FINAL AGENDA

Times shown are approximate. Some items may take more or less time than scheduled, or the Chair may grant requests to hear items in an order other than shown.

1. Consideration of Action to Approve the Minutes of January 23, 2020 Finance, Audit and Power Committee - Goddard (10:00)


3. Discussion and Consideration of Action to Recommend that the Board Approve Additional Spending Authority for Navajo Generating Station Decommissioning Costs - Dunlap (10:20)

4. Discussion of Strategic Reserves Target and Strategy (*Finance: Maintain Coordinated Financial Strategies*) - Dunlap (10:30)

5. Discussion and Consideration of Action to Recommend that the Board Approve Supplemental Guidance to the CAWCD Rate Setting Policy Regarding the Collection of Fixed OM&R Costs for System Conservation - Cullom (10:50)


7. Future Agenda Items (11:25)

8. Public Comment (11:30)

9. Consideration of Action to Convene in Executive Session of the Committee Pursuant to A.R.S. §38-431.03.A.2, discussion and consideration of records exempt by law from public inspection, to update the Committee on the cyber security penetration test results. (*The discussions and minutes of the executive session shall be kept confidential. The executive session of the Committee is not open to the public.*) (11:35)

10. Adjourn

^ *Linkage to 2016 CAWCD Board of Directors Strategic Plan.*

In accordance with the Americans with Disabilities Act (ADA), if you need reasonable accommodations due to a disability, please contact the CAP office at (623.869.2333) or TDD (623.869.2183) at least seventy-two (72) hours in advance of the meeting.
A meeting of the Central Arizona Project Finance, Audit and Power Committee ("Committee") of the Central Arizona Water Conservation District's ("CAP" or "CAWCD") Board of Directors was called to order by Chair Goddard on 1/23/2020 at 10:03 a.m. The meeting was held at the Central Arizona Project, 23636 North Seventh Street, Phoenix, Arizona, in the Board Room.

Committee Members present were: Chair Terry Goddard, Maricopa County; Jennifer Brown, Maricopa County; Karen Cesare, Pima County; Pat Jacobs, Pima County; Jennifer Martin, Maricopa County (via teleconference); and Mark Taylor, Pima County.

Committee Members not present were: Alexandra Arboleda, Maricopa County.

Staff members present were: Ted Cooke, General Manager; Bob Moody, Assistant General Manager; Jay Johnson, General Counsel; Chris Hall, Director of Finance and Administration; Bridget Schwartz-Manock, Director of Public Affairs; Darrin Francom, Director of Operations, Power and Engineering; Brian Buzard, Director of Centralized Maintenance; Doug Dunlap, Finance and Accounting Manager; Ramon Ramirez, Internal Audit Manager; Brian Young, Power Programs Manager; Tanya Luther, Senior Accountant; Megan Casey, Public Affairs Management Analyst; and Jenn Miller, Board Support Specialist.

1. CONSIDERATION OF ACTION TO APPROVE THE MINUTES OF OCTOBER 17, 2019
FINANCE, AUDIT AND POWER COMMITTEE - GODDARD

On a motion (Board Member Jacobs) and a second (Board Member Taylor), approved the minutes of the October 17, 2019 FAP Committee meeting. Motion passed.

Voting yes: Terry Goddard, Jennifer Brown, Pat Jacobs, Mark Taylor
Not voting: Karen Cesare, Jennifer Martin

2. DISCUSSION AND CONSIDERATION OF ACTION TO APPROVE THE 2020-2021 INTERNAL
AUDIT PLAN AND AUDIT UPDATE (PROJECT RELIABILITY: EFFECTIVELY MANAGE,
OPERATE AND MAINTAIN CAP ASSETS^) - RAMIREZ

Ramon Ramirez, Internal Audit Manager, reported on the status of various audit projects, which included the Palo Verde Morgan Transmission Project, Accounts Payable Audit, and the Procurement of Construction Services. Mr. Ramirez indicated that this was the final report on the Palo Verde Morgan Transmission Project, and the audit result concluded that construction costs were billed correctly in accordance with the terms of the project agreement.

Mr. Ramirez also reviewed the Accounts Payable process, focusing on payments made in calendar years 2018 and 2019 up to November 21, and his findings indicated that payments were supported by appropriate documentation and authorizations, also acknowledging that proper workflows were utilized to facilitate the payment process. He noted the findings include
recommendations to improve the accounts payable process, including but not limited to purging unneeded data for processing efficiency and a stricter naming and address convention protocol. As part of the Accounts Payable Audit, Mr. Ramirez reported that he discovered that there were over 6000 vendors still active even though payments were made to only 1372 vendors over the course of 2018-19. He recommended purging outdated vendors and Board Member Jacobs asked if any data would be lost during this type of purge. Mr. Ramirez assured him that there would not be any data lost.

Mr. Ramirez also requested the approval of the 2020-21 Internal Audit Plan by the Board, providing a high-level schedule of planned projects, descriptions and estimated workflow.

Board Member Taylor asked Mr. Ramirez to contrast the level of work performed on the most recent CAGRD audit, in comparison to previous years. Mr. Ramirez indicated that the audit was performed by CAGRD staff which he felt was more appropriate due to their level of expertise, and that he was available to consult on the audit as needed. Board Member Jacobs asked if the internal audits completed by staff would still conform to the same standards as the audits Mr. Ramirez would continue to manage, and if the Board would be informed of the outcomes of said audits now being handled at the staff level. General Manager Ted Cooke suggested that his annual performance plan should have a requirement to report on the annual audit reports of the CAGRD.

Board Member Jennifer Brown requested a report on all the departments and their audit status for the past, present and future. Mr. Ramirez said he could provide a list of the work done by himself and his predecessor, and that the internal audit plan he presented on at the meeting was informed by the work he had done previously.

On a motion (Board Member Taylor) and a second (Board Member Brown), approved the proposed 2020-21 Internal Audit Plan. Motion passed.

Voting yes: Terry Goddard, Jennifer Brown, Karen Cesare, Pat Jacobs, Jennifer Martin, Mark Taylor

3. REPORT ON EXTERNAL AUDIT ACTIVITIES (FINANCE: MAINTAINING CAP'S FINANCIAL HEALTH*) - LUTHER

Tanya Luther, Senior Accountant, reported on the status of the external audit activities for 2019. Ms. Luther referred to the Information Brief that was provided to the Committee members. She also reviewed the audit schedule and indicated that the final audit report would be presented by CliftonLarsonAllen at the April 16 meeting and the Committee would be requested to approve release of the report.

4. REPORT ON NAVAJO GENERATING STATION CLOSURE AND RELATED COSTS AND AGREEMENTS - DUNLAP/FRAFCOM

Darrin Francom, Director of Operations, Power and Engineering, reported on the decommissioning negotiations for both the Coal Supply Agreement (Kayenta Mine) and the Land Lease Extension with the Navajo Nation (NGS).
Mr. Francom indicated that some of the agreements were not finalized and still in negotiations, addressing Chair Goddard’s inquiry. General Counsel Jay Johnson confirmed Mr. Francom’s statement and stated the report today would avoid sharing information on those ongoing negotiations in open session. Ted Cooke, General Manager, clarified the parties currently involved in the agreements mentioned, and Mr. Francom read the names out loud for the Committee.

Doug Dunlap, Finance and Accounting Manager, provided an update on the financial responsibility of the CAWCD, focusing on costs and liability as they were known to date. Mr. Dunlap noted that CAP had previously estimated its 24.3% share of the decommissioning cost resulted in a liability amount of $133.8 million that was initially fully funded. As a result of ongoing negotiations, of which CAP is not a party, that liability had increased to $159.5 million. He indicated staff would explore options for funding the additional $25.7 million liability and would return to the Committee with recommendations for consideration, as well as any additional spending authority needs.

Mr. Dunlap walked through the timeline of when funds had been set aside to eventually pay for decommissioning and the history of negotiations to date. He also identified the assets that the Navajo Nation would retain, and noted that Peabody would retain all the assets of the Kayenta mine. Mr. Dunlap noted that most of the remediation activities would be conducted through 2023, and most of the costs beyond 2024 would be related to a land lease to conduct ongoing environmental testing.

Board Member Jacobs inquired as to the level of CAP staff involvement in the negotiations. Mr. Johnson clarified that CAP was not part of the negotiations, but the Bureau was proactive at including CAP in all updates and in keeping CAP informed. Chair Goddard added that the Navajo Nation is a part of the discussions for the NGS closure, but neither the Hopi nor the Navajo are involved in the discussions related to the mine closure. He noted that Peabody will retain all the assets for the mine closure, and the Tribes are only indirectly impacted by the mine closure for items such as retiree benefits for their members. Mr. Johnson reported that, once the agreements are finalized, the coal supply settlement royalties would be due within ten days.

Chair Goddard then asked what assets the Navajo Nation would retain. Darrin Francom informed the Committee that they would retain components of the railroad and a maintenance building. Additionally, Power Programs Manager Brian Young included that CAP transferred through the US to the Navajo Nation capacity on the transmission system, while retaining the 240 megawatts CAP needed to support its operations.

Board Member Taylor asked what the ongoing costs would be in the out years, and if it was related to reclamation or retirement health, to which Mr. Dunlap stated the costs were already funded and that the repayments were for access to ongoing monitoring of the land after remediation.
Board Member Jacobs asked if the Extraordinary Cost Reserves fund for decommissioning costs was still active and if so, for what purpose would that serve. Mr. Dunlap indicated that the fund still existed with approximately $7M in it, and that the Board would have to approve any use of those funds in the future.

5. **REPORT ON THE VOLUNTARY SUPPLEMENTAL SHORTAGE STABILIZATION PROGRAM (FINANCE: MAINTAINING CAP’S FINANCIAL HEALTH) - DUNLAP**

Mr. Dunlap reported on the status of the Voluntary Supplemental Shortage Stabilization Program that was introduced in 2015. He stated that 26 customers opted in to the program with the intention that the funding would be utilized within the next five years. As of the end of 2019, and with no shortage anticipated for 2020, the program is scheduled to end. Mr. Dunlap indicated that per the program, monies were not fully utilized and therefore CAWCD would initiate a refund to those customers who contributed to the program, including proportionate interest by the first part of 2021.

Mr. Dunlap informed the Committee of an upcoming Stakeholder Roundtable discussion with customers to obtain their feedback on potential options for the program, including following the existing agreement in which CAWCD would refund customers plus interest, or establish a new program that would extend the current program. He stated the results of the upcoming roundtable discussion would be brought back to the Committee with customer feedback and the customer preferred option.

6. **FUTURE AGENDA ITEMS**

Chair Goddard announced that the next meeting of the FAP Committee will be on February 20 and will include the following agenda items: Report on Internal Audit Activities; Discussion of Strategic Reserves Target and Strategy; Discussion and Recommendation to the Board on a Policy on the Collection of Fixed OM&R for System Conservation; and Report on Power Programs.

7. **PUBLIC COMMENT**

Stanley Rios, member of the Tohono O’odham Nation, addressed the Committee with comments on providing water to the Nation’s farming operations.

8. **CONSIDERATION OF ACTION TO CONVENE IN EXECUTIVE SESSION OF THE COMMITTEE FOR THE FOLLOWING PURPOSES:**

*(THE DISCUSSIONS AND MINUTES OF THE EXECUTIVE SESSION SHALL BE KEPT CONFIDENTIAL. THE EXECUTIVE SESSION OF THE COMMITTEE IS NOT OPEN TO THE PUBLIC.)*

On a motion (Board Member Taylor) and a second (Board Member Cesare), entered into executive session at 12:03 p.m. for the purposes listed on the agenda. Motion passed.

**Voting yes:** Terry Goddard, Jennifer Brown, Karen Cesare, Pat Jacobs, Jennifer Martin, Mark Taylor

8.a. **PURSUANT TO A.R.S. § 38-431.03.A.1 TO DISCUSS MATTERS PERTAINING TO THE INTERNAL AUDIT MANAGER’S 2019 PERFORMANCE EVALUATION AND SALARY ADJUSTMENTS AND 2020 PERFORMANCE PLAN; AND**
8.b. PURSUANT TO A.R.S. § 38-431.03.A.3 AND A.4 FOR DISCUSSION OR CONSULTATION WITH THE ATTORNEYS OF THE DISTRICT IN ORDER TO CONSIDER ITS POSITION AND INSTRUCT ITS ATTORNEYS, AND OBTAIN LEGAL ADVICE, REGARDING NGS CLOSURE AND RELATED COSTS AND AGREEMENTS

9. RECONVENE IN OPEN SESSION
The Committee reconvened in open session at 1:14 p.m.

10. DISCUSSION REGARDING ITEMS DISCUSSED IN EXECUTIVE SESSION
None.

11. ADJOURN
There being no further business to come before the Committee, the meeting adjourned at 1:14 p.m.

___________________________
Terry Goddard
Chair
CONTACT: Ramon Ramirez  
623-869-2123  
rramirez@cap-az.com

MEETING DATE: Thursday, February 20, 2020

AGENDA ITEM: Report on Internal Audit Activities (*Project Reliability: Effectively Manage, Operate and Maintain CAP Assets*) - Ramirez

LINKAGE TO STRATEGIC PLAN, POLICY, STATUTE OR GUIDING PRINCIPLE:
2016 CAWCD Strategic Plan

- Project Reliability: Effectively Operate and Maintain CAP Assets

PREVIOUS BOARD ACTION/ACTIVITY:
The Finance Audit and Power Committee (FAP) receives regular reports on Internal Audit activities.

ISSUE SUMMARY/DESCRIPTION:
Annual communications required by International Internal Auditing standards will be addressed in a presentation at this FAP meeting. The presentation will include a confirmation of auditor independence and a discussion of the professional standards to which the Internal Audit Manager is bound to adhere.

ATTACHMENTS:
1. Presentation
Update on 2020 Internal Audit Activities

Ramon Ramirez
Internal Audit Manager
February 20, 2020

Required Communications

Framework for Internal Audit Effectiveness:

• Developed by Institute of Internal Auditors (IIA)
• International Professional Practices Framework (IPPF)

Certain periodic communications are required in order to maintain compliance with professional standards.
Confirmation of Independence

The functional reporting relationship of the Internal Audit Manager to the FAP Committee and the administrative reporting relationship to the General Manager are appropriate to support organizational independence and objectivity of Internal Audit.

As the Internal Audit Manager, I hereby confirm that I am free from organizational and personal impairments to the independence of the internal audit function as of February 20, 2020. As a result, I am able to carry out internal audit responsibilities in an objective and unbiased manner.

Definition of Internal Auditing

The Definition of Internal Auditing states the fundamental purpose, nature, and scope of internal auditing.

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.
Code of Ethics

Principles and expectations governing the behavior of individuals and organizations in the conduct of internal auditing

Two essential components:

1. Principles that are relevant to the profession and practice of internal auditing.

2. Rules of Conduct that describe behavior norms expected of internal auditors. These rules are an aid to interpreting the Principles into practical applications and are intended to guide the ethical conduct of internal auditors.

Code of Ethics Principles

1. Integrity
   The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgment.

2. Objectivity
   Internal auditors exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments.

3. Confidentiality
   Internal auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.

4. Competency
   Internal auditors apply the knowledge, skills, and experience needed in the performance of internal audit services.
Rules of Conduct - Integrity

Internal auditors:

1.1. Shall perform their work with honesty, diligence, and responsibility.

1.2. Shall observe the law and make disclosures expected by the law and the profession.

1.3. Shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization.

1.4. Shall respect and contribute to the legitimate and ethical objectives of the organization.

Rules of Conduct - Objectivity

Internal auditors:

2.1. Shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organization.

2.2. Shall not accept anything that may impair or be presumed to impair their professional judgment.

2.3. Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.
**Rules of Conduct - Confidentiality**

Internal auditors:

3.1. Shall be prudent in the use and protection of information acquired in the course of their duties.

3.2. Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.

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**Rules of Conduct - Competency**

Internal auditors:

4.1. Shall engage only in those services for which they have the necessary knowledge, skills, and experience.

4.2. Shall perform internal audit services in accordance with the *International Standards for the Professional Practice of Internal Auditing (Standards)*.

4.3. Shall continually improve their proficiency and the effectiveness and quality of their services.
Standards

Standards are principle-focused and provide a framework for performing and promoting internal auditing.

The Standards are mandatory requirements consisting of:

• Statements of basic requirements for the professional practice of internal auditing and for evaluating the effectiveness of its performance. The requirements are internationally applicable at organizational and individual levels.

• Interpretations, which clarify terms or concepts within the statements.

• Glossary terms.

Attribute vs. Performance Standards

Attribute Standards
Attribute Standards address the characteristics of organizations and parties performing internal audit activities.

Performance Standards
Performance Standards describe the nature of internal audit activities and provide criteria against which the performance of these services can be evaluated.
Questions?
CONTACT: Doug Dunlap  
623-869-2360  
ddunlap@cap-az.com

MEETING DATE: Thursday, February 20, 2020

AGENDA ITEM: Discussion and Consideration of Action to Recommend that the Board Approve Additional Spending Authority for Navajo Generating Station Decommissioning Costs - Dunlap

RECOMMENDATION: Staff recommends that the Finance Audit and Power Committee recommend that the Board of Directors approve additional spending authority of $25.7 million to record the additional liability related to the decommissioning of NGS and final reclamation costs of the Kayenta Mine.

FISCAL IMPLICATIONS: Yes

Impact on Budget: Increase of $25.7 million in General Fund other expenses

Additional spending authority requested: $25.7 million

Impact on Reserves: To be determined at a future date

Impact on Rates: To be determined at a future date

LINKAGE TO STRATEGIC PLAN, POLICY, STATUTE OR GUIDING PRINCIPLE:
CAWCD 2016 Board of Directors Strategic Plan

- Finance: Effectively communicate financial issues to Board and stakeholders

PREVIOUS BOARD ACTION/ACTIVITY:

April 20, 2017  FAP Committee informed of need to record $48.5 million in decommissioning expense

February 1, 2018  Board of Directors approved utilization of the Extraordinary Cost Reserves for decommissioning

April 5, 2018  Board of Directors approved $41 million water storage tax reserves to be transferred to the decommissioning reserve

December 5, 2019  Board received an update on the Closure of NGS

January 23, 2020  FAP Committee received an update on the status of NGS Costs and Agreements
ISSUE SUMMARY/DESCRIPTION:
As discussed at the last FAP Committee meeting, the Board has been provided periodic updates on the closure and decommissioning and related costs of the Navajo Generating Station (NGS) and the Kayenta Mine.

Previous estimates that had previously been provided by SRP have been recorded for a total of $133.8 million. Funds for the same amount have also been dedicated for decommissioning by the CAWCD Board.

The Kayenta Mine settlement agreement has been finalized by all the related parties. Previously unsettled costs have been agreed to that have resulted in additional costs to CAWCD. In addition, there have been updates to the estimates for the decommissioning of NGS. The current estimate of these costs result in an additional $25.7 million, bringing the current estimate to $159.5 million. Through December, CAWCD has paid $80.7 million of these costs. While the costs are the best estimates currently available, as is the case with large projects such as this one, costs will fluctuate as activities occur.

As previously reported, the Navajo Nation will retain certain structures that lowered some of the decommissioning costs. These assets include the railroad (except the catenary), lake pumps and certain maintenance buildings. Assets are anticipated to be sold for salvage value and may cause some variation in estimates. The Navajo Transmission System will remain in service as is.

Subsequent to recording the additional decommissioning liability, Staff are evaluating alternatives to fund the additional amount and return to the FAP Committee with a funding options and a recommendation.

SUGGESTED MOTION:
I move that the Finance Audit and Power Committee recommend that the Board of Directors approve additional spending authority of $25.7 million to record the additional liability related to the decommissioning of NGS and final reclamation costs of the Kayenta Mine.

ATTACHMENTS:
None
CONTACT: Doug Dunlap  
623-869-2360  
ddunlap@cap-az.com

MEETING DATE: Thursday, February 20, 2020

AGENDA ITEM: Discussion of Strategic Reserves Target and Strategy (Finance: Maintain Coordinated Financial Strategies*) - Dunlap

LINKAGE TO STRATEGIC PLAN, POLICY, STATUTE OR GUIDING PRINCIPLE:
2016 CAWCD Board of Directors Strategic Plan

- Finance: Maintaining CAP’s Financial Health

PREVIOUS BOARD ACTION/ACTIVITY:
April 5, 2018 The CAWCD Board of Directors revised the strategic reserve target to $179 million, updating the strategy to exclude restricted reserves (Master Repayment, Emergency OM&R and Medical Reserves)
March 15, 2018 The Finance, Audit and Power Committee recommended that the Board revise the strategic reserve target and strategy
February 15, 2018 The Finance, Audit and Power Committee discussed the strategic reserve target and strategy

ISSUE SUMMARY/DESCRIPTION:
The current strategy and targets for the General Fund Strategic Reserves were set by the Board in April 2018. The overall target level for these reserves is currently $179 million. As part of the two-year financial planning cycle, one of the activities included on the calendar for “even” years is a review of the Strategic Reserve strategy and targets.

The Strategic Reserve target is made of several reserves, each with its own purpose. Each reserve included in Strategic Reserves is based on its own unique basis as appropriate for that reserve. The targets are analyzed based on a consistent methodology, which is important from a financial management perspective. The methodology is based on best practices of the Government Finance Officers Association (GFOA).

The end of the year is the measurement point for comparison to the target. While the target is an overarching goal, fluctuations will occur year-by-year based on operational needs, capital expenditures, revenue, federal repayment and other operation occurrences.

The purpose for Strategic Reserves are funds for (1) emergency and unexpected use or “rainy day” funds and (2) working capital or day-to-day needs. They are established by the organization based on its own risk considerations. The one restricted reserve that is included in strategic reserves is the Major Repair and
Replacement reserve, which is managed in conjunction with the Capital reserve.

The 2018 analysis recommended a $5 million increase from the previous level to a total of $179 million. The 2020 updated analysis recommends a $25 million increase based on consistent methodology. The analysis indicates two changes, an increase to the Capital Reserve target from $61 million to $70 million and an increase to the Working Capital Reserves from $35 million to $51 million. All other reserve targets remain unchanged.

The increase in the Capital Charge reserve target follows in line with the increasing need of capital projects as the CAP is an aging infrastructure. The increase in the Working Capital reserve target also follows in line with the current operating environment of CAWCD. The Working Capital reserve is utilized to meet intra-year fluctuations of expenditures. As indicated in the attached presentation, month-to-month cash outflows can vary significantly based on the federal debt repayment, payment on capital expenditures, varying power needs, etc. Cash inflows vary month-to-month based on tax receipt timing, water deliveries, capital charges, etc, none of which are smooth throughout the year.

Staff would like to return with a recommendation to revise the targets based on this analysis at a future Committee meeting.

<table>
<thead>
<tr>
<th>Dollars in Millions</th>
<th>2018</th>
<th>2020</th>
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</thead>
<tbody>
<tr>
<td>Operating Reserve</td>
<td>$75</td>
<td>$75</td>
</tr>
<tr>
<td>Capital Reserve (combined)</td>
<td>61</td>
<td>70</td>
</tr>
<tr>
<td>includes:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-Capital Reserve</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>-Major Repair and Replacement Reserve</td>
<td>35</td>
<td>51</td>
</tr>
<tr>
<td>Contingency Reserve</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>Total Strategic Reserves</td>
<td>$179</td>
<td>$204</td>
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ATTACHMENTS:
1. Presentation
CAP’s Two-Year Financial Planning Cycle

<table>
<thead>
<tr>
<th>Even years</th>
<th>Odd years</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Strategic reserve targets and strategy update</td>
<td>• 2-year Budget and Business Plan (e.g. 2020-2021)</td>
</tr>
<tr>
<td>• Long-range financial plan</td>
<td>• Water rate update (if required)</td>
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<tr>
<td>• Set water rates</td>
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<tr>
<td>• Budget update (if required)</td>
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<table>
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<tr>
<th>Every year</th>
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<tbody>
<tr>
<td>• Quarterly financial reviews</td>
</tr>
<tr>
<td>• Set tax rates</td>
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<tr>
<td>• External audit</td>
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</table>
CAP Reserves

<table>
<thead>
<tr>
<th>Unassigned / Unrestricted</th>
<th>Assigned</th>
<th>Restricted</th>
<th>Committed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Working Capital Reserve</td>
<td>Operating Reserve</td>
<td>Contingency Reserve</td>
<td>Capital Reserve</td>
</tr>
<tr>
<td>Contingency Reserve</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Major Repair/Replacement Reserve</td>
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<td></td>
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</tr>
</tbody>
</table>

- **Unassigned Reserves:** Funds at the State Treasurer and Bank of America which are for daily operating purposes.
- **Assigned Reserves:** The Board established these reserves to provide for potential future needs.
- **Restricted Reserves:** These funds are established through contracts or legislation that limit the use for specific purposes.
- **Committed Reserves:** These funds are established through Board action, typically by resolution that identifies reserves to be used for specific purposes. These reserves are not part of strategic reserves.

CAP Strategic Reserves

- **What are Strategic Reserves?**
  - To cover unknown or unplanned events; not for a specific purpose.
  - Exception is the Working Capital Reserve, which is self-replenishing annually and is used to meet daily cash needs.
  - Reserves with a specific purpose that are intended to eventually be used are not included in Strategic Reserves.

- **Why have Strategic Reserves?**
  - Capital and operating reserves to support business needs.
  - Working capital – used to smooth out intra-year fluctuations due to timing, e.g., such as property taxes, federal debt payment & power costs.
  - Inter-year smoothing – e.g. lumpy capital projects.
  - Catastrophic events/ business interruption.
**CAP Strategic Reserves**

- **How are Strategic Reserves funded?**
  - Built up from tax revenues that were not utilized for other needs.
  - Interest on investments at the state treasurer.
  - Are **not** built up from water rates or capital charges.
  - Changes in targets may take time to reach depending on the first 2 items.

- **If Strategic Reserves are used how are they replaced?**
  - If strategic reserves are utilized, the cost of the repair and capital expenditures would be added to water delivery rates.
  - Strategic Reserves would be reimbursed for what was used to cover the expenditures of the event.
  - Reimbursement could be smoothed over time so as to not have a drastic, immediate impact on water delivery rates.

**Unassigned Reserves**

*This reserve, which includes an account at the State Treasurer and the Bank of America operating accounts are for daily operating purposes.*

**Working Capital Reserve**—allows for normal fluctuation throughout the year due to the “lumpiness” of several items:

- Property tax receipts
- Capital charges collections
- Capital expenditures
- Federal debt payment
- Outside services
- Power costs (vary based on pumping schedule)
## Assigned Reserves

_The Board established these reserves to provide for potential future needs._

**Capital Reserve** - Provides coverage for capital expenditures related to repairing or replacing an extraordinary occurrence as well as to keep other projects progressing while repairs are made

- Total capital reserve balance includes the amount that is in this reserve plus the balance in the separate Major Repair / Replacement reserve

**Operating Reserve** - Provides funds to continue operations in the event of a catastrophic event for employees, contractors, materials and supplies, etc. while cash may be delayed if deliveries are reduced or stopped

**Contingency Reserve** - Provides for property and liability damages to be available to respond to any claims, judgments, and related costs against the District, its officers, directors, and employees, if any, in excess of the outstanding insurance coverage; also provides coverage for extraordinary medical claims and legal claims

## Restricted Reserves

_These funds are established through contracts or legislation that limit the use for specific purposes._

**Major Repair / Replacement Reserve** - established in 2007 pursuant to the Settlement Stipulation, to cover the costs associated with major repair or replacement of CAP features; funded by monies received from the additional rate component (ARC) that were not needed to pay for revenue bonds

- This reserve does not have a required amount. As it’s use is the same purpose as the capital reserve, the total capital reserve balance includes both the amount that is in this reserve plus the balance in the separate capital reserve account.
Reserves in a typical year

Discussion of Reserves Target
02/20/2020

Update Recommendation

Discussion of Reserves Target
02/20/2020
Operating Reserve

<table>
<thead>
<tr>
<th>Current Target:</th>
<th>$75 Million</th>
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<tbody>
<tr>
<td>Recommended Target:</td>
<td>$75 Million</td>
</tr>
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- **Purpose**: Covers 12 months of operational cost in the event of an interruption in CAP’s revenue stream
- **Basis**: Based on a 10-year average of operating expenses 4 years back and 6 years forward adjusted for depreciation, amortization, power & capacity, and general ad valorem tax collection income

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Capital Reserve

<table>
<thead>
<tr>
<th>Current Target:</th>
<th>$61 Million</th>
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<tr>
<td>Recommended Target:</td>
<td>$70 Million</td>
</tr>
</tbody>
</table>

- **Purpose**: Allows for extraordinary repair and replacement costs to be covered while continuing current capital improvement projects
- **Basis**: Based on a 10-year average of capital projects 4 years back and 6 years forward. Utilizes 2 years of capital projects to meet intended purpose
  - Bonded projects are backed out and estimated payments are added to the annual capital cost
  - Special-funded projects are backed out
Contingency Reserve

This reserve is made of 3 components

<table>
<thead>
<tr>
<th>Current Target:</th>
<th>$5 Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommended Target:</td>
<td>$5 Million</td>
</tr>
</tbody>
</table>

A. Property/Casualty:

- **Purpose**: Provides immediate funds for expediting expenses in the event of a loss; and provides funds for uncovered events
- **Basis**: Based on industry best practices developed through actuarial information and CAP specific insurance situation

Contingency Reserve

<table>
<thead>
<tr>
<th>Current Target:</th>
<th>$1 Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommended Target:</td>
<td>$1 Million</td>
</tr>
</tbody>
</table>

B. Medical:

- **Purpose**: Cover unanticipated extraordinary medical claim(s) to provide a rate shock buffer. Partially required by State Insurance Department
- **Basis**: Based on statutory requirements and industry best practices developed through actuarial information
Contingency Reserve

Current Target: $2 Million
Recommended Target: $2 Million

C. Legal:
- **Purpose:** Meet extraordinary legal expenses not anticipated in the budgetary process
- **Basis:** Based on CAP’s historical experience with the Repayment litigation, All-American Canal litigation, Indian Water Rights Settlement litigation, basin states issues and environmental litigation, considers potential unplanned future legal needs

Contingency Reserve

<table>
<thead>
<tr>
<th>Amount</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Property/Casualty</td>
<td>$ 5 Million</td>
</tr>
<tr>
<td>B. Medical</td>
<td>$ 1 Million</td>
</tr>
<tr>
<td>C. Legal</td>
<td>$ 2 Million</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$ 8 Million</strong></td>
</tr>
</tbody>
</table>
**Discussion of Reserves Target**

02/20/2020

**Working Capital Reserve**

<table>
<thead>
<tr>
<th>Current Target:</th>
<th>$35 Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommended Target:</td>
<td>$51 Million</td>
</tr>
</tbody>
</table>

- **Purpose:** Provides liquidity to cover the day-to-day cash flow needs; and is a self-renewing reserve to cover seasonal cash flow fluctuations that occur throughout the year and across years.

- **Basis:** The low point and high point of the year are estimated and an amount to cover the variance is recommended as the target over the last 5 years.

**Summary Strategic Reserve**

<table>
<thead>
<tr>
<th></th>
<th>2020 Update</th>
<th>Current Target</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>OPERATING RESERVE:</strong></td>
<td>$75</td>
<td>$75</td>
</tr>
<tr>
<td><strong>CAPITAL RESERVE:</strong></td>
<td>70</td>
<td>61</td>
</tr>
<tr>
<td><strong>CONTINGENCY RESERVE:</strong></td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>Includes:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Property/Casualty Insurance</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>- Medical Insurance</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>- Extraordinary Legal Expenses</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td><strong>Working Capital</strong></td>
<td>51</td>
<td>35</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$204</td>
<td>$179</td>
</tr>
</tbody>
</table>

Discussion of Reserves Target
02/20/2020
Agenda Number 5

CONTACT: Chuck Cullom Greg Adams  
623-869-2665 623-869-2124  
cullom@cap-az.com gadams@cap-az.com

MEETING DATE: Thursday, February 20, 2020

AGENDA ITEM: Discussion and Consideration of Action to Recommend that the Board Approve Supplemental Guidance to the CAWCD Rate Setting Policy Regarding the Collection of Fixed OM&R Costs for System Conservation - Cullom

RECOMMENDATION: Staff recommends that the Finance, Audit and Power Committee recommend that the Board approve supplemental guidance to the current CAWCD Rate Setting Policy regarding the collection of Fixed OM&R fees related to system conservation projects with CAP Project water annually through 2026 per the attached schedule.

FISCAL IMPLICATIONS: Yes

Impact on Budget: None

Additional spending authority requested: None

Impact on Reserves: None

Impact on Rates: Potential incremental increase to Fixed OM&R rates due to reduction in CAP Project Water deliveries from approved system conservation projects.

LINKAGE TO STRATEGIC PLAN, POLICY, STATUTE OR GUIDING PRINCIPLE: Water Supply Reliability

PREVIOUS BOARD ACTION/ACTIVITY: 02/06/20 Discussion on Establishing a Board Policy on the Collection of Fixed OM&R Costs System Conservation

ISSUE SUMMARY/DESCRIPTION: As part of the implementation of the Lower Basin Drought Contingency Plan and the Agreement Regarding Lower Basin Drought Contingency Plan Obligations, CAWCD staff identified the need to develop a policy regarding the collection of Fixed OM&R costs on system conservation projects with CAP Project Water. The working definition of system conservation with CAP Project Water is an intentional reduction in existing and historic beneficial uses with the purpose of providing a benefit to Colorado River system storage in Lake Mead. In order to accommodate system conservation projects in the CAP system, the key considerations are as follows:
1. System Conservation projects require a reduction from an existing, historic beneficial use,
2. The CAP water user must order the conserved water, so that the conserved water is no longer available to
cascade to other junior priority pools including the CAP Excess Pool,
3. CAWCD retains the right to remarket unused water regardless of origin, so to facilitate system
conservation, CAWCD must concur with the system conservation project and commit to forgo remarketing the
conserved water,
4. CAWCD must collect Fixed OM&R costs, so forgoing remarketing of the conserved water will result in an
incremental increase to CAP rate payers.

CAWCD staff conducted a roundtable discussion on January 23, 2020 to obtain input from CAP contractors
and subcontractors regarding approaches to collect Fixed OM&R costs from system conservation projects.
CAWCD staff presented three approaches to address the collection of the Fixed OM&R costs. The three
approaches were: CAP water user pays, conservation funder pays, all CAP water users contribute through
the incremental increase in Fixed OM&R rates. The CAP stakeholders attending the roundtable, including
tribal users, M&I users, and NGO representatives overwhelming supported allowing the incremental increase
in Fixed OM&R rates. They expressed their willingness to voluntarily pay higher Fixed OM&R rates to
facilitate additional system conservation projects. They recognized that additional system conservation is not
required to implement the DCP. In addition, they requested opportunities for additional discussion on the
timing, rate impacts and water supply implications of system conservation programs going forward.

Based on the forgoing, staff recommend supplemental guidance to the CAWCD rate-setting policy to provide
advanced notice of system conservation projects, provide for the consideration and potential action by
CAWCD to forgo remarketing of appropriate system conservation projects, the inclusion of system
conservation projects in the CAP water ordering process, and an intentional reduction in CAP diversions to
accommodate system conservation to provide a benefit to Lake Mead.

SUGGESTED MOTION:
I move that the Finance, Audit and Power Committee recommend that the Board approve supplemental
guidance to the current CAWCD Rate Setting Policy regarding the collection of Fixed OM&R fees related to
system conservation projects with CAP Project water annually through 2026 per the attached schedule.

ATTACHMENTS:
1. Presentation
2. Supplemental Guidance to CAWCD Rate Setting Policy
Definition and Framing

- System Conservation with CAP Project Water is

  the intentional reduction in existing and historic beneficial use with the purpose of providing a benefit to the Colorado River system storage in Lake Mead.

- The doctrine of beneficial use, the priority system, and our collective contracts and rights have not explicitly contemplated intentional conservation programs.

- CAWCD retains authority to remarket unused water regardless of origin. Therefore CAWCD’s concurrence for system conservation is part of the process.
Nature of CAP Water Delivery Contracts/subcontracts

- CAP contracts/subcontracts are for the delivery of CAP Project Water
- Customers exercise their contract through the annual water ordering process
- Water that is unordered is available to the next priority pool for delivery
- Customers are required to pay Fixed OM&R charges on all water scheduled for delivery
- CAWCD determines the Fixed OM&R charge by dividing the estimated Fixed OM&R costs by the estimated amount of Project Water to be delivered

Policy Question

Who should pay the Fixed OM&R equivalency fee for System Conservation Projects with CAP Project Water?
Three Approaches

• Contractor/subcontractor pays
  - consistent with existing contract language
  - avoids increased costs all other CAP users
• Funder pays
  - avoids increased costs to all other CAP users
• All CAP Users Contribute (overwhelming support at roundtable)
  - CAP users will bear the incremental increased costs

Proposal – All CAP Users Contribute Supplemental Guidance

Annually through 2026 operations CAWCD will:

• June Board Meeting – notice of consideration of system conservation projects
• August Board Meeting – staff present an overview of system conservation projects for the upcoming year
• August CAWCD Annual Water Users Meeting – analysis of rate and water supply impacts plus seek water user input
• September Board Meeting – Board considers action regarding proposed system conservation project through forgoing remarketing of conserved water
• October – approved system conservation to be included in water orders
• January – CAP water users reduce water order and CAWCD informs BOR of its reduction in diversions to generate the system conservation
Supplemental Guidance to CAWCD Rate-Setting Policy: Collection of Fixed OM&R for System Conservation Projects with CAP Project Water

Each year through 2026 operations CAWCD will:

1. **June CAWCD Board Meeting** – CAWCD will provide notice of consideration of system conservation projects with CAP Project Water,

2. **August CAWCD Board Meeting** - staff will present to the Board an overview of any proposed system conservation projects for the coming year,

3. **August CAWCD Annual Water Users Meeting** - staff will provide an analysis of the rate and water supply impacts of any proposed system conservation projects in that, and seek water user input,

4. **September CAWCD Board Meeting** – the Board will consider action* regarding the proposed system conservation project through forgoing its authorities to remarket conserved water, recognizing that in so doing Fixed OM&R rates will incrementally increase to CAP rate payers,

5. **October** – Entities with approved system conservation projects involving CAP project water will submit water orders that include the quantity of water intended to be conserved through the system conservation project,

6. **January** – CAP water users with approved system conservation projects will reduce their CAP Project Water order to reflect the appropriate system conservation volume, CAWCD will provide notice to Reclamation that CAWCD is reducing its diversion schedule to accommodate the system conservation project, resulting in conservation to Lake Mead.

*Subject to prior agreements.
Power Programs Update
Brian Young
February 20, 2020

Power Update Topics

- 2019 Recap
- Initial Operation Post-NGS
- AZ Solar 1 Generation
- 2020 Energy Purchases
- 2020 Energy Costs
- 2021/2022 Energy Purchases
2019 Recap

Mar – First Energy Auction - 2020 Products
May – Solar Phase II PPA Signed
May – Energy Auction - 2021/2022 Products
July – El Paso Electric Agreement Signed for 80 MW of Transmission from Palo Verde
Oct – WAPA Network Transmission for Brady, Picacho, and Red Rock PP commenced
Oct – Energy Auction - 2021/2022 Products
Nov – Last NGS generation
Dec – Navajo Transmission 3-Party Agreement signed
Dec – Solar Phase I facility completed and tested

Initial Operation Post-NGS

• From end of NGS operation in mid-November 2019 to end of 2019, CAP operated entirely upon short-term purchased power and Hoover.

• No issues with securing economic energy and meeting load requirements.

• Starting January 1, energy deliveries commenced under Solar Phase I, SRP fleet service agreements and energy purchased from auctions and ACES forward purchases.
AZ Solar 1 Generation

- Commercial energy deliveries from AZ Solar 1 commenced on January 1, 2020, the earliest date provided under the PPA.
- Production of energy for the first month of operation was slightly greater than estimated.
- Firming the solar output with our Hoover resource also commenced on January 1, 2020 and has operated as planned.
AZ Solar 1 Generation

Cloudy Day Solar Production

AZ Solar 1 Generation

Partly Cloudy Day Solar Production
2020 Energy Purchases

- 2020 forward energy was secured both through energy auctions and ACES forward purchases made throughout 2019.

- We entered 2020 energy with over 75% of our expected energy needs secured including long-term resources.

- Forward energy purchases for 2020 averaged about $26.60/MWh entering the year.

- Remaining energy will be secured primarily through daily purchases as pump load is shaped to optimize remaining energy purchases and sales.

2020 Energy Breakdown

- Hoover: 5.77%
- Solar: 21.98%
- SRP: 21.55%
- Auction: 12.95%
- ACES Forward: 33.98%
- ST Purchase/Sales: 3.76%
2020 Energy Costs
January Actuals vs Estimated

• Net cost per MWh = $30.4 vs. $31.9 pre-year estimate.

• Savings due to average daily energy purchases price under $8 per MWh, partially offset by lower sales prices.

Remainder of 2020 energy costs

• Low energy prices are expected to continue through at least spring with very low gas prices and higher than normal Northwest hydro generation.

• 2020 energy costs should finish at or below those in the 2020 energy rate barring unexpected market events.

2021 Energy Purchases/Costs

• Currently have secured almost 60% total resources for estimated 2021 load.

• Forward energy purchases for 2021 have averaged about $27/MWh to date.

• Current projection for total 2021 energy purchases is under $26/MWh and about $27.50/MWh including long-term resources.

• At this point 2021 energy costs are projected to be below those in the 2021 energy rate, with over half of the market energy purchases remaining.
2022 Energy Purchases/Costs

- Currently have secured almost 50% total resources for estimated 2022 load.
- Forward energy purchases for 2022 have averaged about $28.50/MWh to date.
- Current projection for total 2022 energy purchases is about $26/MWh and about $28/MWh including long-term resources.
- At this point 2022 energy costs are projected to be below those in the 2022 energy rate with about 70% of market energy purchases remaining.

Questions?

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