

Internal Monitoring Report

Policy: EL-2D Financial Condition and Activities

Frequency: Three times a year

Date: November 26, 2019

Policy Language:

With respect to the actual, ongoing financial condition and activities of the Madison Water Utility, the General Manager shall not cause or allow the development of fiscal jeopardy or a material deviation of actual expenditures from board priorities established in Outcomes policies.

Accordingly, the General Manager shall not cause or allow conditions, procedures, or decisions that:

1. Fail to ensure long-term financial health.
2. Fail to present a balanced annual operating budget and quarterly updates on actual expenditures and income.
3. Exceed total appropriations for the fiscal year, unless directed to do so by the board.
4. Use any dedicated reserves for purposes other than those for which they are designated, unless directed to do so by the board.
5. Undertake a debt without payoff schedule and identification of revenue stream.
6. Fail to establish an unrestricted reserve equal to a typical three months' operating expenses.
7. Fail to inform the board of where the utility stands with any current rate case in progress.
8. Fail to be able to provide a concise summary of the financial condition of the utility at any time.
9. Fail to adjust spending related to revenue shortfalls in a budget deficit.

General Manager's interpretation and its justification:

This Executive Limitations Policy requires the utility to perform financial management without risk of jeopardy to the utility's financial health and that ensures actual expenditures do not deviate materially from board priorities established in Outcomes policies. The utility has the responsibility to establish, manage and plan for the necessary water rates and borrowings to fund all expenditures and to meet identified capital and operational requirements.

Data directly addressing the General Manager's interpretation:

1. *Ensure the utility's long-term financial health.*

MWU has implemented and uses a financial planning model to evaluate and project funding required for financing infrastructure and operating needs. Through the use of this model, bond sales are planned and rate increases are developed. Additionally, a ten-year financial forecast has been created to analyze various financial paths for the utility to pursue to maintain its financial health for the future. This forecast was submitted to the PSCW on January 31, 2019 to comply with directives outlined in the utility's most

recent rate order. The water utility also has quarterly budget meetings with city finance to update projects for the current budget year. The last meeting was held on October 29, 2019.

The utility is also calculating Key Performance Metrics (KPI's) and developing a Dashboard within the financial software to monitor its financial condition on a routine basis. The financial statements for 2018 have been issued and KPI's updated, however, they have yet to be automated by the City's financial software.

MWU also has a multi-year budget in compliance with the board's Financial Planning/Budget Policy (EL-2C). The 2020 capital and operating budgets are complete and have been submitted to the Mayor for review. The final water budgets have been approved by the Common Council in their November 2019 meetings.

The utility issued its 2018 financial statements in June and cleared all auditor comments and recommendations during the year. This was the first year the utility created their own financial statements without the assistance of the auditor or outside individuals. Our material weakness in financial reporting was removed from the 2018 management and we received a "clean" audit opinion.

The utility is scheduled to finalize measures taken to refinance three revenue bond issuances (2009, 2010 and 2011) in December 2019. The refinancing's are estimated to be save approximately \$5 million, of which a majority of the savings will be realized in 2021 and 2022. Additionally, the utility will be issuing \$20 million in bond anticipation notes (BANS) to finance capital projects budgeted for 2020 and 2021. The BANS are five-year, interest only obligations with a balloon payment in 2024. The utility anticipates participating in the Wisconsin Safe Drinking Water Loan (SDWL) program beginning in 2020 which offers a significantly lower interest rate compared to traditional revenue bonds. The SDWL loans would pay-off the BANS in future periods and be used as long-term financing for the utilities capital projects.

MWU provided its rating agency with five-year cash and revenue projection scenarios to assist the agency with its evaluation of the utility's financial position. A copy of these scenarios is attached to this financial report.

The utility submitted its 2019 water rate application with the PSCW on July 1, 2019 which forecasts an 8.00% increase over current rates. The increase is the result of the utility experiencing lower than forecasted revenues from designed rates due to water conservation and decreased consumption throughout 2019. Utility staff formally submitted responses to the PSCW's questions and has on-going communication with PSCW staff to clarify and finalize follow-up questions. The utility anticipates a final decision sometime in the first quarter of 2020.

The General Manager is not aware of any past or present event or matter that would give rise to a future materially adverse condition affecting the long-term financial health of the utility.

I report compliance.

2. Fail to present a balanced annual operating budget and quarterly updates on actual expenditures and income.

The 2020 operating budget was presented to the mayor on August 12, 2019 and forecasts operating income for 2020 at current water rates. Final approval of this budget was completed in November 2019.

The utility completed its 3rd quarter projections through September 2019 and the results forecast positive net income and cash for 2019. The utility is projecting a modest surplus for 2019 which will contribute to building cash reserves and paying unexpected expenses. Attached is a cash summary and forecast for 2019.

I report compliance.

3. Exceed total appropriations for the fiscal year, unless directed to do so by the board.

Madison Water Utility did not exceed total appropriations in 2018 and does not anticipate any exceedances in 2019. The utility experienced a positive change in net position of \$550,000 despite lower than anticipated revenues in 2018. The 3rd quarter projections for 2019 forecasts lower than budgeted revenues and expenses, however, these deviations from budget do not result in any negative financial outcomes. These projections are based upon the most currently known information to the utility as of the end of September 2019.

I report compliance.

4. Use any dedicated reserves for purposes other than those for which they are designated, unless directed to do so by the board.

MWU's restricted reserves remain only accessible through the City Treasurer's office.

I report compliance.

5. Undertake a debt without a payoff schedule and identification of revenue stream.

MWU's debt repayment schedules are included in the utility's annual financial statements. New debt issued in December 2018 was accompanied by a water rate increase effective for December 2018 to cover repayment of the additional obligations. As noted previously, the utility will be finalizing the refunding of three debt issuances at a substantial savings along with the issuance of bond anticipation notes for 2020 and 2021 capital projects. Additional bond funding would be supported by excess revenues generated with the 2018 rate increase, potential additional revenue generated from the 2019 rate application submitted to the PSCW and savings recognized from refunding three bonds issuances.

I report compliance.

6. Fail to establish an unrestricted reserve equal to a typical three months' operating expenses.

MWU completed the 2018 fiscal year with the equivalent of one and a half months' operating expenses on-hand in unrestricted cash. Management is in the process of developing detailed cash reserve policies to address short-falls in unrestricted cash reserves. Reserve balances are anticipated to increase during 2019 after final payments are made to the city for an inter-departmental loan. The utility's 3rd quarter projections for year-end 2019 currently have positive unrestricted cash flows anticipated for year-end.

See the attached cash and revenue projection for a summary of this information.

I report non-compliance.

7. Fail to inform the board of where the utility stands with any current rate case in progress.

The 2019 rate application was submitted to the PSCW on July 1, 2019. Utility staff have submitted formal responses to the PSCW's questions and has on-going communication with PSCW staff for follow-up clarifications.

I report compliance.

8. Fail to be able to provide a concise summary of the financial condition of the utility at any time.

The General Manager is prepared to provide a summary of the financial condition of the utility during the informational 'items of general interest' portion of the board's meeting agenda.

I report compliance.

9. Fail to adjust spending related to revenue shortfalls in a budget deficit.

MWU completed its year-end cash, revenue and expense projections from 3rd quarter actual data and forecasts to have positive cash flow at December 31, 2019. The timing of year-end transactions such as cash receipts and cash disbursements will fluctuate from year to year. In an effort to reduce this variability, MWU has issued a temporary purchasing stay on all non-essential costs through the remainder of the year.

I report compliance.

Attachments:

MWU Cash Summary – Board 2019

MWU Financial Forecast Scenarios (2019 Q3 – 2025) – 11.12.19 – Rating Agency