

## 5.0 FINANCES

The following sections describe the results of the Financial Report completed by MF Whipple and Associates (MF Whipple) (See **Appendix B** for a copy of the complete report). MF Whipple was asked to assist with an analysis of the issues and options involved in creating a new district with respect to finances. MF Whipple is known for a qualified team of professionals with extensive experience providing financial and feasibility analysis for a wide range of public agencies. They have prepared numerous water rate studies as the lead rate consultant and have also been and are currently engaged by various registered national engineering firms to prepare the water and sewer financial plan components of Water and Sewer Master Plans of water purveyors.

MF Whipple's report is divided into 7 main subject areas: (1) Background, (2) Financial Practices, Policies and Transparency, (3) Financial Information, (4) Key Financial Considerations, (5) Key Financial Principles, (6) Financial Benefits, and (7) Conclusion. The financial structure of the new water district is being considered through the development of principles, these same principles would provide the basis for others joining and producing additional benefits. When considering the creation of a new water district certain challenges and opportunities present themselves as they relate to finances:

**Challenge:** *Ensure that ratepayers from one entity are not unfairly burdened with obligations of the others.*

**Opportunity:** *Create a financial structure that accounts for existing debts, liabilities and assets and provides for a fully transparent and accountable system which shares gained efficiencies.*

**Summary:** An enterprise financial accounting system would provide the ability to address the separation of existing debts, liabilities and assets. Further, an enterprise system would create an accounting system capable to accrue the economy of scale benefits equally. Creation of a new water district also provides the opportunity to incorporate changes to policy which could further improve financial transparency.

### 5.1 Financial Practices, Policies and Transparency

Both NCWD and CLWA desired to conduct a full analysis of the current financial condition and the potential financial impacts that would inform the public and policy leaders as part of considering the formation of a new water district. This was also a reoccurring theme that was expressed by members of the community during the public engagement process.

The MF Whipple Report evaluated both NCWD and CLWA finances based on best practices as recommended by professional associations such as the Government Finance Officers Association (GFOA), California Special Districts Association (CSDA), Government Accounting Standards Board (GASB) and the California Society of Municipal Finance Officers (CSMFO).

### Transparency Information

The MF Whipple Report found that CLWA, SCWD and NCWD are committed to demonstrating accountability and transparency by making financial and other information readily accessible to citizens and stakeholders. The Government Financial Officers Association has long encouraged governments to provide this information on government websites. **Table 5-1** below includes key information provided on the three organizations' websites.

Table 5-1 Transparency Information Available Online			
	CLWA	SCWD	NCWD
Adopted Annual Budget	✓	✓	✓
CAFR	✓	✓	✓
Water Rate Studies	✓	✓	✓
Strategic Plan	✓	✓	✓
Financial Policies	✓	✓	✓
Urban Water Management Plan	✓	✓	✓
Water Quality Reports	✓	✓	✓
Newsletters	✓	✓	✓
Board and Committee Agendas and Minutes	✓	✓	✓
Multi-year Financial Forecasts	✓	✓	✓
Open Gov On-Line Transparency Platform	✓		
CSDA Transparency Certificate	✓	✓	

### Budget Process

Best practices for local government budgeting include a defined budget process, public availability of budget information and an established board and committee process to review and adopt a budget. CLWA, SCWD and NCWD each have a defined budget process and each publishes a comprehensive budget book which includes the adopted budget, but also information on the organization, its current situation, policies, budgetary trends, performance metrics, financial metrics and other such information. All three organizations apply for and receive budget awards for excellence in budgeting. **Table 5-2** below provides a list of key components of best budgeting practices.

Table 5-2 Best Practices in Budgeting			
	CLWA	SCWD	NCWD
Based on a Strategic Plan	✓	✓	✓
Proposed Preliminary Budget on Website	✓	✓	✓
Budget Committee Review at Public Meeting*	✓	✓	✓
Revised Budget Based on Committee/Board Review	✓	✓	✓
Proposed Final Budget on Website	✓	✓	✓
Board Review of Budget and Public Meeting	✓	✓	✓
Comprehensive Adopted Budget Book Prepared	✓	✓	✓
Budget Includes Performance Metrics	✓	✓	✓
Budget Includes Financial Metrics	✓	✓	✓
Budget Promotes Accountability	✓	✓	✓
GFOA Distinguished Budget Awards Received	10	5	8
CSMFO Operating Budget Excellence Awards Received	9	5	Did Not Apply

Note: \*CLWA Finance and Administration Committee; SCWD Retail Operations Committee; NCWD Finance Committee.

### Audit Process

GFOA recommends a rigorous audit process where independent auditors report to the governing body and not to management staff. Further, GFOA has long been at the forefront of efforts to promote the highest standards of accounting, auditing, and financial reporting as represented by Generally Accepted Accounting Principles (GAAP), Generally Accepted Auditing Standards (GAAS), and Government Auditing Standards (GAS). GFOA also believes that state and local governments should not be satisfied with issuing only the basic financial statements required by GAAP, but should instead publish a comprehensive annual financial report (CAFR). CLWA, SCWD and NCWD all follow these best practices. **Table 5-3** below includes key information provided on the three organizations' auditing and financial reporting.

Table 5-3 Financial Reporting			
	CLWA	SCWD	NCWD
Independent Audit Firm Reports to Governing Body*	✓	✓	✓
Publishes CAFR	✓	✓	✓
Unqualified or Clean Management Letter	✓	✓	✓
Comments or Recommendations	none	none	none
GFOA Certificate of Achievement for Excellence in Financial Reporting	11	11	6

Note: \*CLWA and SCWD report to an Ad Hoc Audit Committee and then to the Board of Directors. NCWD reports to the Board of Directors.

**Compliance with Governmental Accounting Standards Board (GASB) Statements**

The GASB is the independent organization that establishes and improves standards of accounting and financial reporting for U.S. state and local governments. GASB is recognized as the official source of Generally Accepted Accounting Principles (GAAP) for state and local governments. GASB issues standards for financial reporting to help government officials demonstrate to their constituents their accountability and stewardship over public resources and requires this information be used in audits and financial reports. GASB statements are quite rigorous and can be difficult to implement. CLWA, SCWD and NCWD have excellent track records in implementing GASB statements in a timely manner. **Table 5-4** includes recent GASB statements for the three organizations’.

Table 5-4 Governmental Accounting Standards Board (GASB) Compliance			
GASB Statement	CLWA	SCWD	NCWD
54 – Fund Balance Reporting and Governmental Fund Type Definitions	✓	✓	✓
59 – Financial Instruments Omnibus	✓	✓	✓
61 – The Financial Reporting Entity: Omnibus	✓	✓	✓
63 – Financial Reporting of Deferred outflows of Resources, Deferred Inflows of Resources and Net Position	✓	✓	✓
64 – Derivative Instruments	✓	✓	✓
65 – Assets and Liabilities	✓	✓	✓
68 – Accounting and Financial Reporting for Pensions	✓	✓	✓

71 – Pension Transition for Contributions Made Subsequent to GASB 68	✓	✓	✓
69 – Government Combinations and Disposals of Government operations	✓	✓	✓
72 – Fair Value Measurement	✓	✓	✓

## 5.2 Financial Information

The MF Whipple Report concludes that the financial information evaluated for CLWA, SCWD and NCWD confirms prudent fiscal management as shown by key financial metrics. Furthermore, the report finds each agency is proactive in the implementation of capital improvement programs ensuring the reliability of their water systems. See **Appendix B** for the full financial analysis.

## 5.3 Key Financial Considerations and Principles

With the potential creation of a new public water district through the integration of NCWD and CLWA, many stakeholders have focused on the fiscal fairness of combining the two entities. This has consistently been identified as one of the most important issues identified during the public engagement process. The following list of principles was developed to help guide the financial policies of the new water district:

- Ensure the cost of one entity does not become the cost of the other
- Ensure assets and liabilities of each entity remain their assets and liabilities
- Ensure the rates are set to reflect each entity's cost of service
- Ensure fiscal equity is achieved

The current status of NCWD, SCWD and CLWA is that all existing assets, liabilities, revenues, and expenses are recorded within the accounting records of each entity. NCWD, SCWD and CLWA have separate service areas with separate rates and charges. In considering the creation of a new water district, a determination needs to be made as to what the appropriate accounting methodology to use would be. The MF Whipple Report finds the approach that best suits the needs of the new district given both the stakeholder concerns and the integration goals would be to utilize an enterprise accounting technique.

### Enterprise Accounting

Enterprise accounting is an accounting method that keeps discrete records for two or more enterprises of the same district, but has the flexibility to be tailored to meet the uniqueness of a given situation. In fact, the nature of the operations for many public utilities requires a detailed accounting system that separates revenues, expenses, and assets and liabilities for different segments of its business. This is also true for NCWD, SCWD and CLWA today as they already have separate accounting records.

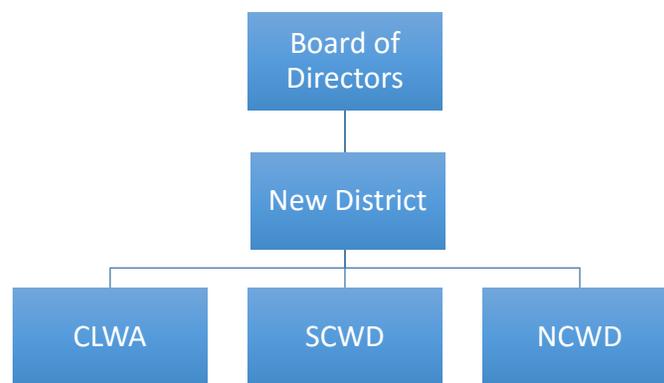
Enterprise accounting would allow for separate and distinct accounting records to be kept for NCWD, SCWD and CLWA. This means that the combining assets, liabilities, revenues, and expenses of each would remain their financial components of the newly

formed district. In other words, each enterprise would maintain an accounting system that, at the point of formation, gives credit for the assets and liabilities of each entity that existed pre-formation. While enterprise accounting records would exist, the new entity would also be able to consolidate the financial position of each enterprise and generate a consolidated financial report as well.

Since each enterprise would have its own accounting records, the ability to establish accurate budgets and rates and charges based solely on the cost to provide service within each enterprise's service area would also be achieved. Enterprise accounting provides a framework that addresses the stakeholder concerns related to fairness and equity and that obligations of one enterprise should not become the responsibility of the other. It also provides for sharing resources. For example, a newly acquired asset purchased or constructed after formation of the new district would be credited only to the benefitting enterprise. However, if a newly acquired asset were to benefit both enterprises, such as, a pipeline moving water through both service areas, the asset cost could be divided between enterprises based on the benefit each receives. These are important concepts as one of the areas of future cost-saving resulting from the new district would be from the duplicate functions now performed by NCWD, SCWD and CLWA.

It is proposed the new district have a wholesale unit and two retail water enterprises (see **Figure 5-1** below). This structure allows for the separation of costs that provide the justification for specific water rates and charges. The new district should prepare its financial reporting as an entity with CLWA as a wholesaler using governmental fund accounting and SCWD and NCWD each as business-type activities, operating as retail water enterprises.

**Figure 5-1** Proposed Financial Reporting Structure



The MF Whipple Report concludes that this segregated accounting structure reinforces financial accountability and enhances financial transparency. Although the management of operations will be combined, the financial performance of each enterprise can be measured directly and each enterprise will be accountable for their own activities under the proposed financial accounting and reporting structure. The enterprise method also provides the ability for the new water district to consider combining the enterprises in the

future, as existing liabilities are retired and the enterprises transition to a more fully integrated organization over time.

## 5.4 Financial Benefits Analysis of New District

MF Whipple prepared a financial summary showing the estimated savings resulting from the formation of the new water district. Information to prepare the financial benefits analysis were provided by CLWA, SCWD and NCWD. **Table 5-6** below compiles the projected savings and costs resulting from the formation of the new water district as presented in the MF Whipple Report. The amount of savings is projected to increase in each of the three years as additional efficiencies are realized and formation activities are completed. Ultimately, shared expenses will need to be reasonably allocated to the enterprises utilizing an appropriate nexus between benefits and costs. Appropriate allocation methods may include: service connections, water production volume, facility capacity, direct labor or other apportionment that bears a relationship to costs and benefits derived.

<b>Table 5-6</b>				
<b>Three Year Estimated New Water District Organizational Savings*</b>				
	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Total</b>
<b>Board</b>	-	(70,000)	(70,000)	(140,000)
<b>Staffing</b>	(125,000)	(588,000)	(1,299,000)	(2,012,000)
<b>Outside Services</b>	(600,000)	(250,000)	(250,000)	(1,100,000)
<b>Formation Cost</b>	250,000	250,000	-	500,000
<b>Total Savings</b>	<b>(475,000)</b>	<b>(658,000)</b>	<b>(1,619,000)</b>	<b>(2,752,000)</b>

Note: \*Provided by NCWD and CLWA.

CLWA and NCWD management estimated that a reduction in staff of up to 11.9 full time equivalent positions could be accomplished (through normal attrition) over a three-year period while maintaining the existing level of service. When combined with a reduction in the number of board members and outside services contracts, savings resulting from the proposed combination of operations could total \$2,752,000 over a three-year period, with ongoing annual savings of up to \$1,619,000 for the new water district. It has been MF Whipple’s experience working on similar projects that such savings are reasonable and can be achieved.

## **5.5 Conclusions and Recommendations**

MF Whipple concludes that CLWA, SCWD and NCWD all follow best practices in transparency, financial practices, financial policy setting and financial reporting and a new water district should continue these best practices. Key challenges identified, such as cross subsidies of expenses and debt among retail water enterprises, will be mitigated through enterprise fund accounting in which expenses and debt are recorded separately.

The financial conditions of all three organizations show prudent fiscal management as shown in key financial metrics. In addition, each organization is proactive in the implementation of capital improvement programs to ensure the reliability of their water systems. The formation of a new water district from the combination of CLWA and NCWD would achieve operational efficiencies and economies of scale resulting in reduced overall cost to provide service to water customers.