Beaufort-Jasper Water & Sewer Authority

General Financial Policies

Adopted: October 27, 2005, Board of Directors
Amended: June 28, 2018, Board of Directors

FINANCIAL MANAGEMENT POLICIES

The Financial Management Policies for Beaufort-Jasper Water & Sewer Authority hereafter referred to as the "Authority," provide the framework and direction for financial reporting, planning, and decision making by the management and the Board of Directors. They are designed to ensure the financial integrity of the Authority and a service delivery system that addresses the needs of the users of financial information. To be relevant in the planning and management of Authority finances, goals and policies should be documented and periodically reviewed to reflect changes in Board policy, legal and professional requirements, and changes in accepted industry practices.

Competent financial management is needed to make effective and efficient use of the Authority's resources and ensure the security of system assets. An important process for assuring that financial management is both consistent and rational is through the documentation and adoption of financial management goals and policies.

General Accounting and Internal Control Policies

In developing and evaluating the Authority's accounting system, consideration is given to the effective implementation of financial accounting policies and, specifically, to the adequacy of internal controls. The Authority's accounting system is designed to assemble, analyze, classify, record, and report financial data on the full accrual basis. Internal accounting controls are an integral part of the Authority's management systems and are designed to provide reasonable assurance that assets are safeguarded from unauthorized use or disposition, and that records used for preparing financial reports and maintaining asset accountability are reliable.

Management is responsible, in all material respects, both for the accuracy of the data and the completeness and fairness of the presentation, including all disclosures. The data is to be reported in a manner designed to fairly present the financial position and changes in the financial position of the Authority. All disclosures necessary to enable the reader to gain an understanding of the Authority's financial and operational activities are to be included.

The Authority's management is further charged with providing the leadership that promotes ethical behavior within the control environment. To aid in carrying out this responsibility, management must strive to maintain a system of internal accounting control, which is established after weighing the cost of such controls against the benefits derived. Due to the inherent limitations of the effectiveness of any system of internal accounting control, management cannot provide absolute assurance that the objectives of internal accounting control will be met. However, as a part of the Authority's ongoing effort to employ comprehensive and cost-effective internal accounting controls, the Controller will review controls and procedures on a continuing basis. The Controller is accountable to the Deputy General Manager, Finance and Administration, and to the General Manager as applicable. (Any intentional violations of internal control that are noted by any manager that either involves a Deputy General Manager or the General Manager are to be reported to the Treasurer of the Board of Directors.)

All activities of the Authority are accounted for within a single proprietary (enterprise) fund. Proprietary funds are used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. Accordingly, the Authority's financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (GAAP).

The Authority utilizes the enterprise fund method of accounting whereby revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. The Authority applies the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 62, "Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements", which incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the Financial Accounting Standards Board ("FASB") Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the American Institute of Certified Public Accountants' ("AICPA") Committee on Accounting Procedures; the provisions of GASB Statement No. 62 additionally eliminates the election provided in Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting" to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements.

The accounting and financial reporting treatment applied to the Authority is determined by its measurement focus. The transactions of the Authority are accounted for on a flow of economic resources measurement focus. Therefore, all assets and all liabilities associated with the operations are included on the statement of net position.

Annual Audit: The Finance Committee of the Authority Board of Directors serves as the Audit Committee of the Authority. It is composed of four members of the Board who are not employees and who provide a broad overview of management's financial reporting and control functions. Generally, this Committee meets with management on a monthly basis to review the financial status of the Authority. Additionally, the Committee meets with management and the independent external auditors to ensure that both parties are fulfilling their obligations with regard to auditing, controls, and other financial reporting factors.

Single Audit: As a recipient of federal and state assistance, the Authority is also responsible for ensuring that an adequate internal control structure is in place to secure compliance with applicable laws and regulations related to those programs. This internal control structure is subject to periodic evaluation by management.

Cash and Investment Management Policies

(See Cash and Investment Management Policy, issued as a separate policy due to its comprehensive nature.)

Revenue Policies

All water and wastewater revenues are recognized on the accrual basis when the related services are provided and the earning process is complete. Services are provided to customers under a rate structure designed to produce revenue sufficient for operating and maintenance costs, capital outlay, debt service, reserves and debt service coverage. Operating revenues are those that result from providing water and wastewater services and non-operating revenues include other activities, such as investing, not related to the provision of water and wastewater services.

In order to provide adequate service to its customers, the Authority must receive sufficient total revenue to cover operation and maintenance expenses, planned cash capital outlays, debt payments, and required cash reserves. While the Authority prepares long-range rate projections based upon revenue sufficiency, these projections are reviewed annually through the budgetary and rate-making process of the Authority.

Management recommends rates based upon a cost of service analysis, which incorporates the principle of revenue sufficiency and equity among customer classes. Rate recommendations and the supporting budgets are presented through the Finance Committee to the Board for approval annually. An analysis is presented with the budget and rate recommendation to ensure that utility revenues are sufficient to recover total cash needs for a three-year projection period.

The general revenue policies, which guide the Authority, are outlined as follows:

- Sufficient total revenue to cover operation and maintenance expenses, planned cash capital outlays, debt payments, and required cash reserves;
- Rates based upon a cost of service analysis, which incorporates the principle of revenue sufficiency and equity among customer classes;
- Effective collections to assure that obligations to the Authority are paid in a timely and appropriate manner to maximize resources and efficiency; and
- Conservative revenue and customer growth projections for consistent budgeting and adequate cash planning.

Capital Contribution Fees: Capital contribution fees (also referred to as capacity or impact fees) are assessed to pay the cost of growth to the extent possible. The Authority collects water and wastewater capacity fees to ensure that current customers do not bear the entire burden of growth. These fees are paid by all new customers and represent, on a residential equivalent unit basis, the cost of the water and/or wastewater capacity represented by the new account. Because the Authority does not use capacity fees to subsidize operations these contributions do not impact operating income. The Authority restricts the use of capacity fee revenue to capital investment in its system and these contributions are reported in the Statement of Cash Flows as a capital financing source. Capacity fees are based upon a cost of capacity analysis and are generally reviewed every year, but are increased only when deemed economically feasible for the Authority.

Operating Budget Policies

The Authority has no taxing power. Operational and maintenance costs are funded from customer fees and charges. The Authority plans, budgets, and manages to assure that current costs are funded through current revenues.

The Authority uses a one-year operating budget process with an additional three-year cash and coverage projection included to encourage a longer term planning and management perspective. An analysis is presented with the budget and rate recommendation to ensure that utility revenues are sufficient to recover total cash needs for a three-year projection period. Total cash needs include annual expenditures to operate the system, capital-related costs of principal and interest payments on debt, contributions to specific reserves, and capital replacements and improvements that are not debt-financed.

Budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America (GAAP). The current operating budget details the Authority's plans to earn and expend funds for charges incurred for operation, maintenance, certain interest and general functions, and other charges for the fiscal year. The Authority adopts flexible annual operating and capital budgets. During the year, management is authorized to transfer budgeted amounts between line items within the Authority's divisions. Depreciation expense is budgeted based upon the remaining lives of existing assets and estimates of new assets, including contributed capital. The capital budget or Capital Improvement Program (CIP) details the plan to receive and expend cash capital contribution fees, special assessments, grants, borrowings and certain revenues for capital projects. The CIP budget is discussed in more detail in the section entitled "Capital Budgeting Policy."

The Finance Department is responsible for analyzing financial data to present a recommended budget based on the following: 1) historical analysis of actual costs compared to budget; 2) cost increases, including inflation; 3) coordination with the recommended Cost of Service rates; 4) new programs or areas of emphasis previously identified, and 5) customer growth. This process is generally completed and distributed by functional area to managers for review by the end of January. Any material increases requested from management must be clearly documented and tied to performance within the budget documentation. Manager reviews generally occur during February and are required to be submitted to Finance before March. Finance compiles the functional budgets, incorporates the annual calculation of the cost of service rates, completes a revenue and cash sufficiency analysis, and submits to Senior Staff for final review.

The operating budget is completed and compiled in April and a summary is presented to the Finance Committee in May with a public hearing in June. At the same time, the cost of human resources is submitted to the Personnel Committee and capital outlay (vehicles, equipment, etc.) is submitted to the Capital Projects Committee for review. The complete proposed budget is submitted to the Authority's Board of Directors in May following Finance Committee review. The operating budget and proposed rates are adopted by resolution of the Board before the beginning of each fiscal year (July 1) and after a public notice and hearing as prescribed by state law.

All unexpended and unencumbered appropriations in the operating budget lapse at the end of the fiscal year. No appropriation for a capital project in the capital budget lapses until the purpose for which the appropriation was made has been accomplished or abandoned.

Preparation of the operating budget is guided by the following policies:

- Revenue projections are to be conservative but sufficient to cover operation and maintenance expenses, planned cash capital outlays, debt payments, and required cash reserves.
- Ongoing expenses are not to be funded by a non-recurring or one-time revenue source, such as debt.
- Self-sufficiency is the overall objective of the operating budget and expenditures must be funded either exclusively or primarily by user fee revenues.
- Management must focus on a performance budget, identifying and clarifying choices related to the provision of on-going or additional services.
- In planning expenditures, management will maintain its facilities and continuously seek ways to operate more efficiently.
- Human resource cost proposals are developed to assure that the compensation program reflects the goal of recruiting and retaining qualified and excellent employees within the constraints of financial resources.
- Adequate operating cash balances are to be maintained, generally equated to four months cash outlay.

Budgetary Controls: The Authority maintains budgetary controls to ensure compliance with legal and Board provisions. Current expenses are controlled at both the functional and operating division levels by continuously monitoring costs compared to budget and by reporting variances and other significant financial data monthly to the Finance Committee. Managers are responsible for budgetary items that are controllable at their organizational levels. Since all expenses are controllable at some level, this dual-monitoring of expenses by both management and the Finance Committee of the Board serves to strengthen overall budgetary and management controls. The following policies are adopted as regards budgetary controls:

- The Authority will maintain a budgeting control system that ensures continual compliance with the adopted budget and that reports any material variances to the Finance Committee and the Board within a timely manner.
- Management will notify the Finance Committee and the Board of Directors of any unbudgeted expenditure that exceeds $100,000 before it is incurred.
- The Finance Committee and the Board of Directors will be provided with interim financial reports comparing actual versus budgeted revenue and expense activity.

<u>Capital Expenditures Policy</u>

The objective of the Authority's capital expenditure accounting policy is to establish a set of standard procedures and policies regarding the inventory and management of property in the capital asset system. Investments in long-term assets (plant, property, and equipment) have a major impact on a company's future stream of earnings and the risk of those earnings. As such, the long-term investment (capital budgeting) decision has a significant impact on the value of the company.

Capital budgeting is the process of planning for purchases of assets whose returns are expected to continue beyond one (1) year (the 1-year period is arbitrary, but serves as a useful guideline). A ***capital expenditure*** is a *material cash outlay* that is expected to *generate a flow of future cash benefits lasting longer than one year*. For purposes of materiality, the Authority has defined this to be a **minimum of $5,000** for equipment purchases (i.e., the equipment itself must cost at least $5,000 without installation and other incidental costs to be considered a capital item). Additionally, for purposes of materiality for BJWSA, the future cash benefits must last a minimum of **three years** in order to be considered a capital asset. Therefore, if an asset acquisition is less than $5,000 for the major component and/or it cannot be assured that the asset will provide an economic benefit for a minimum of three years; the item will be considered a period expense instead of a capital expenditure. Once purchased (or contributed), all capital items are to be maintained, and depreciated if applicable, on the Capital Assets Register until disposed.

Several different types of outlays **may** be classified as capital, including the following:

- The purchase of a new piece of equipment, real estate, or a building in order to expand existing services.
- The replacement of an existing capital asset which has been fully depreciated or has become obsolete. (In this case it is important to review what asset is being replaced to determine whether the replacement is just bringing the value of the asset up to what it should be or whether economic value to future periods has been added.)
- Expenditures for research and development (studies) when the cost can be directly associated with a *verifiable fixed asset* and the *costs are required to create/acquire such asset*.
- Merger and acquisition evaluation when the merger or acquisition actually occurs.

Summary of Significant Accounting Policies Regarding Capital Assets: Property, plant, and equipment in service and construction in progress are recorded at cost, if purchased or constructed. Maintenance and repairs that do not significantly extend the value or life of property, plant and equipment are expensed as incurred.

Assets acquired through contributions from developers or other customers are capitalized at their acquisition value, or at engineers' estimated value or cost to construct at the date of the contribution. Utility systems acquired from other governmental service providers are recorded at the lower of the prior service provider's net book value or fair value, with the cost of and accumulated depreciation recorded. Internal engineering costs are capitalized to the extent of direct support and contribution to construction and expansion projects. Costs of studies that directly result in specific construction projects are capitalized. Contributions are recognized in the Statement of Revenues, Expenses and Changes in Net

Position when earned. Contributions include capacity fees, developer contributed utility systems, capital grants, and other supplemental support by other utilities and industrial customers and federal, state and local grants in support of system improvements.

Interest cost is capitalized on the construction of qualified assets, whether or not borrowings exist for such projects, to the extent of amounts funded by debt or operating results. Interest is not capitalized on project costs funded by contributed capital, such as grants, gifts and impact fees. Interest costs of tax-exempt borrowings are capitalized net of related investment earnings on the proceeds. Interest costs are not capitalized for small projects that will be constructed in less than six months or for those where the amounts are considered immaterial for purposes of interest capitalization. The Authority utilizes the straight-line depreciation method and estimated useful lives of assets in service are as follows:

	Years
Source of supply equipment	15-50
Water treatment plant	10-50
Wastewater treatment plant	10-50
Transmission and distribution systems	10-50
Structures and improvements, including buildings	10-50
Office furniture, equipment and vehicles	3-20
Equipment	3-20
Meters	8

NOTE:
Any change to the existing significant accounting policies must be in accordance with GAAP and must be disclosed in the notes to the financial statements. Additional accounting pronouncements may require additional disclosure (i.e., a change in accounting estimate).

Expenditures related to the Capital Improvement Program (CIP) are reconciled monthly and capitalized when put into service. Capital expenditures and accumulated depreciation are reconciled on a monthly basis and agreed to the capital assets register, where applicable.

At year-end, the Finance department reconciles all general ledger fixed asset accounts to the capital asset system and supplies detailed supporting evidence to the external auditors.

Capital Budgeting Policy

All capital acquisitions must be budgeted through the Capital Improvement Program (CIP) or as part of the Operations & Maintenance (O&M) annual budget. For operational equipment purchases, managers, as part of the operating budget, are tasked with:

- Evaluating all existing equipment and other operating capital items to determine if useful life has been exceeded, or will be exceeded in the upcoming year,
- Determining if equipment needs to be replaced or purchased to meet *new* service requirements, and
- Estimating the total cost to replace or purchase equipment within the budget period.

These operational equipment purchases are funded by gross revenue and included in the Operating Budget.

The CIP is funded by the capital funds generated from capacity fees, transfers from Gross Revenue into the Contingency & Depreciation Fund, the issuance of debt, the receipt of grants and the Military repayment of the Initial System Modifications. The Authority produces a 10-year capital improvement forecast and adopts a three-year capital improvement funding plan that is incorporated into, but produced separately, from the Operating Budget. The CIP is reviewed and updated annually, generally in the summer of each calendar year. By setting CIP priorities early in the fiscal year, the full impact of the financial plan can be incorporated into the upcoming operating budget.

Debt Management Policy

The Authority will manage debt in accordance with all applicable law and adopted debt management policy. In the Bond Resolutions, the Authority covenants and agrees that it will, at all times, prescribe, maintain, and thereafter collect rates and charges for the services and facilities furnished by the Authority, together with other income, that will yield annual Net Earnings in the fiscal year equal to at least one hundred ten percent (110%) of the sum of the annual debt service payments for all bonds outstanding. "Net Earnings" is defined by the bond resolution to mean, for the period in question, the net operating income of the System determined in accordance with generally accepted accounting principles, adding back depreciation, and including interest income not restricted to bond construction and cash capital contributions not received by government grants.

The rate covenant in the Bond Resolution obligates the Authority to review rates not less than once a year and to revise such rates and charges as necessary to meet the coverage test. The Authority further covenants in the Bond Resolution that it will maintain rates and charges that are at all times sufficient to provide for the payment of the bonds; to maintain the debt service funds, debt service reserve funds, and any other related funding instruments related to the debt of the system; to provide for the payment of administrative and operational expenses of the system preserving the system in good repair and working order; and to build and maintain a reserve for depreciation of the system.

Although the Bond Resolutions allow the use of capacity fee revenue (i.e., cash capital contributions) in the calculation of debt service coverage, the Authority has adopted a more stringent internal policy of maintaining one hundred and twenty-five percent (125%) debt service coverage without consideration of capacity fee revenue.

The following are the general policies related to debt:

- Long-term borrowing is restricted to capital improvements too extensive to be financed from current revenues.
- The Authority utilizes capacity fees, to the extent available, for all system growth projects before utilizing debt.
- Proceeds from long term debt will not be used for current, ongoing operations.
- Debt will be retired within a period not to exceed the expected useful life of the

capital project.
- The use of any revenue anticipation borrowing will be avoided. However, if imperative, the Authority will attempt to retire/refinance the debt within the same fiscal year as it is incurred.
- Good communication with bond rating agencies and the State Revolving Fund officers will be maintained and full disclosure included in every audited financial report.
- The Authority shall review its outstanding debt annually for the purpose of determining if the financial marketplace will afford the Authority the opportunity to refund an issue and lessen its debt service costs.

Finance will monitor debt on a monthly basis by reviewing new debt, ratios (such as debt to equity), and debt service coverage. Further, any projections made for the capital improvement program or the operating budget must include considerations of new borrowings and debt service coverage (as well as the rate impact to customers) to ensure adequate revenue and cash sufficiency to maintain the Authority's level of credit.

The debt policy and the CIP must be coordinated to assure that debt is used for priorities and that projects are considered both on (1) their merit as important infrastructure and (2) on their credit worthiness. The Deputy General Manager, Finance & Administration, is responsible for ensuring that the CIP is considered as a key component of debt analysis.

Financial Risk Management Policy

The term *risk* refers to a possible loss or other adverse event that has the potential to interfere with the Authority's financial stability or the ability to fulfill its mission in providing services. Because risk is inherent in most productive activities, even the most conscientious efforts cannot eliminate all risk; they can, however, help the Authority avoid or reduce the impact of risk on operations. As noted in the "Cash and Investment Management Policy," all aspects of cash management operations shall be designed to ensure the absolute safety and integrity of the Authority's financial assets. The overall financial objective is to provide the highest possible income support to the Authority with a very low risk of loss of principal.

The Authority employs a broad-based process to identify risks and to develop the action plans that are required to address them. In addition to maintaining sufficient resources to address financial risk through the Contingency and Depreciation Fund, the Authority insures against damage to property and equipment as well as liability for general claims, and participates with the State Accident Fund in providing workers' compensation coverage to limit exposure to risk. Consultants or independent carriers generally provide rates based upon actuarial studies of risk and the Authority performs a 'cost versus benefit' analysis to determine appropriate coverage.