 2.1, the Wastewater Management Division should improve upon its net present value analysis to include all incremental costs identified and to ensure cost estimates and discount rates reflect the most current available information. Additionally, the analysis should consider the riskiness of estimated future cash flows. This can be accomplished in two ways:

1. Requiring a higher cost-savings threshold for project acceptance for riskier projects.
2. Using higher discount rates for more risky cash flows.

**Agency's original target date for completion: Dec. 31, 2022**

**SUMMARY OF AGENCY ACTION**

Recommendation 2.2 was made alongside Recommendation 2.1 to address the limited and inaccurate analysis the Wastewater Management Division had done for sanitary sewer billing — specifically its use of a net present value analysis. The original recommendation sought to address the risk that the division's use of net present value would provide inaccurate or irrelevant results.

As discussed in the implementation of Recommendation 2.1, the division has implemented a decision framework that aligns with government best practice. We found the framework does not include net present value analysis but instead incorporates other qualitative and quantitative considerations more widely used by governments.

Because the division's framework no longer includes net present value analysis, the risks found in our original audit related to its use of net present value analysis have been eliminated.

As a result, we consider this recommendation fully implemented.
Office of the Auditor

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