



Date: September 23, 2015
To: Water Utility Board
Thru: Tom Heikkinen, General Manager
From: Robin Piper, Chief Administrative Officer
Subject: Response and Work Plan from 2014 Financial Audit

The Finance Section of the Madison Water Utility has reviewed the comments and recommendations included in the 2014 Independent Auditor's Report and Management Letter and is committed to implementing changes in its processes to correct the issues as outlined below. This will include working with the City Finance Department, the Public Service Commission of Wisconsin, and the Baker Tilly Audit team.

Below is a summary of the audit team's recommendations and our plans for implementation.

PERIODIC REVIEW OF REVENUE AND CUSTOMER BILLINGS

- *Complete a monthly consumer analysis to determine the reasonableness of revenue recorded vs. actual billings. This analysis should identify any inconsistencies in the revenue recognition throughout the year as well as the breakdown between customer classes.*

A monthly consumer analysis is being performed using the spreadsheet provided by Baker Tilly during the 2014 audit wrap up. This analysis is completed each month.

- *Periodically re-compute random customer billings from each customer class to ensure proper application of billing rates and customer classification. This process should especially be completed during periods when modifications to the billing system are experienced (i.e. rate changes, customer classification changes, true-up billings, etc.).*

Plans are in place to complete random customer bill re-computations. We select 10 random accounts each month and re-compute the bills to ensure proper application of rates. With the implementation of our new rates and any other modifications to the Madison Municipal Services bill we will increase the number of random accounts that are re-computed to ensure the proper application of billing rates and customer classification.

- *Our initial analysis included comparisons between volume sold, customer changes and actual revenue between years. This analytic analysis should be completed by the financial manager at least on an annual basis.*

We began monthly billing in September of 2014 and we now have a full year's of monthly data for comparison purposes. In addition to the recommended annual comparisons, we will be making monthly comparisons with prior year's data. The Finance Manager or their designee will be responsible for the yearly comparison and staff will be responsible for the monthly comparison.

APPROACH TO FISCAL YEAR 2015

- *We recommended certain revenue analytics and reconciliations are prepared as discussed above.*

Please see above plan notes.

- *Open work orders in Construction Work in Progress need to be reviewed for any items that may need to be expensed in the year the cost was incurred. This was the basis for one of the financial statement restatements during this year's audit.*

All open work orders in the Construction Work in Progress account will be reviewed for items that need to be expensed in the current year and either be closed or that portion that is an expense will be moved into the expenses for the year and out of the Construction Work in Progress account.

- *The utility uses the account Completed Construction Not Classified to hold costs for projects that have been completed but the utility has not had the time to close them out to the proper primary plant accounts. Last year, we verbally recommended this account be properly closed out before the rate study was filed with the PSC since this holding account is only meant for use in temporary and rare situations to begin depreciating projects that have not been closed out. Instead of closing out this account in 2014, the balance grew to \$31,242,000 from \$13,667,000. We recommend this account be properly closed out to primary plant accounts in 2015.*

I am attaching a listing of all of the Completed Construction Not Classified work orders. There are 309 work orders in this account that need to be closed. The plan is to close all of the work orders in this account by the end of the year. We are working with other sections of the Utility to get the information that we need to complete this work.

- *Conversions to new accounting software are often very time consuming and often do not go as planned. An already stressful situation can be made worse by a lack of communication and planning. We learned from finance management that the utility believes it does not have an adequate chart of accounts established for the new accounting software. We also learned that reconciliations for 2015 were substantially behind, perhaps due to the conversion. It is critical that the chart of accounts concerns be addressed and any remaining conversion issues are cleared with the City as soon as possible. 2015 month end closing and reconciliations should be caught-up to date as soon as possible as well.*

We are working with City Finance to finalize a chart of accounts for use in the new Munis software. We are also working with City Finance staff to get reports out of Munis that provide detailed information of charges made to the Water Utility's fund. The City has

not “closed” any periods in 2015 yet, as the transition to Munis has not gone as smoothly as was hoped. Our goal is to get caught up as quickly as we can.

PRIOR YEAR COMMENTS AND RECOMMENDATIONS

➤ **REVIEW OF CUSTOMER ADVANCES**

The utility collects customer advances for construction and meter projects. Once a project is complete, the utility will determine whether the customer advances related to the project should be recognized as revenue or a refund is given to the customer if the actual project costs were less than the advance received. It was noted that there are several customer advances received that date back to 2006, which could mean there are customer advances retained that are related to completed projects. We are recommending that the utility review customer advances to see if related projects are complete and whether the utility should recognize the advances related to completed projects as revenue or provide a refund to the customer.

Status Update – 12/31/2014

The utility did not address this comment during the year. The projects in question remain in the customer advance liability even though they have been completed and placed into service. We continue to recommend the utility address this comment.

We will review all customer advances and move all completed project’s advances to either revenue or refund any excess funds that were advanced for a completed project by the year end close.

➤ **EVALUATION OF PROPERTY HELD FOR FUTURE USE**

Currently this balance represents tower and well sites, which are owned by the utility but not currently used during the course of operation. The listing of these projects are vague, in that there are no explanations on where the costs have come from, the expectations on when the projects will begin, what triggers the projects, and the evaluation process to ensure that the costs should not have been expensed. We are recommending that the utility review the current listing of properties that are being held for future use, and for each item provide an explanation describing the costs, when the project will begin, what triggers the project and the evaluation to describe why the costs are not being expensed.

Status Update – 12/31/2014

During the audit we noted several smaller projects classified as property held for future use were removed from the account and a more descriptive explanation was provided for each project. This was done at the direction of the Public Service Commission of Wisconsin during the rate review process. We recommend the utility continue to monitor this account for proper accounting treatment.

We will continue to monitor the property in the Property Held for Future use account for proper accounting treatment.

➤ **REVIEW OF WORK ORDER CLOSING PROCESS**

The utility completes a significant amount of construction each year and as such the proper accounting for capital assets is a key area for the finance department. Costs including labor, materials, contractor charges and overheads are accumulated in a separate work order for each project. When the project is complete, finance obtains reports from engineering on the types of assets and quantities installed and removed.

This is used to close the work order and record the assets in the detailed property accounts as required by the Public Service Commission of Wisconsin (PSCW). We recommend that the utility review the process of closing work orders and work with engineering to help in determining whether projects with open work orders have been placed in service and should be closed to capital assets. In addition, work orders have also been closed to a temporary account called completed construction not classified. This account is depreciated on an annual basis but is meant as a temporary account. This account should be reviewed and properly classified before the utility intends to file the next water rate increase.

Status Update – 12/31/2014

The finance department did not address this comment during 2014. Work orders were reclassified to the completed construction not classified account during the year and were not unitized to the recommended PSCW plant accounts. The balance in this account increased \$17.6 million from the prior year and remains significant to the financial statements. We continue to strongly recommend the utility address this comment as the proper classification capital costs directly affects the utility's rate base and determination of future rates. A number of the projects referred to above are private contractor projects. During the audit, we noted the utility has delayed closing many of these projects until final information from the developer has been received and processed. Many of these projects have been completed for a significant amount of time but final information has not been received. We recommend the utility implement a process to ensure this information is received from the developers on timely basis in order to properly close out projects.

The plan is to close out the all of the Construction Completed Not Classified work orders as detailed under the Current Year Comments and Recommendations.