



Financial Services Audit Committee Communication

Date: January 19, 2018

To: Great Lakes Water Authority Audit Committee

From: Kim Garland, Management Professional – Public Finance

Re: Analysis of Retail and DWSD Receivable as of June 30, 2017

Background: On the effective date of the regional water and sewer system leases for the Great Lakes Water Authority (GLWA), certain assets and liabilities of the Detroit Water & Sewerage Department (DWSD) transferred to the GLWA. The assets included the retail system accounts receivable as of December 31, 2015 which were recorded in the financial records of the GLWA (“Assumed Retail Accounts Receivable”). Subsequent retail system customer billings and receivables for services provided in the month of January 2016 and after are recorded in the financial records of the DWSD in accordance with the terms of the leases.

Beginning January 2016, water and sewer system services are provided by GLWA to the City of Detroit through the DWSD. Accordingly, DWSD is allocated a revenue requirement for those regional system services in accordance with a services agreement. Consistent with the terms of the GLWA Master Bond Ordinance, which is applicable to assumed pre- and new post-bifurcation debt of the DWSD which transferred to GLWA on the effective date, the cash receipts of both DWSD and GLWA are deposited in a Trust Estate and distributed in accordance with the terms of the Master Bond Ordinance (MBO). Those cash receipts are then distributed in accordance with the MBO in accordance with a defined flow of funds for both GLWA (the “Regional System”) and DWSD (the “Local System”) for their respective financial commitments (“MBO Requirements”) including operations & maintenance funds, debt service, legacy pension, water residential assistance program, budget stabilization fund, improvement & extension fund, and reserves.

The complexity of the accounting, reconciliation, and coordination of these transactions is significant. The staff of both GLWA and DWSD work together to coordinate these activities. As both entities near the completion of their respective FY 2017 year-end close and related audit fieldwork, the financial impact of the nature of the transaction and related cash flows results in a cumulative receivable from DWSD as shown on the attached analysis. The analysis provides the status of retail cash receipts applied to the a) assumed retail accounts receivable on January 1, 2016 and b) Regional System service charges billed and credited

through June 30, 2017 as recorded on the books of the GLWA. While the nature of the two activities are distinct, both are linked to the same cash collections and were subject to business judgement on how to best appropriately apply the cash receipts.

Analysis: Key points related to these two activities is noted below.

Assumed Retail Accounts Receivable: The January 1, 2016 Assumed Retail Accounts Receivable (AR) includes all related activities and account balances including: Retail AR, Allowance for Retail AR, Wayne County ("County") Revolving Fund Loan and related AR and Allowance, City General and Tax Fund balances related to County Revolving Fund, Customer Deposits, and Detroit Residential Water Assistance Program.

1. It should be noted that, in October 2017, the City of Detroit ("City") transferred \$16,851,450 to GLWA consisting of retail receipts and a County Revolving Fund settlement for property tax year 2016 (consisting largely of original billings from 2015 and/or prior). This transfer has further reduced the GLWA December 31, 2015 assumed retail accounts receivable balance presented.
2. The Assumed Retail Accounts Receivable was recorded on January 1, 2016 net of an allowance for doubtful accounts consistent with prior assumptions of collection rates. The subsequent cash collections of the Assumed Retail Accounts Receivable have had a positive variance. Collections exceeded what appears to have now been conservative allowance reserves as of January 1, 2016 by nearly \$31 million.

Regional System Service Charges to DWSD and Local System MBO Requirements: The following relates to new transactions since January 1, 2016.

1. The attached schedule presents total balances due per the general ledger. This balance provides a current and non-current portion. The current portion represents two months of Regional System Service Charges and MBO Requirements which total \$2.6 million for water and \$31.2 million for sewer. Bills for Regional System Services are due 45 days from the bill date. The MBO requirements are considered due when the monthly transfers are made.
2. There are differences between DWSD and GLWA balances as of June 30, 2017. These are summarized as follows:
 - a. *Treatment of First Month of MBO Requirements* (i.e. January 2016) – DWSD recorded five months of MBO requirements in fiscal year 2016 instead of six. GLWA believes that six months of MBO requirements is consistent with the terms of the lease terms. (Note that the effective date of the leases was halfway through FY 2016, hence six months of activity.) This difference is \$8.4 million.

- b. *Various other differences* – DWSD reports \$1.28 million less due to variances related to various collection activities and allocations, such as customer refunds, bank charges, debt payment variances, and miscellaneous other retail receipt transactions.

Overall Financial Position: Cumulatively, the retail cash receipts are not sufficient to fund the Assumed Retail Accounts Receivable and Regional System service charges to DWSD as well as the Local System MBO Requirements

Proposed Action: Receive and file report.