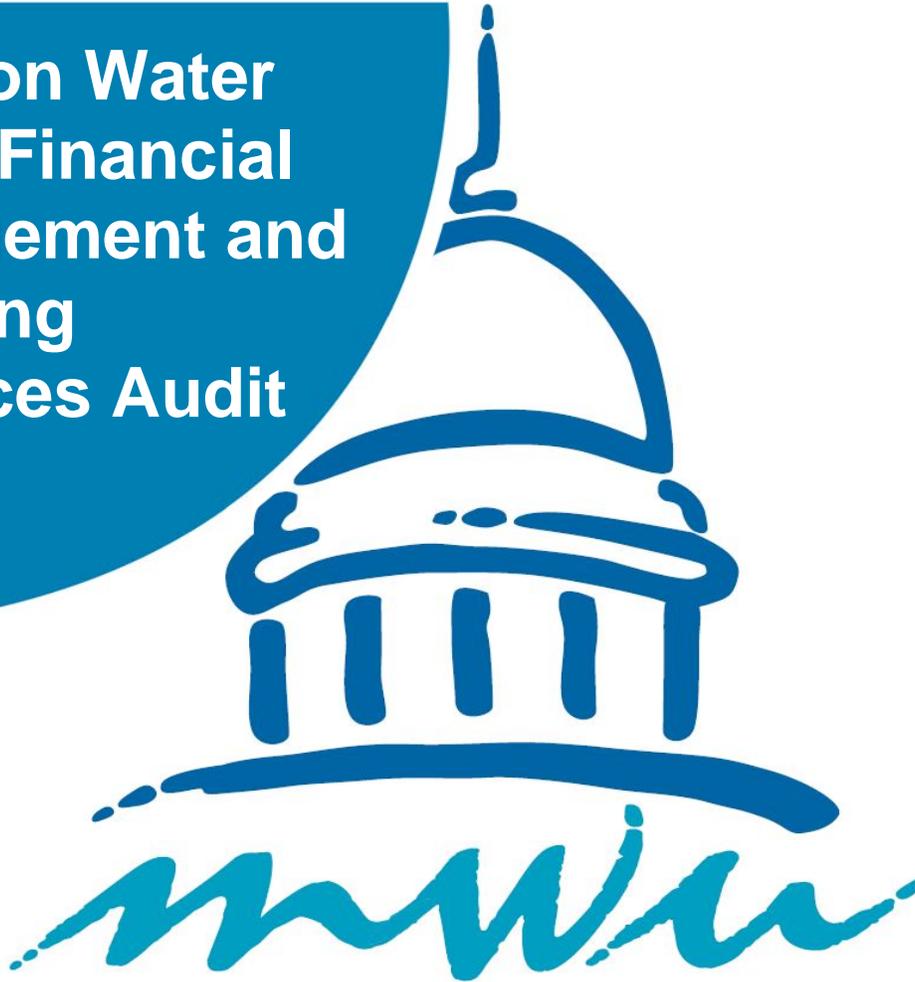


# Madison Water Utility Financial Management and Planning Practices Audit



# Madison Water Utility

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## TABLE OF CONTENTS

1.	EXECUTIVE SUMMARY .....	1-1
	A. PROJECT OBJECTIVES .....	1-1
	B. OUR APPROACH .....	1-2
2.	MADISON WATER UTILITY .....	2-1
	A. OVERVIEW .....	2-1
	B. COLLABORATION AT THE TOP .....	2-1
	C. ASSET MANAGEMENT .....	2-2
	D. ROLE AND AUTHORITY OF THE CFO .....	2-3
	E. STAFF EDUCATION .....	2-3
	F. INTERNAL COMMUNICATION.....	2-4
	G. STAFFING LEVELS .....	2-4
3.	CITY FINANCE .....	3-1
	A. OVERVIEW .....	3-1
	B. REGULATORY CONSTRUCT – PUBLIC SERVICE COMMISSION OF WISCONSIN .....	3-1
	C. MUNIS .....	3-2
	D. UTILITY BILLING SYSTEM CHANGE .....	3-2
4.	CONCLUSION .....	4-1

## 1. EXECUTIVE SUMMARY

Madison Water Utility (MWU) and Madison City Finance (MCF) engaged Ruckert & Mielke, Inc. and Wegner CPAs to conduct a financial management and planning practices audit. The motivation for the audit came from the cash shortfall that the water utility experienced at the end of 2017. This cash shortfall happened for several reasons, including increased capital expenditures, timing of large operations and maintenance projects, and decreases in consumption without rate increases that matched spending. One of the immediate consequences of this shortfall was a shift to negative outlook on the rating of the City's debt, which was recently restored to stable due to progress made on MWU's financial stability.

Those we interviewed within both MWU and MCF believe that the water utility is improving its financial health thanks to new measures it has undertaken, along with the aid it has received from MCF. The measures taken to forestall another cash shortfall include actions such as hiring a Chief Financial Officer (CFO). In the wake of the shortfall, MCF has provided oversight of the water utility to monitor the utility's financial health. The monitoring should continue to ensure the utility keeps moving in the right direction. The high level of debt the utility has incurred will not be reduced quickly, so the utility will need to sustain its efforts over the years to come.

To continue improving its financial health, MWU can take the following steps:

1. Collaborate more effectively across the following internal departments, allotting each department equal footing: Water Quality, Water Supply, Engineering, Finance, and Operations.
2. Finalize and implement its Asset Management Plan.
3. Clarify the role and authority of the new CFO.
4. Educate all staff on financial procedures and decision making, along with all relevant Public Service Commission (PSC) regulations.
5. Improve internal communications, especially with regard to budgeting and the vision for the utility as a whole.
6. Assess staffing levels based on planned and future technological changes.

MCF can help MWU to keep improving by taking the following steps:

1. Continue to work with MWU to improve understanding of Tyler Munis ERP (Munis) and make accounting changes as needed so that it can fulfill PSC regulations.
2. Continue a collaborative approach on implementing the new utility billing system.

These steps will advance Madison Water Utility's journey toward more robust financial health.

### A. Project Objectives

Ruckert & Mielke and Wegner CPAs have created this report to offer constructive feedback on MWU's decision-making procedures regarding financial and operational matters. This feedback includes assessing the effectiveness of said procedures. Also included in our review is examining the utility's current organizational chart to compare MWU staffing levels to those of other similar utilities.

For this audit, we did not consider MWU as an isolated entity but also examined the impact of external parties on these processes, especially MCF since we interviewed several employees within this department. Including both major entities led us to examine communication between

the two, and we have included feedback on how this communication can be improved. We have also recommended several changes regarding the roles and responsibilities for MWU and MCF to help enhance MWU's performance and decision-making capabilities.

## B. Our Approach

To facilitate our review, we conducted in-person interviews with 22 key personnel from MWU, MCF, and two other City departments. Personnel interviewed included leadership and several managers of both MWU and MCF. These interviews provided insight into the inner workings among and between the departments. The following personnel were interviewed:

### Madison Water Utility

Asset Manager, Seth McClure  
Chief Financial Officer (CFO), Jeff Stanek  
Construction Supervisor, Jeff Belshaw  
Control Systems Programmer, Chris Wilkens  
Customer Service Supervisor, Marie Van Aartsen  
Engineer 4, Adam Wiederhoeft  
Finance Supervisor, Kathy Schwenn  
General Manager, Tom Heikkinen  
Maintenance Supervisor, Doug Van Horn  
Mapping/GIS Coordinator, Pete Braselton  
Meter Shop Supervisor, Rick Marx  
Principal Engineer, Al Larson  
Public Information Officer, Amy Barilleaux  
Public Works General Supervisor, Tom Rosemeyer  
Water Supply Manager, Joe DeMorett  
Water Quality Manager, Joe Grande

### Madison City Finance

Accounting Services Manager, Patricia McDermott  
Finance Director, David Schmiedicke  
Financial Systems Analyst, Brian Falkowski  
Principal Accountant (Purchasing), Randy Whitehead

### Madison Parks Department

Assistant Superintendent of Planning, Development and Finance, Kay Rutledge

### Madison Engineering Department

Engineering Financial Officer, Steve Danner-Rivers

The observations and recommendations that follow this section stem from these interviews and our collective understanding of municipal utilities.

2. MADISON WATER UTILITY

A. Overview

The impetus for this report comes from the substantial cash shortfall the utility faced at the end of 2017. The main cause of the cash shortfall was the utility spent significantly more than it collected in revenue, which has led to a substantial amount of long-term debt.

Beginning in 2007, annual capital expenditures increased from \$6 million to \$22 million. The rate of borrowing has likewise increased dramatically. The timing of rate increases did not match timing of the spending increases, and cashflow suffered. The following chart presents the impacts of the increased capital spending:

	Total Plant In Service – Utility Financed	Total Long-Term Debt	Total Operating Revenues	Total Gallons Sold (000)
<b>12/31/07</b>	\$108,000,000	\$68,000,000	\$19,000,000	10,170,000
<b>12/31/18</b>	\$284,000,000	\$203,000,000	\$35,000,000	8,033,000
<b>Change</b>	\$176,000,000	\$135,000,000	\$16,000,000	(2,137,000)
<b>Change %</b>	163%	198%	84%	(21%)

This increased spending has occurred despite water sales dropping by over twenty percent. Much of the spending had to be financed by debt. The PSC has criticized the utility for its capital structure, which is composed of 80% debt and 20% equity. The PSC expects the utility to reduce its share of debt to 50% as soon as feasible. This effort will take years if not decades.

All the interviewees, including leadership of both MWU and MCF, believe that MWU has made significant improvements and that they are well positioned to recover from its financial troubles. This belief has been fostered by several recent key additions to personnel: a CFO, a Finance Supervisor, and a Customer Service Supervisor. These hires have strengthened the relationship between MWU and MCF, facilitating an increase in communication, trust, and confidence regarding the processes and financial guidance at MWU. While the changes have improved the utility’s financial position, a sustained effort will be required for many years to come to ensure the viability of the utility.

There are several opportunities for MWU to continue this upward trend. These include developing a more collaborative operational and financial decision-making process, finalizing and implementing its Asset Management Plan (AMP), clarifying the new CFO’s role and authority within MWU, educating staff on financial matters and PSC regulation, and communicating better and more often, especially with regards to budget decisions.

B. Collaboration at the Top

Within the MWU organizational structure, much more authority is given to the Engineering Department than other departments, especially with regards to capital budgeting and project selecting. This authority was very recently increased by elevating the head of Engineering to the newly created position of Assistant General Manager. While we understand that Engineering has recently taken a more collaborative approach, without a more equitable distribution of authority, MWU has no guarantee that this trend will continue.

We propose that MWU create a structure that shares authority between Water Quality, Water Supply, Engineering, Finance, and Operations. All of these departments should have equal input regarding capital decisions. With collaboration and input from all departments, MWU can mitigate past missteps that led to the current financial stresses. These missteps include aggressive capital spending with little regard to financial and rate implications. While aging infrastructure must be replaced, involving more departments in the process could prove helpful.

More collaboration between the departments would yield greater cost savings and more judicious prioritizing of projects, as well as improved operational outcomes. For instance, MWU could find less costly solutions to the PFAS contamination at Well #15, perhaps by renting the needed treatment equipment, rather than enacting the proposed \$5,000,000 capital expenditure. Involving both Finance and Water Supply in these decisions would prove prudent for MWU.

Leadership will play a critical part in balancing authority between the departments. Leadership believes that a collaborative culture already exists among MWU management while MWU management sees many opportunities to improve collaboration.

We recommend the following measures:

- Engage in a comprehensive organizational review and discussion using an outside consultant to explore the current culture and develop a roadmap to genuine collaboration. Complete this process by the end of 2020.
- Create a formal binding document that lays out the authority and relationship between the departments, especially as it pertains to decision making on capital expenditures. Finalize this document by the first quarter of 2021.

#### C. Asset Management

MWU has made significant strides over the past few years in regards to Asset Management. Still, the utility possesses a wealth of information on water system assets that can and should be better used in capital spending decisions.

Finalizing and implementing the AMP to create a more robust framework for prioritizing which assets to replace would benefit MWU both financially and operationally. Over \$100 million has been spent in the last ten years on infrastructure replacement, and many question whether that investment addressed the most pressing needs of the utility.

Many believe that using the AMP to establish a process for identifying projects that mitigate the greatest risk would provide far greater value, making it a worthy investment of capital dollars. If MWU integrated this AMP into its strategic asset management planning and included all internal departments in the decision-making process, the utility could achieve more effective results from its projects while operating at a lower cost. Relying on an AMP would limit the effects that seniority, emotions, and personal preferences have on project selection. Therefore, we recommend the following steps:

- Finalize the AMP by the fourth quarter of 2020.
- Integrate the AMP into the decision-making process for capital expenditures for the budgeting process for 2021.
- Institute key performance indicators (KPIs) regarding cost and effectiveness to track the AMP's results in 2021 and make improvements as needed (ongoing).

#### D. Role and Authority of the CFO

All the staff need to know the role and responsibilities of the CFO. It is understandable that not all staff understand the CFO's role, as this is a newly created position for MWU; however, there is some confusion among many of the staff regarding who has certain decision-making authorities. Particularly, the issue arises as staff wonder whether they should speak with the CFO, the Finance Supervisor, or someone else regarding various operational and financial concerns. Leadership should identify the key authorities both in writing and during an all-staff meeting. We recommend the following steps:

- Leadership identifies and delineates the key authorities of the CFO, the Finance Supervisor, and other staff in charge of crucial financial decisions in the first quarter of 2020.
- Leadership shares this information in a document available to all staff in the first quarter of 2020.
- Leadership walks staff through this delineation in an all-staff meeting to ensure understanding in the first half of 2020.

#### E. Staff Education

Numerous interviewees expressed confusion about financial processes, decision making, and the role of the PSC regarding financial matters. There is also confusion regarding the proper use of Munis for answering various questions, the relationship between MWU and MCF, how decisions are made (especially for budgeting), and more crucially, where cash comes from and how it is spent. Some employees do not understand the PSC's regulatory role and how the rate-making process works.

The caliber of the new CFO and Finance Supervisor ought to be used to educate their colleagues. Although these two have made inroads, they need to implement a more systematic, sustained approach to financial education. We recommend that they teach the crucial topics mentioned above to their colleagues in the all-staff meetings. Recording the lessons and requiring new hires to watch them would help to integrate new staff. Creating process documents with simple instructions and screenshots for Munis functions would mitigate the need for one-on-one tutorials and provide an always-available resource. The utility can also leverage the resources that MCF has provided to them on learning Munis. This training will help field staff to more quickly enter information into the system so that a more accurate financial picture is formed in a timely fashion.

The staff also needs training in how to properly notify the PSC regarding construction projects. Most projects require prior authorization from the PSC. If costs for authorized projects exceed estimates by ten percent or more, the utility must immediately notify the PSC. Prior to MWU's 2017 rate case, MWU did not include all project costs in the authorization, resulting in the PSC disallowing \$5.5 million from the projects included in the utility's rate base. To prevent possible loss of revenue, the CFO should be involved in all major projects. Key staff should be trained to ensure that they always obtain construction authorization whenever needed and alert the PSC should costs exceed the initial estimates by ten percent or more.

We recommend the following measures:

- The CFO and Finance Supervisor continue to educate staff on key topics, including the role of the PSC in construction authorization, as well as how and when to enter information into Munis (ongoing).
- MWU should record training sessions and have new hires view them as part of the onboarding process (ongoing).

## F. Internal Communication

MWU could improve its internal communication in several areas, with budgeting topping the list. Most of the staff we interviewed see budgeting as a black-box process. They prepare their particular department's capital and operating budgets and then receive little to no information as to why their budgets are cut or how these cuts are decided. At a minimum, leadership should conduct a meeting to recap the final budget and explain why decisions were made for the relevant adjustments. Ideally, leadership would involve each department in a collaborative process whereby everyone discusses how to reach an entity-wide budget target. This way, the departments can ensure that no crucial needs go unmet and that spending is optimized. If overseen properly, such a process would also engender greater trust between departments.

Another area for improvement relates to the inherent communication gaps that exist by having separate locations for administration and operations. As a result, field employees feel as though their voices are not heard by the higher levels. Conducting additional face-to-face meetings would aid in bridging these gaps. We suggest alternating the locations of leadership meetings between the administrative and operations locations. Having a concrete presence and holding regular meetings at the operations center would prove vital for strengthening bonds and communications between the facilities.

Finally, leadership needs to provide a clearer direction for the vision and future of the utility. Numerous employees expressed confusion regarding where the utility was headed. Conveying this direction would help clarify decision making and communication occurring within the utility. Confusion and misinformation can proliferate in the absence of a clearly communicated direction provided from the top. Our recommendation is that leadership share the short-term and long-term goals of the utility, along with the means for achieving those goals.

We recommend the following steps:

- Beginning in 2020, leadership holds a meeting every year to explain how and why specific budgeting decisions were made.
- Leadership designs and implements a collaborative process by which departments can collectively determine where to make cuts by the budget process for 2021.
- Leadership alternates meeting locations for both high-level and all-staff meetings between the administrative center and the operations center, beginning in 2020.
- Leadership articulates both the short-term and long-term goals of the utility, along with how those goals will be achieved, both in writing and at least annually in all-staff meetings, by the end of 2020.

## G. Staffing Levels

MWU stands apart from other utilities throughout the state because of its size. Milwaukee operates a much larger utility while all the other municipalities have much smaller utilities. MWU's unique size makes it difficult to compare it to its peers to determine appropriate staffing levels. However, our experience in the industry and interviews at MWU have led us to conclude that current staffing levels suit the needs of the utility, with one exception. The rapid technological changes imposed on the utility may require additional staff to implement and troubleshoot. This is especially likely if the Tyler billing system is implemented, given the challenges of ensuring that all interfaces are working properly. We recommend the following measure:

- Annually in its budgeting process, MWU staff evaluate Information Technology support needs across all departments, identify gaps in coverage, and then budget and hire accordingly.

### 3. CITY FINANCE

#### A. Overview

MCF has provided financial oversight, assistance, and guidance to MWU since the financial crisis of 2017 and interacts with MWU on a regular basis. The interactions between the two departments have been effective and impactful. MCF has provided much support to MWU, including providing training and manuals on Munis and repeated reworking of the chart of accounts within Munis to align with PSC accounting. There are a few ways that MCF could further aid MWU's progress.

MCF should continue to assist MWU with getting up to speed with Munis and help to leverage MWU's knowledge of PSC regulations within the overall financial structure of the City. MCF staff are working closely with MWU to develop a responsive approach to implementing the executive and legislative mandate to fully incorporate MWU financial operations into the City's ERP suite, Munis. MCF should continue to work closely with MWU staff and be responsive and sensitive to processing timelines, system interface needs, and regulatory responsibilities.

#### B. Regulatory Construct – Public Service Commission of Wisconsin

Wielding considerable power, the PSC governs nearly all operational and financial facets of water utility operations. The PSC decides the extent to which utilities can raise their rates, whether to authorize the construction of various utility projects, how utilities need to perform accounting and financial reporting, and how to adjudicate disputes between utilities and customers. Perhaps most importantly, the PSC prescribes strict parameters for utility billing and collections.

One particularly notable constraint under which utilities operate surfaces during rate applications. Utilities must apply to the PSC to raise rates to provide sufficient revenue to operate, maintain, and reinvest in their systems. As part of the application process, utilities must prove evidence of their need. This process entails answering many questions that delve into the utilities' accounting. Many of the numbers the PSC considers are measured based on percentages and not absolute amounts, so an amount that might come across as immaterial to many registers as significant to the PSC.

In our collective experience working with the PSC on numerous rate cases, we have encountered questions on applications for amounts we deem to be immaterial. The PSC monitors immaterial amounts to ensure utility compliance with the PSC Uniform System of Accounting (USOA). PSC scrutiny simply does not allow a water utility to ignore a discrepancy based on materiality – the PSC can and often does deem small amounts as material. The water utility must comply with the USOA no matter the dollar amount involved.

We understand that the dollar value of some of the transactions that MWU would like to correct seem immaterial. However, the PSC may deem them material. Therefore, MWU and MCF should clearly communicate and establish standard protocols regarding the materiality of all transactions. This would allow MWU's accounting to more readily comply with the PSC's USOA. Without accounting that is faithful to the USOA, MWU risks incurring more work and significant delays in rate cases, which means delays in increasing their revenue and achieving their financial goals.

### C. Munis

A previous report by the Government Finance Officers Association went into detail on evaluations and recommendations of MWU's transition to Munis. The discussion that follows focuses on Munis only insofar as it applies to the financial and operational decision-making processes at MWU.

As MWU adjusts to being on Munis, MCF could take a few steps to aid MWU. First, MCF and MWU can clearly communicate regarding the journal entry and approval process, including journal entries made by MCF for MWU. Better communication between MCF and MWU would help ensure compliance with PSC accounting standards. If MWU is aware of changes made on its behalf, it can verify that these changes comply with PSC standards.

Second, we encourage MWU and MCF to continue to regularly discuss the processes mentioned above, as well as other related issues, such as cash reconciliation. The two entities can discuss how these processes and issues affect MWU's ability to understand and forecast its cash position. Such continued discussions will be mutually beneficial.

### D. Utility Billing System Change

As with all City agencies, MWU is in the process of implementing Munis. Similar to other City agencies when Munis was first implemented in 2015, it is taking time for MWU staff to become familiar with Munis since implementation of the general and project ledger elements began in January 2019. The next phase of implementation is utility billing.

Personnel from both departments identified the timeline for implementing utility billing as a potential area of risk. That timeline will need to be responsive to the following:

1. MWU's current system, Advanced Utility Systems, interfaces with 13 separate systems to complete the billing process. Each of the interfaces must be successfully transitioned, or else the system will not work. City IT will need to guide the process of interfacing the separate systems with utility billing to ensure a successful completion.
2. With close to 70,000 customers, weekly billing, and daily cash deposits, MWU will require frequent data refreshes to proactively manage the conversion.
3. Additional functionality within the utility billing module may be needed to provide MWU with the functionality it requires. Utility billing affects a number of City departments, so a successful implementation is critical.

MCF staff have already indicated that they would be flexible in the timeline to accommodate the transition. We encourage them to continue in that approach given the risks that must be mitigated and issues that must be addressed for the transition to be successful.

Personnel from MCF, MWU, and City IT recognize that utility billing is an important project that will require close cooperation with the vendor, a high degree of integration between the three agencies, careful monitoring of progress and costs, and comprehensive testing of interfaces with other systems. MCF will be focusing on overall project management and planning, system administration and special assessments implementation. MWU will be focusing on utility billing

implementation. City IT will lead efforts on interfaces and related issues. Compromises may need to be made regarding current business processes and system capabilities. The contract between the City and the vendor includes a fixed fee for implementing utility billing. If additional costs are necessary due to the complexity of the project, MCF and MWU have indicated both will work cooperatively to identify either process modifications or additional resources to help reach a positive outcome for the City.

4. CONCLUSION

Our interviews revealed a consensus that MWU has found a path toward financial health and is taking the steps needed to improve its financial position. The interviews also revealed that MWU and MCF can take additional steps to improve MWU's operational and financial decision making. MWU can improve collaboration, implement an Asset Management Plan, fully empower its CFO by clarifying the CFO's role and authority within the utility, educate its staff on financial and PSC matters, and strengthen its internal communications. MCF and MWU should continue to work cooperatively to facilitate MWU understanding of Munis, as well as with the development and implementation of utility billing. These efforts to improve MWU must continue over the years to come to improve the utility's financial picture.