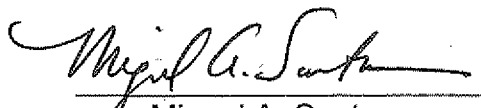


0220-04718-0008

**TRANSMITTAL**

TO The Mayor The Los Angeles City Council	DATE 03-19-14	COUNCIL FILE NO. 04-0161
FROM Miguel A. Santana, City Administrative Officer		COUNCIL DISTRICT All

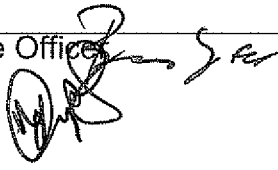
Transmitted herewith for your consideration is the Inspector General's (IG) status update report on the Department of Water and Power's (DWP) revenue collection and impact to the City's Annual Power Transfer and Utility Users' Tax receipts for Fiscal Year 2013/2014. The IG indicates that no impact on the City's Annual Power Transfer Amount is anticipated this fiscal year. However, a potential deferred revenue impact of \$9 million to \$12 million on the City's Electrical Users' Tax receipts and approximately \$61 million for Sewer Service Charges and Solid Waste Fees, combined. Lastly, this status update report suggest some recommendations to proactively monitor the Department of Water and Power's revenues, such as increasing oversight of the department's outstanding accounts receivable and reporting on the City's auditing efforts to examine receipts related to the Electricity Users' Tax.

  
Miguel A. Santana  
City Administrative Officer

**CITY OF LOS ANGELES**  
INTER-DEPARTMENTAL CORRESPONDENCE

CAO File No.: 0220-04718-008  
Council File No.: 14-0161

Date: March 19, 2014

To: Miguel A. Santana, City Administrative Officer 

From: Fernando Campos, Inspector General 

Subject: **DEPARTMENT OF WATER AND POWER (DWP) REVENUE COLLECTION STATUS UPDATE AND IMPACT TO CITY'S ANNUAL POWER REVENUE TRANSFER AND UTILITY USERS TAX**

### SUMMARY

In September 2013, the Department of Water and Power (DPW) unveiled its Customer Care and Billing (CC&B) System to replace an existing 40 year old customer billing and related systems. This report provides a response to a City Council motion (Fuentes-Krekorian) C.F. 14-0161, which requested a report on the status of DWP's (a) revenue collection for Fiscal Year 2013-14 and (b) potential impacts to the annual transfer and the Utility User Tax as result of the implementation of DWP's CC&B System. In summary, there is no negative impact anticipated to the Power Revenue Transfer for Fiscal Year 2013-14. However, there is a potential deferred revenue impact of about \$9 million to \$12 million related to the Electricity Users' Tax. Furthermore, there is a potential impact to the City's Sewer Service Charges and Solid Waste Fees estimated at \$50 million and \$11 million, respectively. Based on these potential impacts, it is critical that the City Council take into consideration the concerns raised in this report related to DWP's billing practices and collection efforts when making budgetary decisions. In particular, there is no time certain when the billing issues will be fixed, including impacts to typical collection remedies. Therefore, continued close monitoring is required.

### RECOMMENDATIONS

That the Los Angeles City Council, subject to approval by the Mayor:

1. REQUEST the Department of Water and Power dedicate necessary resources to address billing and collection issues in a timely manner, including the monitoring of these efforts;
2. REQUEST the Department of Water and Power to provide the Office of the Inspector General of City-wide Collections the necessary data and resources needed on an on-going basis to allow for the independent monitoring and close oversight of its delinquent accounts receivable portfolio, including progress made to improve its overall collection rate;
3. INSTRUCT the Office of Finance to report on its auditing and/or review efforts related to Electrical Users Tax revenue submitted by the Department of Water and Power; and

4. CONSIDER whether the State of California's request to audit DWP should be supported.

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## FISCAL IMPACT STATEMENT

Approval of the proposed recommendations will not have a direct fiscal impact to the City's general fund. This status update report on DWP's revenue collections and billing system highlights a potential deferred revenue impact of \$9 million to \$12 million from the City's Electricity Users' Tax and approximately \$61 million (combined) related to the City's Sewer Service Charges and Solid Waste Fees for the current fiscal year. As improvements are made to DWP's billing system and collection remedies exercised, the potential gap in deferred revenue may partially decrease.

## DISCUSSION

On February 4, 2014, the Energy and the Environment Committee of the Los Angeles City Council requested the Department of Water and Power (DWP) and Office of the City Administrative Officer (CAO) to report on the status of DWP's (a) revenue collection for fiscal year (2013/2014), including projections for the remaining portion of said year, and (b) potential impacts to the City's Reserve Fund from lower-than-expected revenue collections on the annual transfer and the Utility User Tax (see Council File Motion No. 14-0161). In addition to the aforementioned, the City Administrative Officer requested a cursory review of the Department of Public Works, Bureau of Sanitation's revenue impact on its Sewer Service Charge and Solid Waste Fee receipts since both revenue sources are billed and collected through the DWP since 1972 and 1983, respectively.

In September 2013, DWP unveiled its Customer Care and Billing (CC&B) System to replace an existing 40 year old customer billing and related systems. This initiative to replace the CC&B System, according to DWP<sup>1</sup>, was a "massive and complex task" that resulted in "too many [customers]...experience[ing] problems [such as]: bad estimates, improperly drafted accounts, and in some cases, no bills at all. However, DWP reports that more than "95% of [its] customers are currently experiencing no problems with their bills." Nevertheless, as of the City's Mid-Year Financial Status Report for Fiscal Year 2013-2014 (CF 13-0600), the City is experiencing a delayed or deferred revenue collections projected at approximately \$10.4 million for Electrical Users Tax, an unknown amount for Solid Waste Fees, and approximately \$50 million for Sewer Service Charges as of January 2014.

By February 2014, approximately 65,000 customers in aggregate have been affected and have not received a bill since the implementation of the CC&B System. DWP indicates that it is making progress and in early March 2014 released a message to its customers providing them an update of the problem, including notice that the number of customers affected decreased to approximately 60,000. Furthermore, certain measures have been implemented or are in

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<sup>1</sup> See Message to DWP customers sent on March 3, 2014. Letter can be accessed at [https://www.ladwp.com/ladwp/faces/wcnav\\_externalId/r-ce-billpmnt-message?\\_adf.ctrl-state=vd3x0u2x8\\_4&\\_afzLoop=239518299777511](https://www.ladwp.com/ladwp/faces/wcnav_externalId/r-ce-billpmnt-message?_adf.ctrl-state=vd3x0u2x8_4&_afzLoop=239518299777511) [Accessed on March 15, 2014].

progress to improve DWP's customer experience and fix the problem resulting from its new CC&B System. These improvement measures include:

- Hired one new senior manager to oversee customer experience;
- Hired 21 Emergency Meter Readers (currently now in training);
- Hired 49 Emergency Customer Service Representatives;
- Restarted its Auto-Collection Efforts on or about February 21, 2014;
- Offered (and still offering) Payment (Installment Plans) to Pay Outstanding Debt
- E-mailed or Sent Reminder Delinquency Letter to Residential Customers with Past Due Amount of \$50 or More; and
- Launched Payment Bill Campaign Targeting Commercial and Residential Delinquent Customers, including Focus on Commercial Accounts with Outstanding Balance of \$10,000 or more.

### POWER REVENUE AND IMPACT TO CITY PAYMENT

There is no negative impact anticipated at this time for both Fiscal Years 2013-14 and 2014-15 Power Revenue Transfers to the City. As of February 2014, the City has received \$151.8 million in payments for the City's Power Revenue Transfer and anticipates the remaining amount of \$101.2 million by the end of this fiscal year. For Fiscal Year 2014-15, DWP reported to its Board of Water and Power Commissioners in March 2014 that the anticipated Power Revenue Transfer is budgeted for \$261 million. At this time, there is insufficient data, including other unknown variables (i.e. timing to fix the billing problem, timing to collect deferred revenues, etc.), to determine what, if any, impact DWP's CC&B System may have on revenue projections for Fiscal Year 2015-16. Due to some unknown variables at this time, such as, it is difficult to project the actual impact amount, if any. Nevertheless, the Office of the CAO will continue to monitor future year impacts and provide status updates through its recurring financial status reports.

Understanding the context of DWP's revenue treatment protocols is important. For example, DWP reports its revenue collections through its Water and Power Revenue Funds. In aggregate for Fiscal Year 2013-14, DWP's planned revenue is \$6.3 billion (or \$4.6 billion for Power and \$1.7 billion for Water) net of adjusted fund balances<sup>2</sup>. Delineating between both Water and Power Revenue Funds is as important.

For example, DWP's Power Revenue Fund receipts (revenue), per the City's budget books, are comprised of six categories, which are:

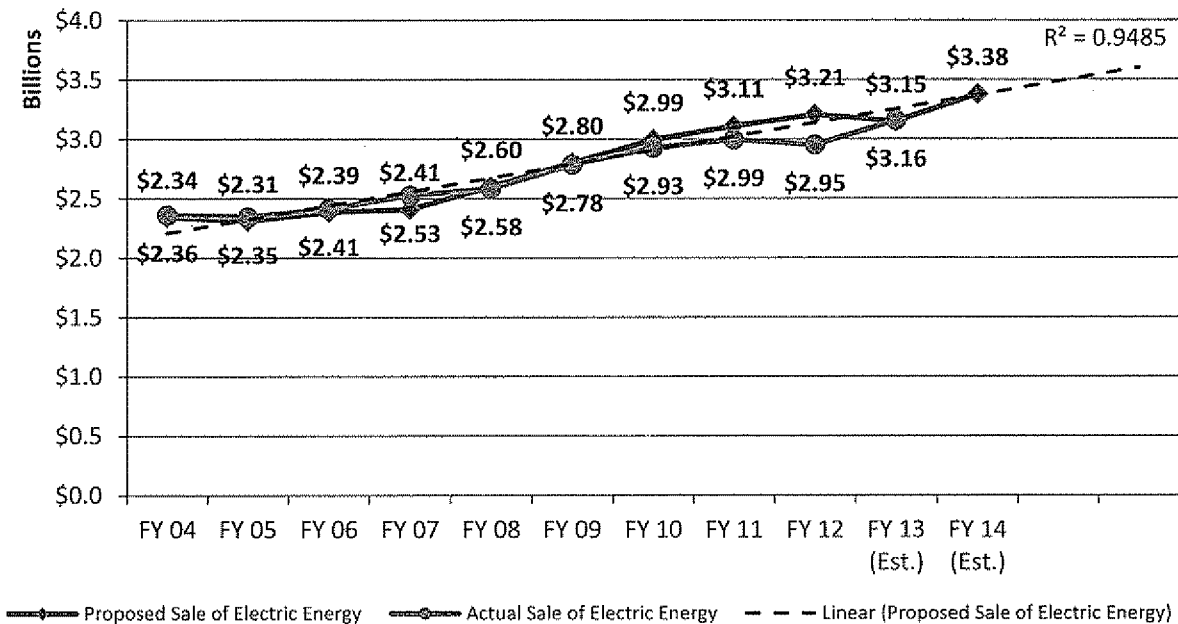
<u>Receipt Category</u>	<u>Estimated Receipts (Revenues)</u>
➤ Sale of Electric Energy	\$ 3,378 million
➤ Proceeds from Sale of Bonds	\$ 662 million
➤ Water Rev. Fund – Svcs./Materials	\$ 273 million

<sup>2</sup> Adjusted balance is calculated by subtracting payments to the City of Los Angeles (also known as the Power Revenue Transfer Payment) from the prior fiscal year ending cash balance available for the respective fund. For example, DWP's Power Revenue Fund for Fiscal Year 2013/2014 indicates a total ending revenue fund balance of \$4.96 billion. After adjusting \$341 million (or ending cash balance at \$594 million from prior year operations minus payments to the City of Los Angeles at \$253 million), the remaining fund balance is \$4.62 billion (or \$4.96 billion minus \$341 million represents total revenue).

➤ Ind., Companies, Govt. Agency – Svcs./Materials	\$ 200 million
➤ Miscellaneous Revenues	\$ 93 million
➤ Contributions in Aid of Construction	\$ 20 million
<b>Total Receipts</b>	<b>\$ 4,626 million</b>

For Fiscal Year 2013-14, the total anticipated revenue is \$4.6 billion, which is net of adjustments for payments to the City (Power Revenue Transfer) at \$253 million and adjusted ending cash available balance of \$341 million. Nearly 75% or about \$3.4 billion of the \$4.6 billion in Power Revenue Fund receipts is derived from the Sale of Electric Energy. The following graph provides a ten year overview of proposed (at time of budget publication) and actual Sale of Electric Energy receipts<sup>3</sup> from Fiscal Years 2003-04 to 2013-14.

### Department of Water and Power Sale of Energy (FY05 to FY14)



Source: City of Los Angeles, Office of the City Administrative Officer Budget Books

In summary, between Fiscal Years 2003-04 through 2013-14, the Sale of Electric Energy actual receipts has increased by approximately \$800 million from nearly \$2.4 billion to nearly \$3.2 billion, representing an increase of about 33%. Utilizing an Ordinary Least Square<sup>4</sup> (Linear – see dotted method to forecast a receipt trend line), the Sale of Electric Energy receipts is expected to increase by about \$100 million in Fiscal Year 2014-15 and reaching to slightly more than \$3.5 billion (estimated) by Fiscal Year 2015-16, all things equal.

However, the release of DWP's CC&B System has added a new variable for consideration that has impacted revenue collections. For example, as of January 2014, DWP reports its

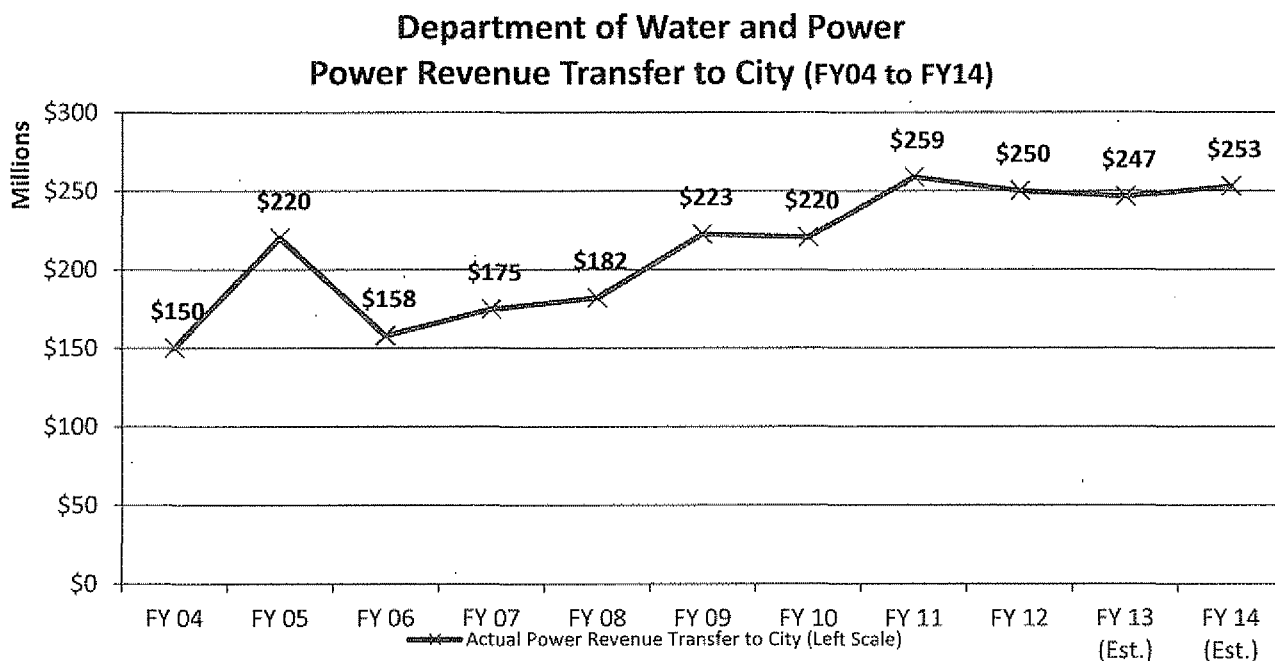
<sup>3</sup> Amounts captured are as published in the City's budget book; however, a more accurate depiction of said receipts is reflected in DWP's financial audited statements. Audited records include adjustments made in financial records post budget adoption.  
<sup>4</sup> Forecasting the trend line using a linear model explains 94% of the variance; whereas exponential modeling explains the variance at 94% and logarithmic at 78%. The variance is noted as R square.

anticipated revenue collection forecast for the period July 2013 through January 2014 is \$3.4 billion yet actual collections for the same period is \$3.1 billion.

The variance of approximately \$300 million is primarily driven by the uncollected amount for:

- Sale of Electric Energy at approximately \$223 million;
- Sewer Service Charges and Solid Waste (Resource) Fees combined at approximately \$55 million;
- Utility Users Tax (e.g. Electricity Utility Tax) at approximately \$22 million.

Examination of actual receipts from the Sale of Electric Energy and/or Operating Revenue is critical as it serves as a key determinant (variable) to calculate the City's Power Revenue Transfer or City Transfer amount. The below graph provides an overview of Power Revenue Transfer Amounts between Fiscal Year 2004 and 2014.



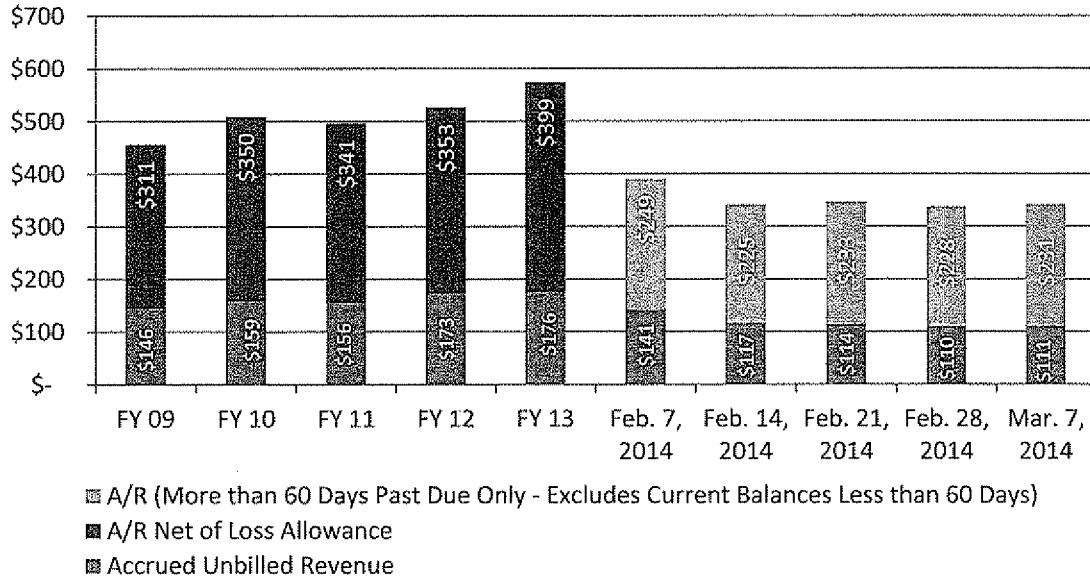
Source: DWP Audited Financial Statements

The following graph provides a snap shot of DWP's outstanding accounts receivable balance activity between Fiscal Year 2008-09 through Fiscal Year 2012-13, including most recent activity from February 1, 2014 through March 7, 2014 (note: the latter illustrates unpaid accounts more than 61 days delinquent). As the graph illustrates, DWP's aging (or delinquent) accounts receivable balance demonstrated some improvements in collections in early February 2014 reducing from \$249 million to \$225 million in billed amounts yet payment not received<sup>5</sup>. However, as of the first week of March 2014, the outstanding accounts receivable

<sup>5</sup> Information can be accessed through the Department of Water and Power's website within the Customer and Billing System Dashboard section at [https://www.ladwp.com/ladwp/faces/wcnav\\_externalld/r-cs-billpmnt-dashboard?\\_af.curl-state=vd3x0u2x8\\_4&\\_af.r.oop=239044988271980](https://www.ladwp.com/ladwp/faces/wcnav_externalld/r-cs-billpmnt-dashboard?_af.curl-state=vd3x0u2x8_4&_af.r.oop=239044988271980) [Accessed on March 15, 2014].

balance experienced a slight increase in non-payment to approximately \$231 million. This data illustrates the need for close monitoring of DWP's outstanding accounts receivable portfolio.

**DWP's Accounts Receivable (A/R) Balance (in Millions)**  
**Weekly Figures Include A/R for 61 Days or More Past Due Only**



The need for ongoing monitoring cannot be understated given that approximately 75% of DWP's outstanding accounts receivable weekly balances for the month of February 2014 is more than 90 days past due or delinquent. Since more aged accounts receivable are less likely to be collected, it is critical that DWP dedicate resources to monitor its collection efforts, including review of its revenue management governance structure. *Therefore, it is recommended that DWP (1) dedicate necessary resources to address billing and collection issues in a timely manner, including the monitoring of these efforts and (2) provide the Office of the Inspector General of City-wide Collections the necessary data and resources needed on an on-going basis to allow for the independent monitoring and close oversight of its delinquent accounts receivable portfolio, including progress made to improve its overall collection rate.* A status update on the progress of DWP's accounts receivable portfolio can be provided at the City's 2013/2014 Fiscal Year end Financial Status Report.

**IMPACT TO ELECTRICITY USERS TAX**

Based on updated revenue receipts associated with the Electricity Users' Tax (EUT) as of February 2014, it is anticipated that the City may experience a deferred revenue impact of \$9 million to \$12 million for this fiscal year, all things equal. However, based on recent initiatives implemented by DWP, some deferred revenue may be realized by the end of this fiscal year. Again, at this time, given the various uncertainties highlighted in this report, it is still too early to predict if the actual impact can be reduced. Therefore, it is recommended that the City Council consider reducing its revenue projection in EUT receipts from the adopted budget for this fiscal year.

In summary, the City's Utility Users Tax (UUT) is comprised of three revenue billing profiles, which are the Electricity Users' Tax (EUT), Gas Users' Tax (GUT), and Communications or Telephone Users' Tax (CUT). The below table provides a five year overview of actual revenues received, including estimated receipts for Fiscal Years 2012-13 and 2013-14.

	<u>2009-10</u>	<u>2010-11</u>	<u>2011-12</u>	<u>2012-13</u>	<u>2013-14</u>
	<u>ACTUAL</u>	<u>ACTUAL</u>	<u>ACTUAL</u>	<u>REVISED</u>	<u>ADOPTED</u>
<b>Electricity</b>	\$293,554	\$303,812	\$303,765	\$324,200	\$342,717
<b>Gas</b>	70,397	72,410	68,295	65,300	65,800
<b>Communications</b>	267,097	251,847	242,974	235,800	233,081
	<u>\$631,048</u>	<u>\$628,068</u>	<u>\$615,034</u>	<u>\$625,300</u>	<u>\$641,598</u>
% Change	-2.6%	-0.5%	-2.1%	1.7%	2.6%

Source: Reprinted from CAO FY 14 Proposed Revenue Outlook Book

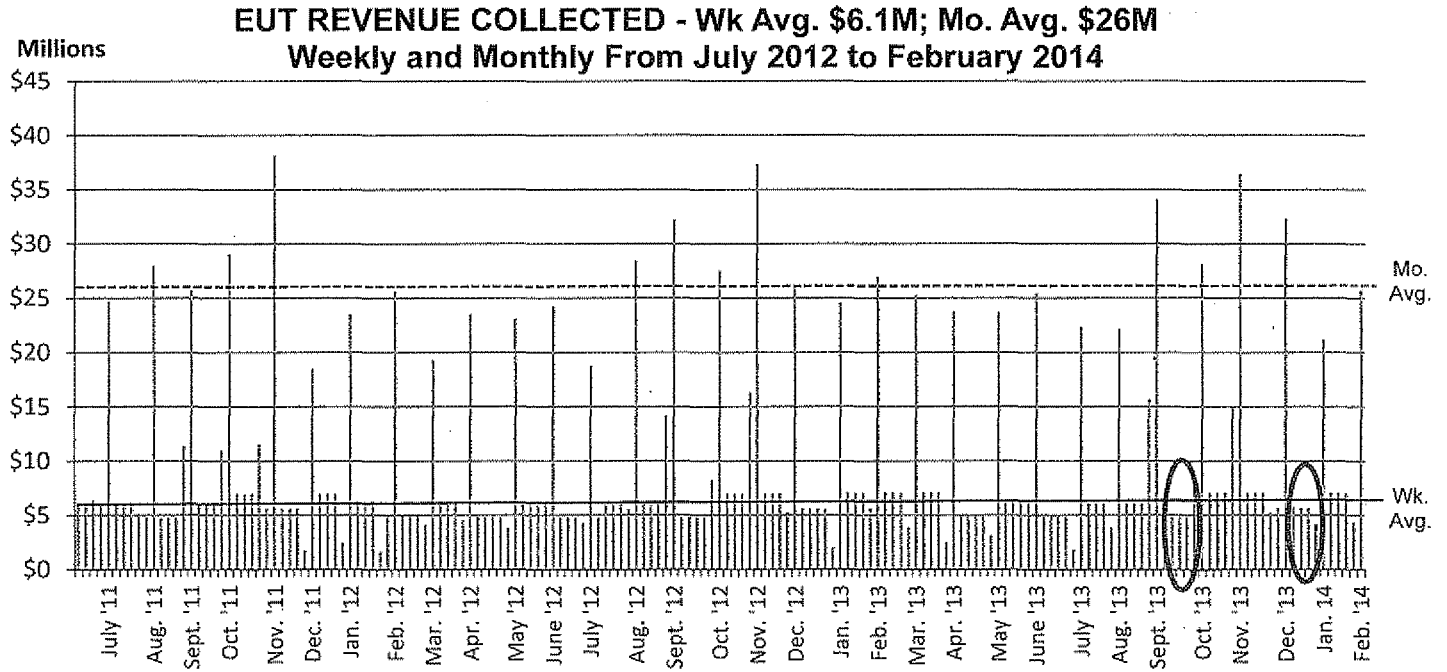
For Fiscal Year 2013-14, the adopted revenue for the EUT is \$342.7 million. As of February 2014, the City's received \$222.5 million while the planned budgeted amount for that period close was \$228.5 million or approximately 67% of the targeted amount. The variance or shortfall is \$6 million, which reduced the projected shortfall discussed in the Mid-Year Financial Status Report by \$4.4 million from \$10.4 million to \$6 million (see CF 14-0600). As of March 17, 2014, the City received an additional \$14.2 million from DWP or two weekly estimated payments of \$7.1 million each. Updating the projections through mid-March 2014, the City's projected revenue is \$240.2 million (or 70.8% of the planned revenue) yet received approximately \$236.8 million (or 69.1% of the planned revenue). The variance through mid-March is less than 2% or \$3.4 million.

However, based on the receipt schedule from DWP for EUT collections, the last week deposit of each month reflects DWP's reconciliation to either adjust the EUT up or down based on actual EUT collections. These adjustments should be closely examined by the City. *Therefore, it is recommended that the Office of Finance report on its auditing and/or review efforts related to Electrical Users Tax revenue submitted by DWP.* Further, on February 10, 2014, a request from the State of California Assemblymember, the Honorable Raul Bocanegra, was sent to State Assemblymember, the Honorable Adam Gray, requesting an audit of the DWP Customer Information System (or CC&R System). DWP indicates that it has responded to said request in late February 2014. City Council may be aware of said request and *therefore, should consider whether or not to support the State of California's request to audit DWP.*

The following graph provides a 31 month historical overview of payments received from DWP for EUT delineated by weekly payments (note: weekly payment are illustrated as a smaller bars preceding the monthly aggregate payment or typically illustrated as a taller bar. Also, some months reflect five weeks of payments; therefore five small bars before the larger bar). Also, full month aggregate payment amounts. It is important to note that the weekly average based on this 31 month overview is approximately \$6.1 million and the monthly average is \$26 million during the same time period. Also, it is important to highlight that since the release of



DWP's CC&R System in September 2013, only the weeks in October 2013 (see circled area below) and January 2014 (see circled area below) have been below the 31 month average. Similar results are illustrated for monthly aggregated payments compared to the 31 month average.

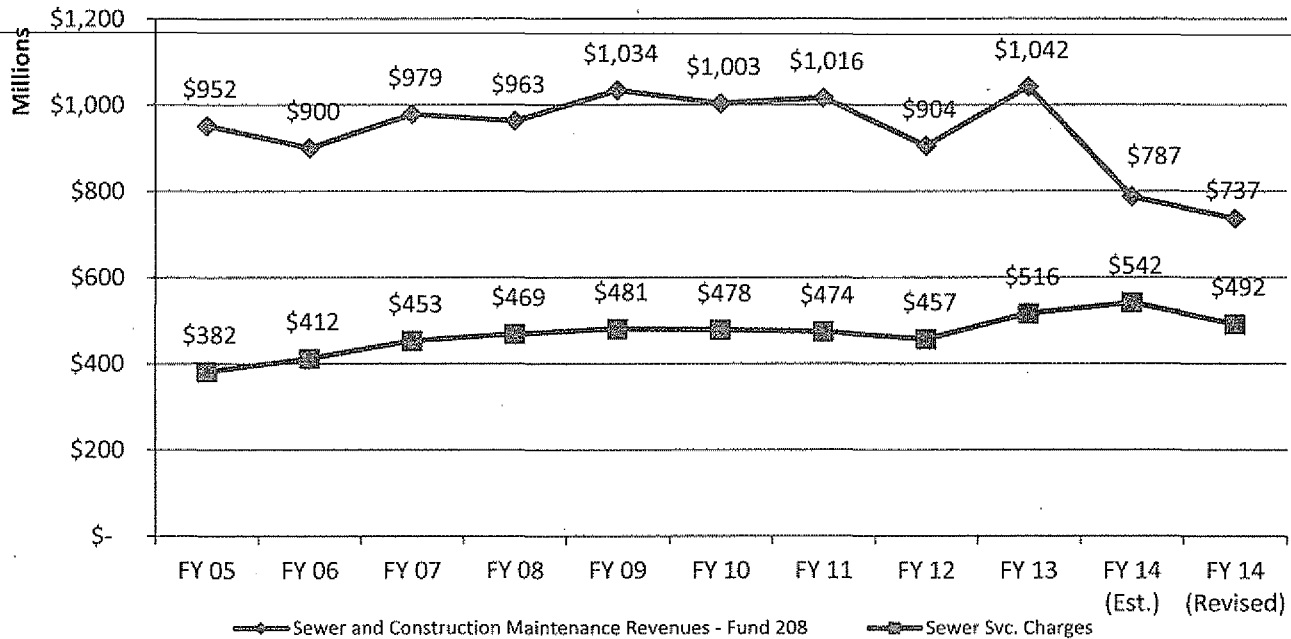


**IMPACT TO SEWER SERVICE CHARGES**

In short, it is anticipated that the Department of Public Works, Bureau of Sanitation's Sewer Service Charges will experience approximately \$50 million in deferred revenue due to delay in collections and billings from DWP<sup>6</sup>. Based on updated actual revenue receipts, as of February 2014, related to Sewer Services Charges, the Bureau of Sanitation received \$328.4 million (or 9% lower than planned). This represents approximately \$33 million in revenue not received yet anticipated. Based on trends observed in the EUT (see above referenced section), the same methodology could be applied to this billing profile. Therefore, a deferred revenue amount of \$4.2 million per month or \$16.8 million from March through June 2014 plus \$33 million in existing deferred revenue is anticipated. The aggregate deferred revenue amount is approximately \$50 million (see graph below for historical revenue history from Fiscal Year 2004-05 through Revised Fiscal Year 2013-14). Again based on various unknown factors (i.e. time delays associated with fixing DWP's billing issues, and time delays to collect, and collection behaviors factors typically associated with delinquent collections, etc.), it is difficult to project when and if all said deferred revenues will be realized. It is important to note that the Bureau of Sanitation has reported to the Budget and Finance Committee that it can absorb this projected revenue deferral this fiscal year.

<sup>6</sup> Deferred revenue and collection is associated with residential customer billing. As of February 2014, DWP indicates that of the 1.6 million customer accounts, Residential Accounts represent about 82.6% or close to 1.4 million accounts. In terms of revenue make-up, Residential Accounts represent about 41% of DWP's power revenue.

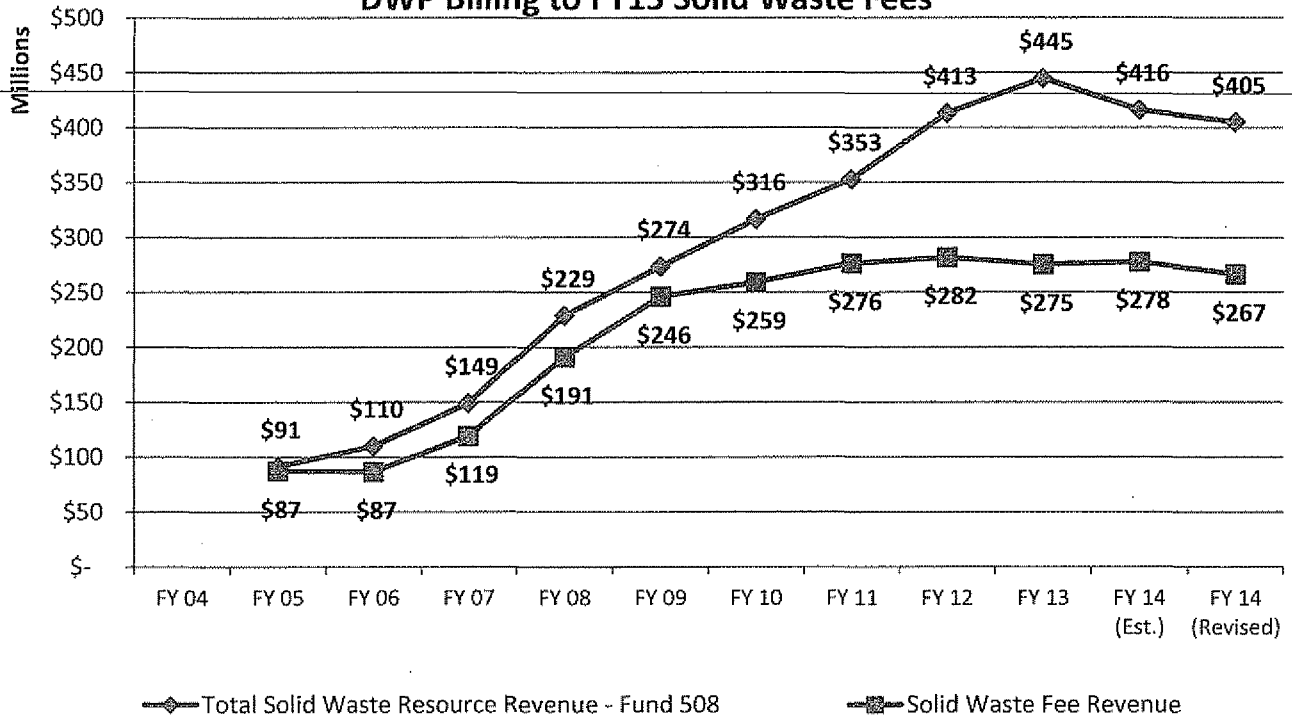
**\$50 Million in Deferred Revenue from  
 DWP Billing Impact on FY 15 Sewer Service Charges**



**IMPACT TO SOLID WASTE FEES**

Similar to that of the City's Sewer Service Charges, projected revenues for the City's Solid Waste fees are expected to decrease by \$11 million from \$277.6 million to \$266.6 million for Fiscal Year 2013-14. This decrease is considered deferred revenue due to delay in collections and billings from DWP. For example, as February 2014, Solid Waste Fees collected ended at \$177.6 million yet the planned revenue receipts is \$185 million (based on eight equal receipt distribution). This is a \$7.4 million (or 4% lower than planned). Using the same methodology to project end of year deferred revenue impact, approximately \$920,000 is deferred per month or \$3.7 million from March through June 2014 plus \$7.4 million in existing deferred revenue is anticipated. The aggregate deferred revenue amount is approximately \$11.1 million (see graph below for historical revenue history from Fiscal Year 2004-05 through Revised Fiscal Year 2013-14). However, these amounts could change as more information becomes available or when DWP concentrates on billing and collecting from Residential Accounts. Again based on various unknown factors (i.e. time delays associated with fixing DWP's billing issues, and time delays to collect, and collection behaviors factors typically associated with delinquent collections, etc.), it is difficult to project when and if all said deferred revenues will be realized. It is important to note that the Bureau of Sanitation has reported that it can absorb this projected revenue deferral this fiscal year.

### \$11 Million in Deferred Revenue from DWP Billing to FY15 Solid Waste Fees



The Inspector General and the Office of the CAO will continue to closely monitor this issue and report any updates in its financial status report, unless instructed otherwise by the Mayor and/or City Council.

Should you have any questions, please do not hesitate to contact me at (213) 473-7533 or via e-mail at [Fernando.Campos@lacity.org](mailto:Fernando.Campos@lacity.org).

- cc: Antoinette D. Christovale, Director, Office of Finance
- Rick Cole, Deputy Mayor, Budget and Innovation
- Gerry F. Miller, Chief Legislative Analyst
- Marcie Edwards, DWP General Manager
- Dr. Fred Pickel, Director, Office of Public Accountability
- William Koenig, CAO