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# Karegnondi Water Authority

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**Financial Report**  
**September 30, 2018**

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## Independent Auditor's Report

To the Board of Directors  
Karegnondi Water Authority

### Report on the Financial Statements

We have audited the accompanying basic financial statements of Karegnondi Water Authority (the "Authority"), a component unit of Genesee County Water and Waste Services, as of and for the years ended September 30, 2018 and 2017 and the related notes to the financial statements.

#### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

#### *Opinions*

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of Karegnondi Water Authority as of September 30, 2018 and 2017 and the changes in its financial position and its cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

To the Board of Directors  
Karegnondi Water Authority

***Required Supplemental Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, as identified in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplemental information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Plante & Moran, PLLC*

January 30, 2019

Karegnondi Water Authority (KWA or the "Authority") was incorporated in October 2010 pursuant to Act 233, Public Acts of Michigan, 1955, as amended, by the County of Genesee, Michigan (Genesee Co.), the County of Lapeer, Michigan, the County of Sanilac, Michigan, the City of Flint, Michigan (Flint), and the City of Lapeer, Michigan for the purpose of providing its member communities with a new source of water for treatment and distribution. This new water source comes from a Water Supply System (the "System") which was completed in 2017. The System delivers Lake Huron water to its customers.

The System is currently providing untreated water to the Genesee County Drain Commissioner (the "County Agency") as its primary water source pursuant to the Genesee Water Purchase Contract. Under a contract with Flint (the "Flint Water Purchase Contract"), Flint has the right to the delivery and use of up to 18 million gallons per day of untreated water. Under a long-term water supply contract entered into by Flint and the Great Lakes Water Authority (GLWA) as of December 1, 2017 (the "GLWA Water Service Contract"), GLWA will supply Flint with treated water as its primary water source for an initial period of 30 years. Pursuant to the terms of the GLWA Water Service Contract, Flint has granted to GLWA certain rights of Flint under the Flint Water Purchase Contract to untreated water from the System.

### **The System**

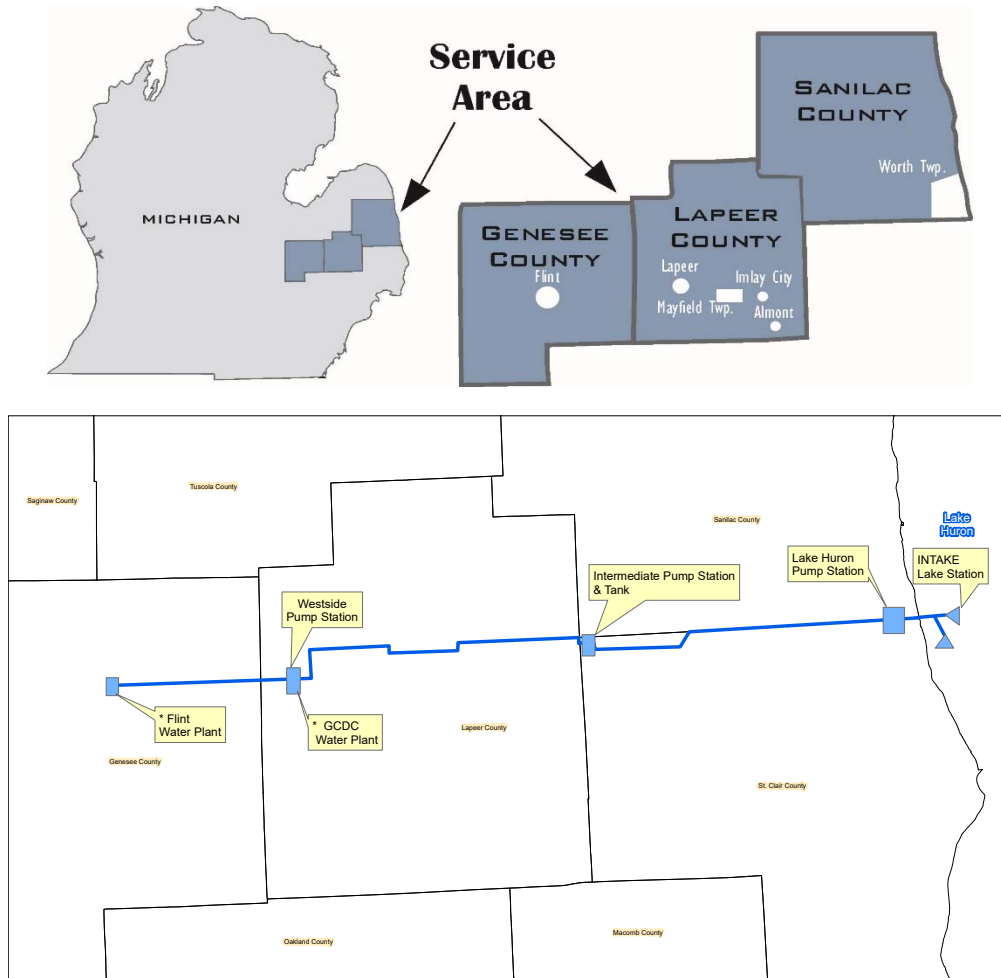
To supply water to its contracting members, KWA constructed two lake intakes in Lake Huron, approximately 63 miles of pipe from the intake to the City of Flint, and three pump stations. These facilities collectively constitute the System. The engineering design of the System was to withdraw water from Lake Huron and pump it to a standpipe in Lynn Township in St. Clair County, and from there, repump the water to a site in Oregon Township in Lapeer County, approximately 14 miles east of Flint. That site features a 125 million gallon reservoir (also known as an impoundment) which was completed in 2016, along with the County Agency's new water treatment plant which was completed in June 2017.

The impoundment and new treatment plant are owned and operated by the County Agency. A third pump station is capable to pump untreated water from the County Agency's site to Flint's water treatment plant. Figure 1 shows the location of the System's facilities, the Flint water treatment plant, and the County Agency treatment plant and impoundment.

# Karegnondi Water Authority

## Management's Discussion and Analysis (Continued)

Figure 1



The intake facility and property were financed through the issuance of bonds by the County Agency in the principal amount of \$35,000,000 in October 2013, with the understanding that the County Agency would make the intake and property available to KWA for use by KWA as part of the System. The County Agency is solely responsible for paying the principal of and interest on these bonds from the net revenue derived from its users. Genesee County has pledged its limited tax full faith and credit as additional security for the bonds.

The lake intake construction and testing were completed in 2016. The County Agency has entered into an agreement which calls for the ownership of the intake to be transferred to KWA once the intake debt has been retired.

# **Management's Discussion and Analysis (Continued)**

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KWA retained the services of the County Agency to administer the design and construction of the System. The County Agency provided these services at no cost to KWA since its inception through September 2014. In October 2014, KWA began paying the County Agency \$3,000.00 monthly for these services. Then in June 2017, after the system was completed and operational, KWA contracted with the County Agency for operation and maintenance of the System. The County Agency has significant experience in planning, operating, and managing water and wastewater systems, having been responsible for planning, operating, and managing its own system since 1966. The County Agency currently employs approximately 155 people in connection with the operation and management of its current system, and from this group, approximately five full-time-equivalent employees are involved in the operation and maintenance of the System. KWA does not have any employees.

### **Objectives**

The main objectives of KWA were to build and maintain a high-quality water delivery system at rates which would be fair and cost effective to all concerned. And in accordance with its bylaws, KWA maintains a yearly budget of income and expenses. The budget is reviewed and approved by the KWA board.

### **Using this Annual Report**

This annual report consists of a series of financial statements. The statement of net position, the statement of revenue, expenses, and changes in net position, and the statement of cash flows provide information about the activities of KWA as a whole and assist in presenting a longer-term view of its finances.

## Karegnondi Water Authority

# Management's Discussion and Analysis (Continued)

### Condensed Financial Information

The following tables present condensed information about the Authority's financial position compared to the prior two years:

	September 30			(Decrease) Increase	Percent Change
	2016	2017	2018		
<b>Assets</b>					
Current assets	\$ 7,267,552	\$ 6,197,784	\$ 8,106,481	\$ 1,908,697	31%
Restricted assets	45,429,465	39,968,773	36,284,709	(3,684,064)	-0.0921736
Capital assets	310,377,287	331,427,489	326,178,422	(5,249,067)	-2%
Total assets	363,074,304	377,594,046	370,569,612	(7,024,434)	-2%
<b>Liabilities</b>					
Current liabilities	18,575	68,943,071	129,327	(68,813,744)	-100%
Liabilities payable from restricted assets	12,573,368	21,105,256	13,783,666	(7,321,590)	-35%
Other noncurrent liabilities	5,118,032	5,258,648	5,258,648	-	0%
Long-term debt	340,503,990	260,770,138	326,555,780	65,785,642	25%
Total liabilities	358,213,965	356,077,113	345,727,421	(10,349,692)	-3%
<b>Net Position</b>					
Net investment in capital assets	1,778,879	14,802,771	13,970,685	(832,086)	-6%
Restricted for debt service	950,515	7,514,028	8,182,677	668,649	9%
Unrestricted	2,130,945	(799,866)	2,688,829	3,488,695	-436%
Total net position	<u>\$ 4,860,339</u>	<u>\$ 21,516,933</u>	<u>\$ 24,842,191</u>	<u>\$ 3,325,258</u>	15%

	Year Ended September 30				Percent Change
	2016	2017	2018	Change	
<b>Operating Revenue - Sale of water</b>	\$ -	\$ 441,074	\$ 3,484,113	\$ 3,043,039	690%
<b>Operating Expenses</b>					
Office supplies and insurance	4,186	69,222	84,204	14,982	22%
Utilities	-	289,743	869,156	579,413	200%
Repairs and maintenance	-	17,002	85,721	68,719	404%
Contractual and professional services	190,313	1,216,017	475,064	(740,953)	-61%
Other expenses	-	4,854	29,772	24,918	513%
Depreciation	-	-	5,528,448	5,528,448	100%
Total operating expenses	194,499	1,596,838	7,072,365	(52,921)	343%
<b>Operating Loss</b>	(194,499)	(1,155,764)	(3,588,252)	3,095,960	210%
<b>Nonoperating Revenue (Expenses)</b>					
Water supply contract operating subsidy	1,938,000	-	-	-	0%
Capacity/Debt service fee	-	17,760,242	22,027,212	4,266,970	24%
Investment income	11,270	52,116	570,260	518,144	994%
Interest & fiscal charges	-	-	(15,116,988)	(15,116,988)	
Bond issuance costs	(563,218)	-	(566,974)	566,974	100%
Total nonoperating revenue	1,386,052	17,812,358	6,913,510	(9,764,900)	-61%
<b>Change in Net Position</b>	<u>\$ 1,191,553</u>	<u>\$ 16,656,594</u>	<u>\$ 3,325,258</u>	<u>\$ (13,331,336)</u>	-80%



## Karegnondi Water Authority

# Management's Discussion and Analysis (Continued)

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### Major Capital Assets and Debt Activity

KWA and the local units entered into a contract whereby KWA was authorized to issue bonds with a total par value not to exceed \$300,000,000 (collectively, the "System Bonds") to finance the facilities for the System in anticipation of the contractual payments to be made by the local units as provided therein. The contract is contemplated in the water purchase contracts and sets forth the manner in which the capital costs of the System's facilities would be allocated. Under the contracts, Flint and the County Agency are responsible for paying approximately 34 percent and 66 percent, respectively, of the debt service on the System Bonds. This allocation takes into account and credits the County Agency for financing and being responsible for the payment of 100 percent of the costs of the intake. In addition, Genesee County, Michigan pledged its limited tax full faith and credit to 100 percent of the debt service on the System Bonds.

KWA sold \$220,500,000 par value in water system supply bonds in April 2014. Sources and uses of funds were as follows:

#### *Sources of Funds*

Par amount of bonds - \$220,500,000.00  
Net original issue premium/discount - \$11,815,544.05  
Total sources - \$232,315,544.05

#### *Use of Funds*

Deposit to construction fund - Initial - \$187,137,367.59  
Deposit to construction fund - Subsequent - \$8,606.00  
Capitalized interest - \$28,282,364.06  
Deposit to debt service reserve account - \$15,237,437.50  
Costs of issuance - \$703,394.00  
Underwriters' discount - \$946,374.90  
Total uses - \$232,315,544.05

KWA sold \$74,370,000 par value in water system supply bonds in June 2016.

Sources and uses of funds were as follows:

#### *Sources of Funds*

Par amount of bonds - \$74,370,000  
Net original issue premium/discount - \$0.00  
Total sources - \$74,370,000.00

## Karegnondi Water Authority

# Management's Discussion and Analysis (Continued)

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### *Use of Funds*

Deposit to construction fund - \$61,999,332.18  
Capitalized interest - \$4,878,159.88  
Deposit to debt service reserve account - \$6,954,939.94  
Costs of issuance - \$223,680.50  
Purchaser's fee - \$313,887.50  
Total uses - \$74,370,000.00

KWA sold \$65,735,000 par value in water system supply bonds in March 2018.

Sources and uses of funds were as follows:

### *Sources of Funds*

Par amount of bonds - \$65,735,000  
Net original issue premium - \$6,983,918.70  
Reserve Fund Release - \$5,224,828.81  
Total sources - \$77,943,747.51

### *Use of Funds*

Refund 2016 Bonds - \$74,370,000  
Deposit to construction fund - \$3,006,773.11  
Costs of issuance - \$232,383.25  
Underwriters' discount - \$334,591.15  
Total uses - \$77,943,747.51

## **Financial Review**

A discussion of the significant financial activity during the current year is as follows:

### **Statement of Net Position**

- Operating cash and cash equivalents increased from \$5,877,667 to \$7,766,606 primarily due to the increase in total operating revenues in the current year.
- Capital assets decreased \$5,249,067. 2018 marked the first-year depreciation was taken on system assets which is reflected in the decreased capital assets figure.
- Both current liabilities and liabilities payable from restricted assets decreased substantially due to the 2016 bonds being refunded in full during 2018. And conversely, long-term debt increased by over \$65 million due to this same short-term for long-term debt conversion.

## **Karegnondi Water Authority**

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# **Management's Discussion and Analysis (Continued)**

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- The overall result of operations, debt sales, and debt service was an increase in total net position from approximately \$21,500,000 in 2017 to \$24,800,000 at the end of 2018.

### **Statement of Revenue, Expenses, and Changes in Net Position**

- 2018 was also the first year with a full 12 months of operating revenue. Raw water sales to the County Agency amounted to \$3,484,113. Due to lower operating costs in 2018 and similar projections for 2019, the raw water rate charged by KWA to the County Agency was lowered from \$6.00/MCF (Thousand Cubic Feet) to \$4.50/MCF beginning October 1, 2018. As a result, raw water sales are budgeted at approximately \$2,524,000 for fiscal 2019.
- Excluding depreciation, 2018 operating expenses decreased slightly to \$1,543,917. Operating expenses are budgeted at approximately \$1,925,000 for fiscal year 2019.
- KWA continues to invoice the County Agency and Flint for full yearly debt service, which amounted to \$22,027,212 of nonoperating capacity/debt service fee revenue. This figure will be approximately \$22,177,000 for fiscal 2019 and will match the KWA debt service expense.
- Bond issuance costs increased \$566,974 due to new debt being issued during the year.

### **Contacting Management**

This financial report is intended to provide our constituents, future water users, and bondholders with a general overview of Karegnondi Water Authority's accountability for the money it receives. If there are questions about this report or if additional information is needed, we welcome anyone to contact the CEO.

**Statement of Net Position**

**September 30, 2018 and 2017**

	<u>2018</u>	<u>2017</u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents (Note 2)	\$ 7,766,606	\$ 5,877,667
Receivables:		
Accrued interest receivable	29,677	-
Other construction receivables (refunds)	-	81,409
Due from other governmental units	<u>310,198</u>	<u>238,708</u>
Total current assets	8,106,481	6,197,784
Noncurrent assets:		
Restricted assets (Note 3)	36,284,709	39,968,773
Capital assets: (Note 4)		
Assets not subject to depreciation (Note 4)	-	331,427,489
Assets subject to depreciation - Net (Note 4)	<u>326,178,422</u>	<u>-</u>
Total noncurrent assets	<u>362,463,131</u>	<u>371,396,262</u>
Total assets	370,569,612	377,594,046
<b>Liabilities</b>		
Current liabilities:		
Accounts payable - Operations	129,327	119,751
Accounts payable - Construction	-	1,537,842
Current portion of long-term debt	<u>-</u>	<u>67,285,478</u>
Total current liabilities	129,327	68,943,071
Noncurrent liabilities:		
Payable from restricted assets (Note 1)	13,783,666	21,105,256
Lease interest payable	5,258,648	5,258,648
Long-term debt (Note 5)	<u>326,555,780</u>	<u>260,770,138</u>
Total noncurrent liabilities	<u>345,598,094</u>	<u>287,134,042</u>
Total liabilities	<u>345,727,421</u>	<u>356,077,113</u>
<b>Net Position</b>		
Net investment in capital assets	13,970,685	14,802,771
Restricted for debt service	8,182,677	7,514,028
Unrestricted	<u>2,688,829</u>	<u>(799,866)</u>
Total net position	<u><u>\$ 24,842,191</u></u>	<u><u>\$ 21,516,933</u></u>

## Karegnondi Water Authority

### Statement of Revenue, Expenses, and Changes in Net Position

Years Ended September 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
<b>Operating Revenue</b> - Charges for sales and services - Sale of water	\$ 3,484,113	\$ 441,074
<b>Operating Expenses</b>		
Insurance expense	84,204	69,222
Repairs and maintenance	85,721	17,002
Utilities	869,156	289,743
Contractual and professional services	475,064	1,216,017
Other expenses	29,772	4,854
Depreciation	5,528,448	-
Total operating expenses	<u>7,072,365</u>	<u>1,596,838</u>
<b>Operating Loss</b>	(3,588,252)	(1,155,764)
<b>Nonoperating Revenue (Expense)</b>		
Investment income	570,260	52,116
Capacity/Debt service fee	22,027,212	17,760,242
Interest and fiscal charges	(15,116,988)	-
Bond issuance costs	(566,974)	-
Total nonoperating revenue	<u>6,913,510</u>	<u>17,812,358</u>
<b>Change in Net Position</b>	3,325,258	16,656,594
<b>Net Position</b> - Beginning of year	<u>21,516,933</u>	<u>4,860,339</u>
<b>Net Position</b> - End of year	<u><u>\$ 24,842,191</u></u>	<u><u>\$ 21,516,933</u></u>

**Years Ended September 30, 2018 and 2017**

	<u>2018</u>	<u>2017</u>
<b>Cash Flows from Operating Activities</b>		
Receipts from customers	\$ 3,412,623	\$ 202,366
Payments to suppliers	<u>(1,534,341)</u>	<u>(1,495,662)</u>
Net cash and cash equivalents provided by (used in) operating activities	1,878,282	(1,293,296)
<b>Cash Flows from Capital and Related Financing Activities</b>		
Bond proceeds received	72,718,919	-
Bonds refunded	(74,370,000)	-
Capacity/debt service fee	22,027,212	17,760,242
Purchase of capital assets	(3,467,668)	(9,353,924)
Principal and interest paid on capital debt	(20,555,479)	(14,422,572)
Bond issuance costs	<u>(566,974)</u>	<u>-</u>
Net cash and cash equivalents used in capital and related financing activities	(4,213,990)	(6,016,254)
<b>Cash Flows from Investing Activities</b>		
Investment income	540,583	566,624
Purchases of investment securities	<u>3,225,547</u>	<u>(3,964,103)</u>
Net cash and cash equivalents provided by (used in) investing activities	3,766,130	(3,397,479)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	1,430,422	(10,707,029)
<b>Cash and Cash Equivalents - Beginning of year</b>	<u>8,262,701</u>	<u>18,969,730</u>
<b>Cash and Cash Equivalents - End of year</b>	<u><b>\$ 9,693,123</b></u>	<u><b>\$ 8,262,701</b></u>
<b>Classification of Cash and Cash Equivalents</b>		
Cash and cash equivalents	\$ 7,766,606	\$ 5,877,667
Restricted cash	36,284,709	39,968,773
Less amounts classified as investments	<u>(34,358,192)</u>	<u>(37,583,739)</u>
Total cash and cash equivalents	<u><b>\$ 9,693,123</b></u>	<u><b>\$ 8,262,701</b></u>
<b>Reconciliation of Operating Loss to Net Cash from Operating Activities</b>		
Operating loss	\$ (3,588,252)	\$ (1,155,764)
Adjustments to reconcile operating loss to net cash from operating activities:		
Depreciation and amortization	5,528,448	-
Changes in assets and liabilities:		
Due from other governmental units	(71,490)	(238,708)
Accounts payable	<u>9,576</u>	<u>101,176</u>
Net cash and cash equivalents provided by (used in) operating activities	<u><b>\$ 1,878,282</b></u>	<u><b>\$ (1,293,296)</b></u>

**Noncash Investing, Capital, and Financing Activities** - During the years ended September 30, 2018 and 2017, there were no significant noncash activities.

**Note 1 - Significant Accounting Policies**

***Reporting Entity***

Karegnondi Water Authority (the "Authority" or KWA) is governed by an appointed 15-member board and was created pursuant to Act 233, Michigan Public Acts of 1955. Its purpose is to acquire and operate a water pipeline that provides water to its customers. The Genesee County Drain Commissioner has financial accountability for KWA. This is subject to change based upon redistribution of capacity units. KWA began full operations in November 2017.

***Accounting and Reporting Principles***

The Authority follows accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental units. Accounting and financial reporting pronouncements are promulgated by the Governmental Accounting Standards Board (GASB). The following is a summary of the significant accounting policies used by the Authority:

***Fund Accounting***

The Authority accounts for its various activities in an enterprise fund in order to demonstrate accountability for how we have spent certain resources.

***Proprietary Fund***

The proprietary fund includes an enterprise fund, which provides goods or services to users in exchange for charges or fees. The Authority only has one fund, the Water Fund, which provides water to customers through a pipeline constructed from Lake Huron. All activities necessary to provide such services are accounted for in this fund, including, but not limited to, administration, maintenance, billing, and collection.

***Basis of Accounting***

Proprietary funds use the economic resources measurement focus and the full accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred regardless of the timing of related cash flows.

***Report Presentation***

This report includes the fund-based statements of the Authority. In accordance with government accounting principles, a government-wide presentation with program and general revenue is not applicable to special purpose governments engaged only in business-type activities.

***Specific Balances and Transactions***

***Cash and Cash Equivalents***

Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired.

***Investments***

Investments are reported at fair value or estimated fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates.

***Prepaid Items***

Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid items in the fund financial statements.

September 30, 2018 and 2017

**Note 1 - Significant Accounting Policies (Continued)**

**Restricted Assets**

The Authority's bond indenture requires amounts to be set aside in a construction account and in debt service reserve accounts. These amounts have been classified as restricted assets, as well as amounts on deposit at the county being held for the construction or debt service of Karegnondi Water Authority water lines.

**Liabilities Payable from Restricted Assets**

The current accrued interest due and principal due on the capital lease, the 2014A Water Supply System Bonds, and the 2018 Water Supply System Bonds will be paid from these restricted assets and, therefore, has been reported as a noncurrent liability to the extent of restricted assets available. The construction accounts payable will be liquidated from unspent bond proceeds and have also been reported in this category to the extent of restricted assets available. At September 30, 2018 and 2017, the liabilities payable from restricted assets is composed of \$6,290,000 and \$12,747,100 of principal, \$6,759,076 and \$5,891,712 of interest, and \$734,590 and \$2,466,444 of construction accounts payable, respectively.

**Capital Assets**

Capital assets are defined by the Authority as assets with an initial individual cost of more than \$10,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated acquisition value at the date of donation. The water transmission line costs from Lake Huron are being reported as a capital asset, as the asset was fully placed in service during fiscal year 2018, and are depreciated over their estimated useful lives.

Interest incurred during the construction of capital assets of business-type activities is included as part of the capitalized value of the assets constructed. Interest expense (net of interest income) of \$0 and \$14,903,686 was capitalized as part of the cost of assets under construction for the years ended September 30, 2018 and 2017, respectively.

**Long-term Obligations**

Bond premiums are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium. Bond issuance costs are expensed at the time they are incurred.

**Net Position Flow Assumption**

Sometimes the Authority will fund outlays for a particular purpose from both restricted (e.g., restricted bond or grant proceeds) and unrestricted resources. In order to calculate the amounts to report as restricted net position and unrestricted net position in the proprietary fund financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. It is the Authority's policy to consider restricted net position to have been depleted before unrestricted net position is applied.

**Proprietary Funds Operating Classification**

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of the Water Fund is charges to customers for sales or services. Operating expenses for the enterprise fund include the cost of sales or services and administrative expenses. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.



September 30, 2018 and 2017

**Note 1 - Significant Accounting Policies (Continued)**

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

**Subsequent Events**

The financial statements and related disclosures include evaluation of events up through and including January 30, 2019, which is the date the financial statements were available to be issued.

**Note 2 - Deposits and Investments**

Deposits and investments are reported in the financial statements of September 30, 2018 and 2017 as follows:

	2018	2017
Cash and cash equivalents	\$ 7,766,606	\$ 5,877,667
Investments	36,284,709	39,968,773
Total	\$ 44,051,315	\$ 45,846,440

These amounts are classified into the following deposits and investment categories:

	Primary Government	
	2018	2017
Cash deposits with financial institutions	\$ 9,493,123	\$ 8,262,702
County deposits	200,000	-
Investments - Certificates of deposit (with maturities in excess of 90 days)	14,439,789	11,406,457
Investments - Money markets	19,918,403	26,177,281
Total	\$ 44,051,315	\$ 45,846,440

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The law also allows investments outside the state of Michigan when fully insured. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The Authority has designated two banks for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in bonds and securities of the United States government and bank accounts and CDs, but not the remainder of state statutory authority, as listed above. The Authority's deposits and investments are in accordance with statutory authority.

**Note 2 - Deposits and Investments (Continued)**

The Authority's cash and investments are subject to several types of risk, which are examined in more detail below:

***Custodial Credit Risk of Bank Deposits***

Custodial credit risk is the risk that, in the event of a bank failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. For the years ended September 30, 2018 and 2017, the Authority had \$10,510,234 and \$7,234,078, respectively, (checking and savings accounts) that were not fully insured or collateralized. The Authority also has \$34,108,192 and \$37,319,517 of deposits at September 30, 2018 and 2017, respectively, that are uninsured, but collateralized with securities held by the pledging financial institution, but not in the Authority's name.

***Interest Rate Risk***

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Authority's investment policy does not restrict investment maturities other than commercial paper, which can only be purchased with a 270-day maturity.

***Fair Value Measurements***

The Authority categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. Investments that are measured at fair value using net asset value per share (or its equivalent) as a practical expedient are not classified in the fair value hierarchy. As of September 30, 2018 and 2017, all cash and investments owned by the Authority are properly valued at cost; therefore, there is no fair value hierarchy applicable.

**Note 3 - Restricted Assets**

At September 30, 2018 and 2017, restricted assets are restricted for the following purposes:

	2018	2017
Unspent bond proceeds and related interest	\$ 1,726,517	\$ 1,856,411
County construction deposits	200,000	528,624
General obligation bond restrictions:		
Debt reserve	19,918,403	26,177,281
Capacity/Debt service fee for debt service	14,439,789	11,406,457
Total restricted assets	\$ 36,284,709	\$ 39,968,773

The general obligation bond debt reserve is restricted for debt service per the bond agreement. The capacity/debt service fee is restricted per the bond agreement for current principal and interest payments on general obligation bonds and the capital lease.

Net position has been restricted at September 30, 2018 and 2017 for \$8,182,677 and \$7,514,028, respectively, related to the restricted assets held for debt service net of the related payable.

**September 30, 2018 and 2017**

**Note 4 - Capital Assets**

Capital asset activity of the Authority's business-type activities for the years ended September 30, 2018 and 2017 was as follows:

***Business-type Activities***

	Balance October 1, 2017	Reclassifications	Additions	Disposals	Balance September 30, 2018
Capital assets not being depreciated - Construction in progress of water pipeline	\$ 331,427,489	\$ (331,706,870)	\$ 279,381	\$ -	\$ -
Capital assets being depreciated - Water pipeline	-	-	331,706,870	-	331,706,870
Accumulated depreciation	-	-	5,528,448	-	5,528,448
<b>Net business-type activity capital assets</b>	<b>\$ 331,427,489</b>	<b>\$ (331,706,870)</b>	<b>\$ 326,457,803</b>	<b>\$ -</b>	<b>\$ 326,178,422</b>

	Balance October 1, 2016	Additions	Disposals and Adjustments	Balance September 30, 2017
Capital assets not being depreciated - Construction in progress of water pipeline	\$ 310,377,287	\$ 21,050,202	\$ -	\$ 331,427,489

***Construction Commitments***

The Authority has an active construction project at year end. The project is to complete the water pipeline. At year end, the Authority's commitment with contractors is as follows:

	Spent to Date	Remaining Commitment
Water pipeline	\$ 259,383,585	\$ 1,922,401

September 30, 2018 and 2017

**Note 5 - Long-term Debt**

The Authority issues bonds to provide for the acquisition and construction of major capital facilities. General obligation bonds are direct obligations and pledge the full faith and credit of the Authority.

**Business-type Activities**

	2018				
	Beginning Balance	Additions	Reductions	Ending Balance	Due within One Year
Business-type activities:					
Bonds	\$ 294,870,000	\$ 65,735,000	\$ (78,475,000)	\$ 282,130,000	\$ 5,390,000
Plus - Deferred amounts - Issuance premiums	10,240,138	6,983,919	(643,277)	16,580,780	-
Total bonds payable	305,110,138	72,718,919	(79,118,277)	298,710,780	5,390,000
Capital lease (Note 6)	35,000,000	-	(865,000)	34,135,000	900,000
Total business-type activities long-term debt	<u>\$ 340,110,138</u>	<u>\$ 72,718,919</u>	<u>\$ (79,983,277)</u>	<u>\$ 332,845,780</u>	<u>\$ 6,290,000</u>
	2017				
	Beginning Balance	Additions	Reductions	Ending Balance	Due within One Year
Business-type activities:					
Bonds	\$ 294,870,000	\$ -	\$ -	\$ 294,870,000	\$ 78,475,000
Plus - Deferred amounts - Issuance premiums	10,633,990	-	(393,852)	10,240,138	-
Total bonds payable	305,503,990	-	(393,852)	305,110,138	78,475,000
Capital lease	35,000,000	-	-	35,000,000	865,000
Total business-type activities long-term debt	<u>\$ 340,503,990</u>	<u>\$ -</u>	<u>\$ (393,852)</u>	<u>\$ 340,110,138</u>	<u>\$ 79,340,000</u>

**General Obligation Bonds and Contracts**

The Authority issues bonds to provide for the acquisition and construction of major capital facilities. General obligation bonds are direct obligations and pledge the full faith and credit of the Authority.

**Business-type Activities**

2014A Water Supply System Bond, used to construct water pipeline, bearing interest from 3 percent to 5.25 percent, maturing in 2043	\$ 216,395,000
2018 Water Supply System Bond, used to construct water pipeline, bearing interest from 3 percent to 5 percent, maturing 2045	<u>65,735,000</u>
Total	<u>\$ 282,130,000</u>

Total interest expense for the years ended September 30, 2018 and 2017 was \$15,759,515 and \$15,418,194, respectively, of which \$14,903,686 (interest expense net of interest income) was capitalized.

Debt due within one year of \$6,290,000 is included in payable from restricted assets on the statement of net position.

**Note 5 - Long-term Debt (Continued)**

Annual debt service requirements to maturity for the above bonds and note obligations are as follows:

Years Ending September 30	Business-type Activities		
	Principal	Interest	Total
2019	\$ 5,390,000	\$ 14,287,367	\$ 19,677,367
2020	5,670,000	13,864,762	19,534,762
2021	5,895,000	13,611,612	19,506,612
2022	6,175,000	13,339,862	19,514,862
2023	6,445,000	13,044,363	19,489,363
2024-2028	37,375,000	59,918,469	97,293,469
2029-2031	47,980,000	49,009,863	96,989,863
2032-2036	61,525,000	35,143,381	96,668,381
2037-2041	79,155,000	17,058,693	96,213,693
2042-2046	26,520,000	1,283,000	27,803,000
<b>Total</b>	<b>\$ 282,130,000</b>	<b>\$ 230,561,372</b>	<b>\$ 512,691,372</b>

**Note 6 - Leases**

**Capital Leases**

The Authority has entered into a lease agreement as lessee for financing the purchase of the intake pump station. This lease agreement qualifies as a capital lease for accounting purposes and, therefore, has been recorded at the present value of the future minimum lease payments as of the inception date. The future minimum lease obligations and the net present value are as follows:

Years Ending September 30	Amount
2019	\$ 2,509,588
2020	2,507,888
2021	2,504,813
2022	2,499,937
2023	2,502,562
2024-2028	12,479,075
2029-2033	12,429,956
2034-2038	12,361,306
2039-2042	10,048,148
Total minimum lease payments	59,843,273
Less amount representing interest	(25,708,273)
Present value	<u>\$ 34,135,000</u>

Interest has been accruing on the capital lease since inception. As of September 30, 2018, \$678,161 is current accrued interest payable and \$5,258,648 is long-term accrued interest payable. The current interest payable is included in noncurrent liabilities - payable from restricted assets.

**Note 7 - Capacity/Debt Service Fee**

KWA entered into two separate water purchase contracts to supply untreated water, each with an effective date of October 1, 2013. A contract with the Genesee County Drain Commissioner provides the right to the delivery and use of up to 42 million gallons per day of untreated water. In July 2017, the Authority began providing untreated water to the Genesee County Drain Commissioner for testing purposes. A contract with the City of Flint, Michigan provides the right to the delivery and use of up to 18 million gallons per day of untreated water.

Under a long-term water supply contract entered into by the City of Flint, Michigan (Flint) and the Great Lakes Water Authority (GLWA) as of December 1, 2017 (the "GLWA Water Service Contract"), GLWA will supply Flint with treated water as its primary water source for an initial period of 30 years. Pursuant to the terms of the GLWA Water Service Contract, Flint has granted to GLWA certain rights of Flint under the Flint Water Purchase Contract to untreated water from the Authority's System. A KWA Financing Contract is included in the KWA Water Purchase Contracts and sets forth the manner in which the capital costs of the Authority facilities will be allocated. Under the KWA Financing Contract, the City of Flint, Michigan and the Genesee County Drain Commissioner are responsible for paying approximately 34 percent and 66 percent, respectively, of the debt service on the KWA System Bonds. (This allocation takes into account and credits the Genesee County Drain Commissioner for financing and being responsible for the payment of 100 percent of the costs of the Intake portion of the project.) These debt service payments by the City of Flint, Michigan and the Genesee County Drain Commissioner constitute the capacity/debt service fee collected in the amount of \$22,027,212 and \$17,760,242 as of September 30, 2018 and 2017, respectively.

**Note 8 - Related Party Transactions**

The 2014A and 2018 Water Supply System Bonds of Karegnondi Water Authority are guaranteed through 2046 by Genesee County and the City of Flint, Michigan in the amounts of approximately 66 percent and 34 percent, respectively, in accordance with the Karegnondi Water Authority Financing Contract. The Genesee County Division of Water and Waste Services provides management of the day-to-day operations of Karegnondi Water Authority, for which it allocates a portion of the costs to the Authority. Water and Waste Services has also issued \$35 million of bonds that it used to construct the water intake and related pumps for KWA. Once the bonds are redeemed, the title to the water intake and related pumps will be transferred to KWA.

January 30, 2019

To the Board of Directors  
Karegnondi Water Authority

We have audited the financial statements of Karegnondi Water Authority (the "Authority" or KWA) as of and for the year ended September 30, 2018 and have issued our report thereon dated January 30, 2019. Professional standards require that we provide you with the following information related to our audit.

### **Our Responsibility Under U.S. Generally Accepted Auditing Standards**

As stated in our engagement letter dated August 28, 2018, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities. Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement.

As part of our audit, we considered the internal control of KWA. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

### **Planned Scope and Timing of the Audit**

We performed the audit according to the planned scope and timing previously communicated to you in our meeting about planning matters on November 29, 2018.

### **Significant Audit Findings**

#### ***Qualitative Aspects of Accounting Practices***

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by Karegnondi Water Authority are described in Note 1 to the financial statements.

No new accounting policies were adopted, and the application of existing policies was not changed during 2018.

We noted no transactions entered into by the Authority during the year for which there is a lack of authoritative guidance or consensus.

We noted no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

There were no significant balances, amounts, or disclosures in the financial statements based on sensitive management estimates.

The disclosures in the financial statements are neutral, consistent, and clear.

#### ***Difficulties Encountered in Performing the Audit***

We encountered no significant difficulties in dealing with management in performing and completing our audit.

#### ***Disagreements with Management***

For the purpose of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report.

We are pleased to report that no such disagreements arose during the course of our audit.

#### ***Corrected and Uncorrected Misstatements***

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management.

We did not detect any misstatements as a result of audit procedures.

#### ***Significant Findings or Issues***

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, business conditions affecting the Authority, and business plans and strategies that may affect the risks of material misstatement, with management each year prior to our retention as the Authority's auditors. However, these discussions occurred in the normal course of our professional relationship, and our responses were not a condition of our retention.

#### ***Management Representations***

We have requested certain representations from management that are included in the management representation letter dated January 30, 2019.



***Management Consultations with Other Independent Accountants***

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. If a consultation involves application of an accounting principle to the Authority’s financial statements or a determination of the type of auditor’s opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

This information is intended solely for the use of the board of directors and management of Karegnondi Water Authority and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

**Plante & Moran, PLLC**

A handwritten signature in black ink, appearing to read "Will Brickey", written in a cursive style.

William Brickey, CPA  
Partner