



Financial Services Audit Committee Communication

Date: November 16, 2018

To: Great Lakes Water Authority Audit Committee

From: Nicolette Bateson, CPA
Chief Financial Officer/Treasurer

Re: Reconciliation Committee Update

Background: The Reconciliation Committee is defined by the Water and Sewer Services Agreement (WSSA) between the Great Lakes Water Authority (GLWA) and the Detroit Water & Sewerage department (DWSD) as a DWSD Board Member and GLWA Board Member along with GLWA's Chief Executive Officer, DWSD's Director, and their respective Chief Financial Officers and General Counsels.

The 2018 Memorandum of Understanding, finalized in June 2018, between GLWA and DWSD requires the parties to meet at a minimum quarterly (January, April, July, and October). The purpose of the quarterly meetings is to expand the level of communication between the two entities related to financial, operational, legal, capital planning, and other matters and opportunities for improved management and coordination of both entities and foster a positive partnership in the water services sector. The results of those meetings shall be reported back to the respective Boards by the Board liaison.

In the event that there is a budget shortfall, the WSSA require that the Reconciliation Committee meet promptly for the purpose of reviewing actions the City proposes to take to address such significant unfavorable variance. Following the meeting of the Reconciliation Committee, the City agrees to take actions to address any such significant unfavorable variance and to make appropriate adjustments to the related Detroit Local System Budget in the current and succeeding Fiscal Year.

Analysis: The Reconciliation Committee held its first meeting on October 19, 2018. A primary topic at that meeting was a net budgetary shortfall in the local sewer fund of \$56.27 million through June 30, 2018 (unaudited) of which \$29.52 million was outstanding as of June 30, 2017. The action items from that meeting were for the DWSD representatives to discuss the matter with their Board, which they did on November 7, 2018. The next step for

DWSD is to provide written notice as it relates to the plan to address the shortfall. DWSD has a number of remedies available as described below.

The 2018 MOU provides that if DWSD experiences a cumulative negative variance of more than two percent (2%) of the total budget for either Local System (a "Budget Shortfall") from its budget adopted pursuant to the Water and Sewer Services Agreement based on DWSD's quarterly reports to GLWA, DWSD, as the agent of GLWA, shall, within thirty (30) days thereafter, schedule a meeting of the Reconciliation Committee to discuss the magnitude and reasons for the shortfall and possible approaches to address the shortfall. Within sixty (60) days after the Reconciliation Committee meets, DWSD, as agent, shall develop a plan to cure the Budget Shortfall and the time period within which the shortfall will be cured, taking into account the reasons for and magnitude of the shortfall. If Revenues, including, but not limited to, adjustments to Local O&M expenditures and the use of subsequent positive receipts, are not available to cure the Budget Shortfall within the same Fiscal Year, DWSD shall reallocate available funds in the related DWSD I&E Account or reallocate any unencumbered Lease Payment to eligible debt service to satisfy the Budget Shortfall.

Budget Shortfalls not cured by the end of the Fiscal Year following the year in which they arise shall be repaid in full, in installments, over a period not to exceed the next three fiscal years, plus a surcharge calculated as provided below, as part of the Revenue Requirement payable by DWSD. The surcharge factor on the portion of the Budget Shortfall which remains unpaid at June 30 of the Fiscal Year following the fiscal year in which the Budget Shortfall arises shall be based on the three-year U.S. Treasury Note Rate, as published in the Wall Street Journal, plus 150 basis points.

Until the Budget Shortfall is repaid, and unless DWSD has other resources available for that purpose or otherwise agreed to by GLWA, DWSD shall apply any available funds in the related DWSD I&E Account for that purpose. GLWA Board approval shall be required for repayment terms in excess of three (3) years. The quarterly Reconciliation Committee meetings shall include a review of the progress in eliminating the Budget Shortfall.

Proposed Action: Receive and file report.