Budgeting and Finance 101

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Session Objectives

- Learn how to budget for your water operations separately
- Understand your costs and revenues
- Moving from “paycheck to paycheck” to longer term planning

Budgeting 101

- An instrument to implement and manage public policy by obtaining (through rates and fees) and allocating (through the budget process) resources for service delivery

The Role Budgets Play

- Appropriation/Allocation of funds
- Setting rates and revenues
- Public education
- Measuring and promoting financial and operational performance

Budget for water separately

- Government-owned water systems operate as “enterprise funds”—stand-alone business units within the government that are self-sustaining (or at least that is the idea)

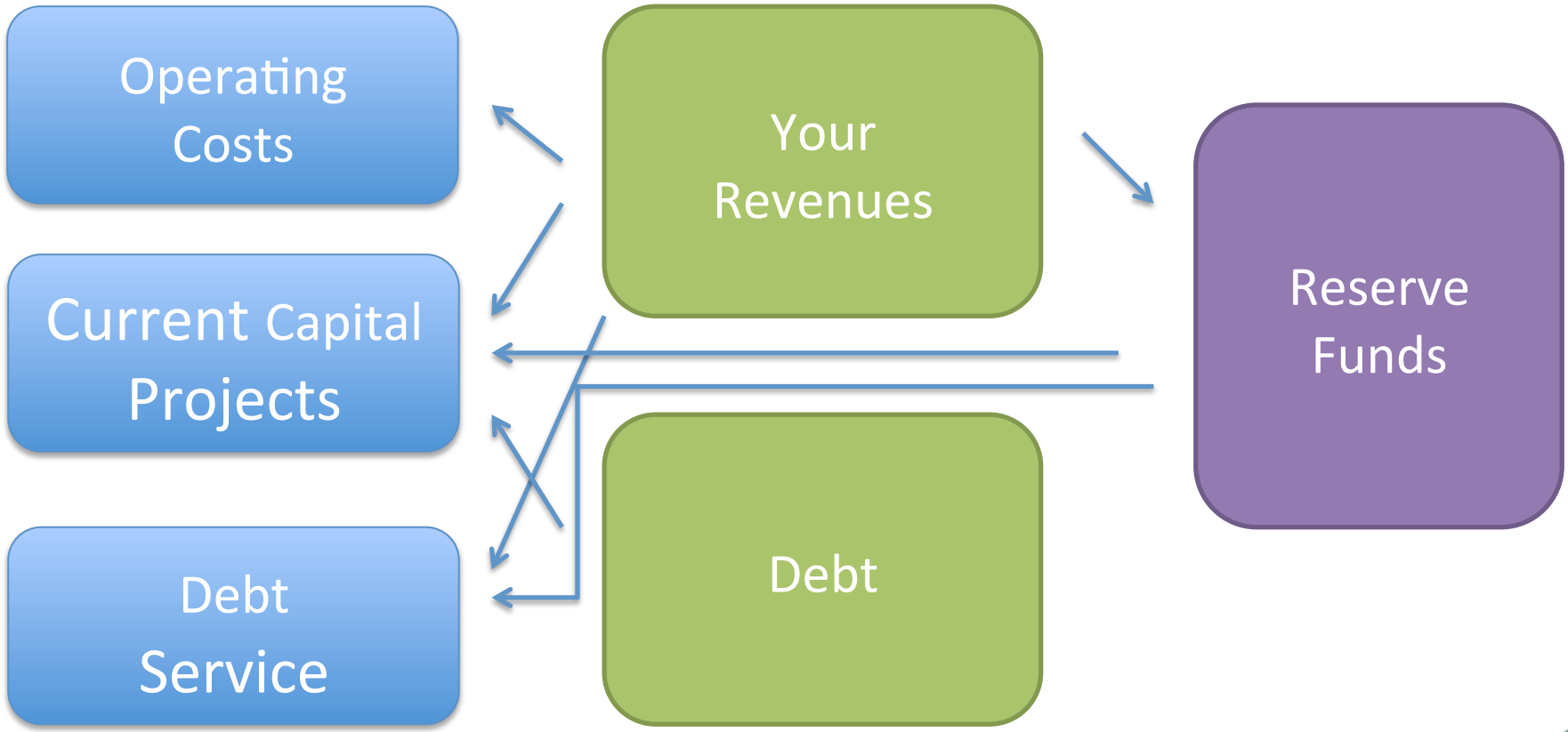
How do you treat your water system as part of your overall enterprise? Separate entity? Core function?

Why This Is Important

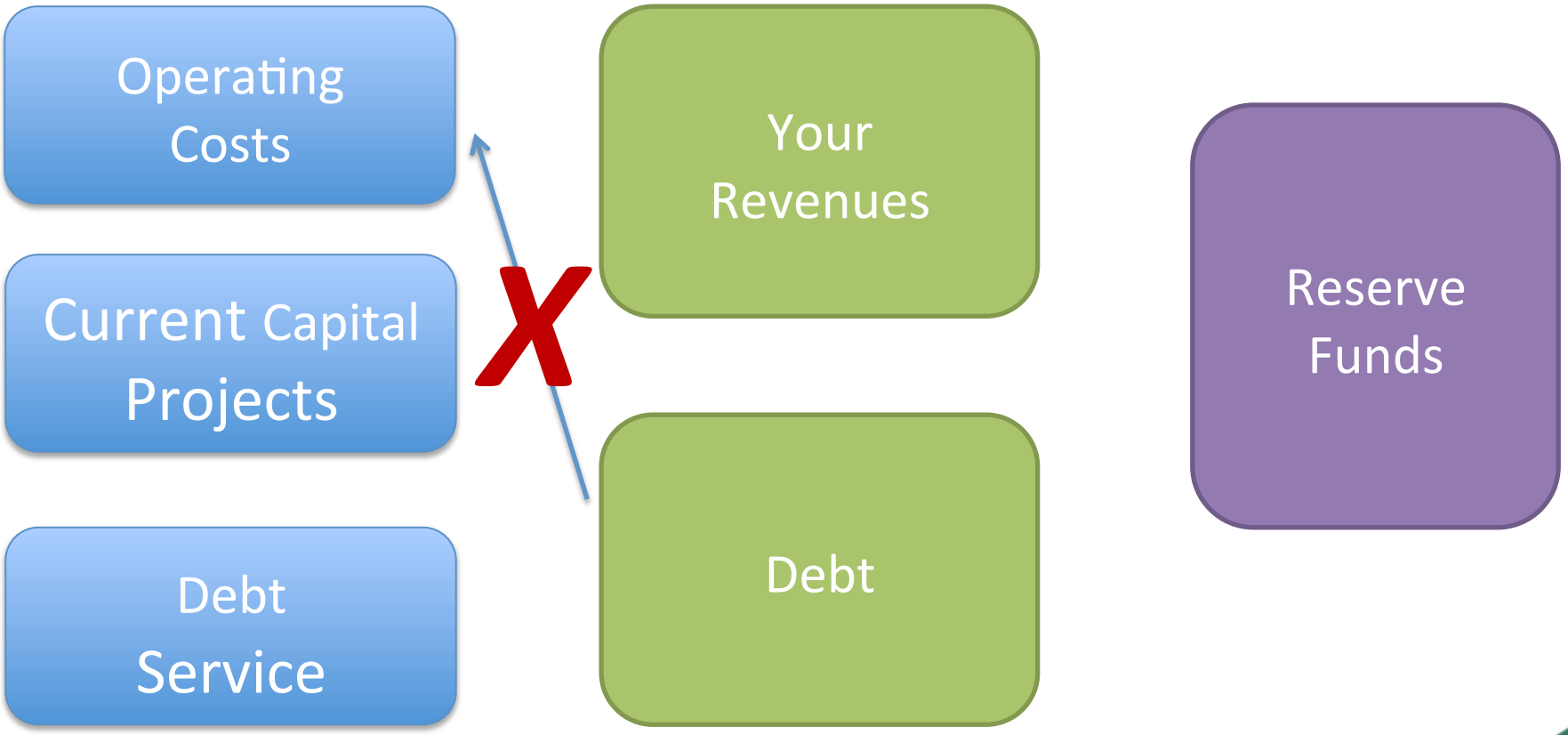
- Funders are used to treating water systems as independent entities. It's easier to understand system needs that way

- A separate budget for your water operations is a way to look at its finances independent of your other operations

Water System Finance Diagram



One More Note...



Understanding Operating Costs

- What you need to run your business day in and day out

- What are your operating cost categories? Let's make a list

Understanding Operating Costs

- Personnel
- Water bulk purchases
- Chemicals
- Office equipment
- Computers
- Supplies
- Etc.

Understanding Capital Costs

- The “big stuff”
- Repair & replacement of existing infrastructure
- New infrastructure as needed to serve your customers

Understanding Capital Costs

- What are your capital cost categories? What pieces of equipment do you want to budget for?

- Let's make a list

Understanding Debt Service

- What you owe on loans and bonds, paid back on a regular schedule

Your Budget's Cost Side

- Needs to include all three categories
- EPA's STEP Guides can be a help

EPA United States Environmental Protection Agency

Setting Small Drinking Water System Rates for a Sustainable Future

One of the Simple Tools for Effective Performance (STEP) Guide Series

Cost Table

Example Annual Costs Worksheet	
Date Worksheet Completed/Updated: 6/19/05	
Personnel Costs	$126,627
Non-Personnel Costs (excluding debt service)	$84,857
Debt Service	$25,570
Total Costs	$235,054

Now on to Revenue

In the Old Days...

- Water systems took advantage of the federal government's ambitious construction grants program of the 1970s and 1980s

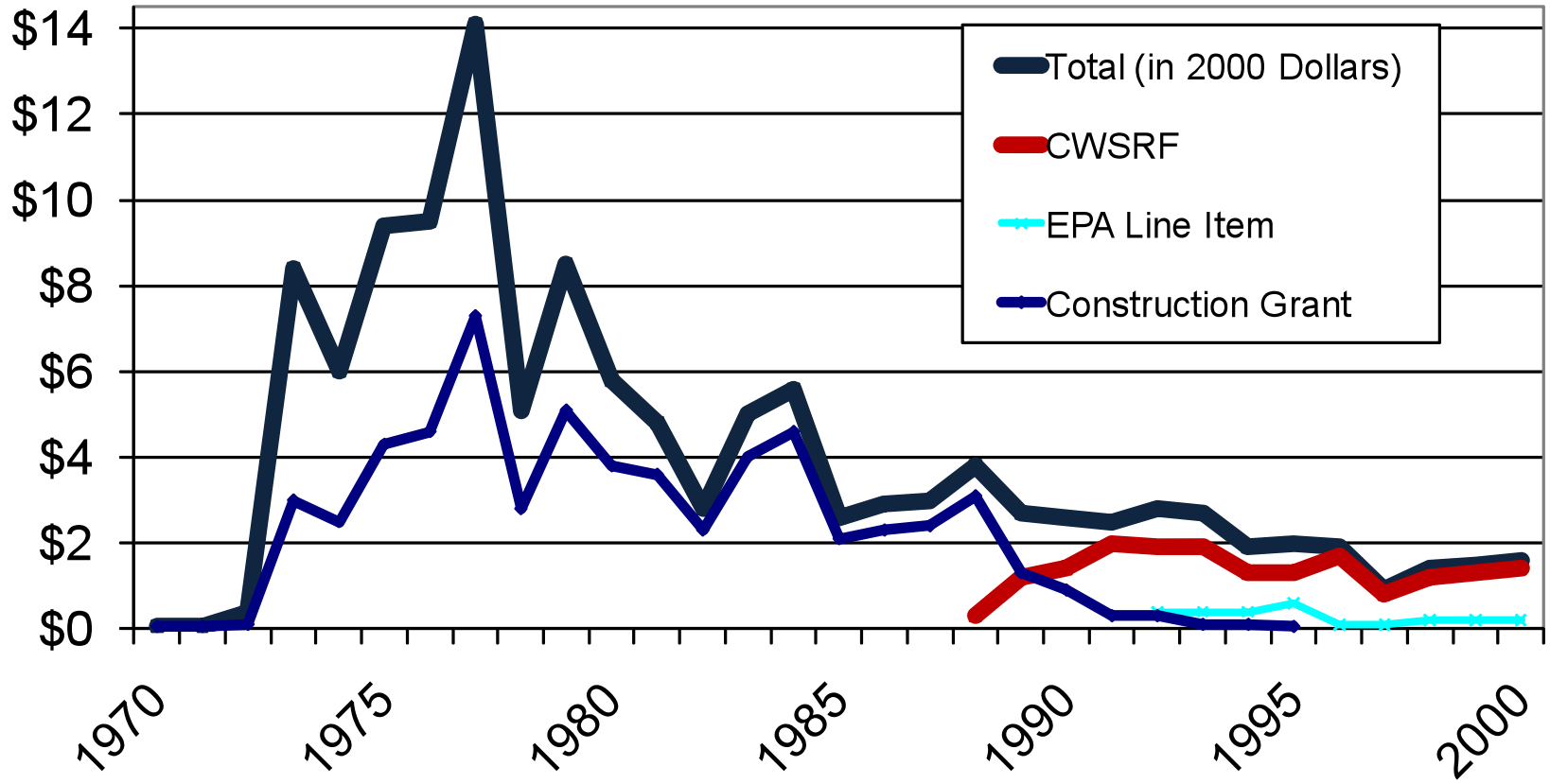
- Everybody loved their "free" money

Capital Finance Today

- The money never really was “free”—it came from tax dollars

- Today, the financial burden has been shifted away from federal and state tax dollars to funds raised by the water system itself. For example...

EPA Wastewater Spending (1970-2000)

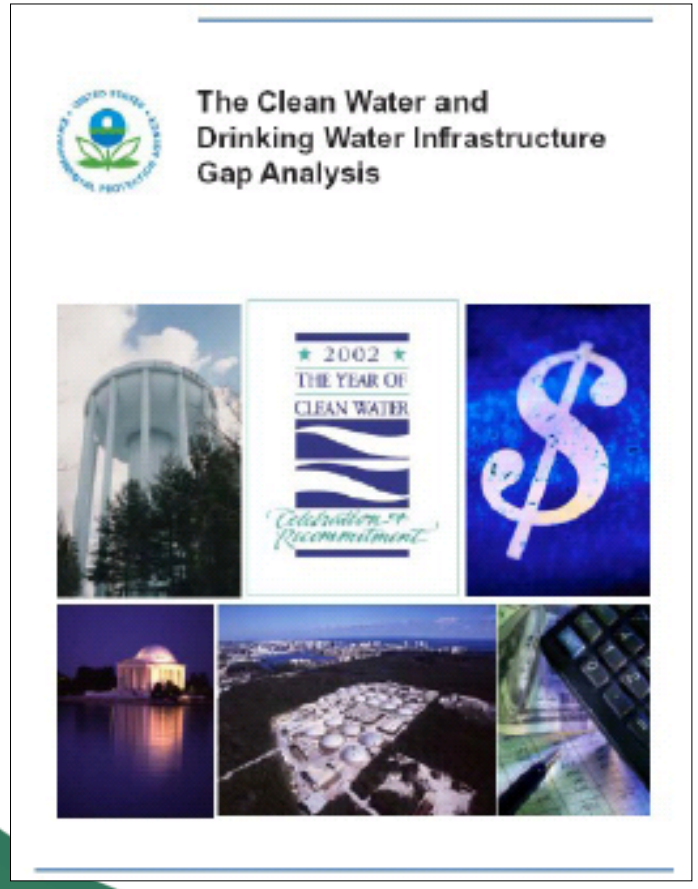


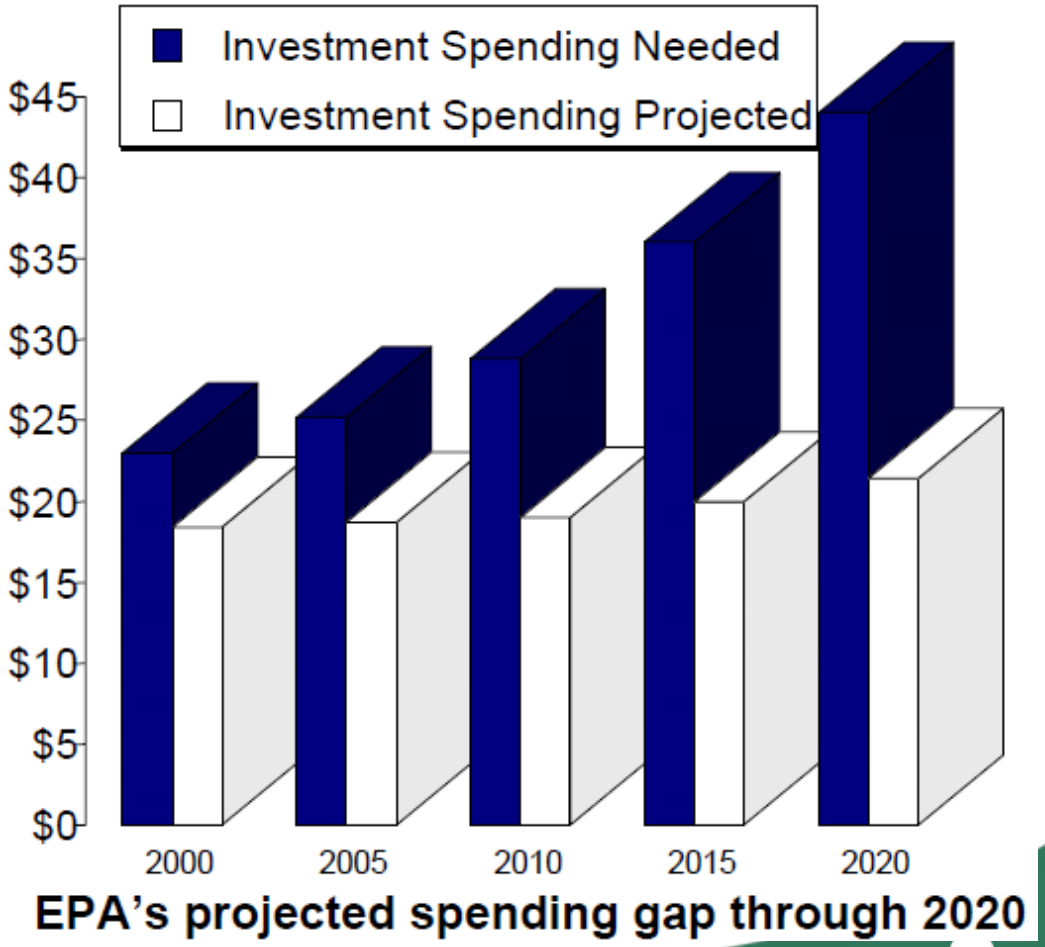
Capital Finance Today

- In other words, you pay (no sense in sugar-coating this)

- The harsh reality is that water and wastewater infrastructure is expensive, regardless of the size of your system. Smaller or poorer systems will likely have a hard time paying for capital improvements

Infrastructure Gap





EPA's projected spending gap through 2020

Source: Steve Allbee, USEPA

Understanding your Revenue

- Simply put, the money you have to cover your costs

- If you were a room of local governments, we'd be talking about rates tied to usage.

Where does your water system revenue come from?

Revenue Table

Example Annual Revenue Worksheet	
Date Worksheet Completed/Updated: 6/19/05	
Operating Revenue and Interest	
Water Sales	$221,465
Fees and Service Charges (Include late fee, connection fee, fire fee, system development fee, etc).	$4,881
Interest	$967
Other	$711
Subtotal Operating Revenue and Interest	$228,024
Additional Revenue (Subsidies)	
Grants	$1,824
Transfer Payments	$4,000
Other	$432
Subtotal Additional Revenue (Subsidies)	$6,256
Total Annual Revenue	$234,280

Balancing the Budget: All Categories

- At the end of the year, you should bring in at least enough revenue to cover all of your costs

- This includes operating costs, capital costs, debt service and maybe...

...This Funny Thing Called Depreciation

- This is an accounting solution to the problem of things getting old

- You have a “cost” every year of your infrastructure wearing out, a percentage of its value

Financial Benchmark: Operating Ratio

- Revenues / Costs
- May or may not include depreciation
- Goal is to be more than 1.0, especially if not including depreciation

Reserve Account

- If revenues exceed costs, the extra money can go into a reserve account specifically for the water system

- If you include depreciation as a cost, this is where that money would go

Budgeting for the Future

- Capital rehab or replacement
- System expansion
- Costs always going up
- Changes to revenue, expected or not
- Think 5-10 years out

Why Do You Need a Reserve Account?

- Future Capital Needs
- Rainy Day Fund—what happens if your revenue is decreased?
- Emergency Fund

How Much Do You Need In Your Reserves?

- It depends

- Enough to pay for your most expensive piece of equipment?
- Enough to cover your costs if you had no revenue for two months?
- Enough to cover the projects in your capital improvement plan?

Financial Benchmark: Days Cash On Hand

- Your cash reserves / operating expenses excluding depreciation

- Ask yourself, if we got no more revenue after today, how long could our system run?

"Full Cost Pricing"

- Operations & maintenance expenditures
- Taxes and accounting costs
- Contingencies for emergencies
- Principal and interest on long-term debt
- Reserves for capital improvement
- Source water protection

Soooooooooooo....

- How do we estimate the future costs and revenues?