



TO: Honorable Mayor and Members of the City Council
Alex Meyerhoff, Interim City Manager

FROM: Steve Groom, Director of Finance and Budget
James Dean, Utility Services Division Manager

DATE: May 13, 2020

RE: Utility Fund Reserves and Utility Billing

To contribute to the question being asked by council whether fund balances can be used to pay a month's bill for utility customers, this will provide the facts a city council member would want to be briefed on in conjunction with Legal and Public Works information provided separately.

While the Finance Department, as the protector of the city's assets, urges City Council to exercise caution in eroding Utility Fund reserves, we recognize that this is exactly the discretionary policy issue that City Council is tasked with deciding and financial facts are needed. The following, while technical in places, is provided as foundational for policy-level city council members to aid in decision-making and our intent is truly to be helpful.

Fund Accounting. Governmental Fund Accounting, mandated by the Government Accounting Standards Board (GASB), matches restricted revenues and expenditures. Some restrictions accompany revenues, such as federal and state programs in which the city has a fiduciary duty on behalf of specific funding requirements. The city has a responsibility to demonstrate legal compliance in expending restricted funds for the purposes they are dedicated. Some restrictions come from the governing authority of the city council itself embodied in the budget adoption ordinance in the City's annual appropriated budget. In issuing debt, the city pledges revenue which is then obligated in the repayment of that debt.

Funds. Generally, all funds except the General Fund are restricted. The City of Yakima segregates the following Enterprise funds, keeping each separate: Airport, Stormwater, Transit, Refuse, Wastewater, Water, and Irrigation. In addition, there are many funds, reported in the City's audited annual financial report, for: Economic Development Fund for HUD grants, Community Relations Fund for Cable TV franchise fees, Arterial Streets Fund for motor vehicle taxes, Cemetery Fund for site sales, Emergency Services Fund for a voter-approved special tax levy, Public Safety Communications Fund for dispatch contracts and telephone utility tax, Police Grants for grant-specific revenues, Downtown Yakima Business Improvement District for business assessments within the boundary, Trolley Fund for trolley grants, Tourist Promotion Area for a dedicated \$2/room night fee self-imposed by the lodging participants, two Public Facilities Districts for the 0.25% and 0.33% sales tax credit for Convention Center and Capitol Theatre. There exist debt service funds and capital expenditure funds which further account for already-restricted revenues to provide for payments on long-term projects. There are separate funds to account for city liabilities for unemployment, employee health benefits, risk management, and vehicle replacement, and workers compensation.

Enterprise Funds. By definition, Enterprise Funds are used to report activities for which a fee is charged to external users for goods or services. Generally Accepted Accounting Principles (GAAP) requires the use of an enterprise fund for any activity whose principal revenue sources are either 1) debt backed solely by fees and charges, 2) a legal requirement to recover cost, or 3) a government's policy decision to recover cost. In recovering costs, both operating and capital costs are forecasted in arriving at the fees to charge for the particular service so that they are borne only by the recipients, the users, of the fund's service. The principle behind matching utility-user revenues and expenses is that it would be unfair to charge non-users for part of the cost of a service they didn't use. Also, Enterprise Funds are required to use full-accrual accounting, unlike governmental funds like the General Fund, Parks and Streets. A new street is fully expensed when the labor and materials are spent. Because an attempt is made to match rate payers with the cost of services in the same year of service, full-accrual means that assets such as treatment plants and distribution and collection systems are expensed by depreciating annually over the life of each asset. This also means that "fund balance" does not represent actual cash on hand, because some of the assets in a fund balance are composed of the *value* of tangible assets (such as a treatment plant) and amounts that are owed to the City, but not yet received ("receivables"). In other words, though the fund balances show a positive amount, much of the fund balance is not actually in cash, and the illiquid capital assets and receivables can't be "drawn down," used or spent.

Fund Balances. Fund Balance is the difference, at a point in time, between the assets and liabilities in a fund. It's the cumulative difference of all revenues and expenditures since the fund's creation, and therefore the result of the cumulative budgeting and operating decisions and events since the fund's creation. Because of seasonality, some funds have different inflows and outflows during different times of the year. Due to the complex nature of a year-end closing, with accruals that may only be done once a year in conjunction with the annual audit, with annual actuarial reports and interfund transfer true-ups, annual reports are most reliable. Annual budgeting must provide balanced budgets so only exceptions or deviations from budget would cause a change in fund balance. As part of long-term budgeting, large future expenditures savings must be anticipated and either paid through debt payments or savings or a combination of both. The capacity for debt payments in each annual budget is limited so fund balances in anticipation of large future expenditures must be considered.

Enterprise Fund Reserves. *In the case of Enterprise Funds*, large future capital projects or debt issues must still be financed by the user fees that cover all present and future costs for the restricted purposes of that fund and are considered in fee studies and rate decisions. For that reason, working capital (*current* assets minus *current* liabilities) is better considered as reserves and yet uncollected receivables must still be subtracted to arrive at what is truly currently spendable.

The Quarterly Financial Report goes to City Council for review to assure the governing body that the city's assets are being managed and protected and also as a progress report on the execution of the adopted budget. The most recent report shows Enterprise Fund balances as follows:

ENTERPRISE OPERATING FUNDS

Fund	2020	As of March 31th		
	Beginning Balance	2020 Actual Rev.	2020 Actual Exp.	Ending Balance
Airport Operating	\$ 227,055	\$ 351,088	\$ 417,621	\$ 160,522
Stormwater Operating	1,418,779	544,795	513,394	1,450,180
Transit Operating	5,269,065	1,815,303	1,825,907	5,258,461
Refuse	2,239,915	1,823,127	1,663,434	2,399,608
Wastewater Operating	4,596,230	5,826,598	3,946,749	6,476,079
Water Operating	2,220,102	2,226,908	1,952,364	2,494,646
Irrigation	721,032	533,951	658,586	596,397
Utility Services	(381,561)	223,563	349,989	(507,987)
Total Enterprise Operating Funds	\$ 16,310,617	\$ 13,345,333	\$ 11,328,044	\$ 18,327,906

Utility Fund Cash Flow. The Quarterly Accounts Receivable Report for City Council review is also to assure the governing body that the city's assets are being managed and protected. Specifically and most materially, the utility billing in that report reveals to what extent the City has expended the costs of delivering services for Water Treatment and Distribution, Wastewater Collection and Treatment, Refuse Collection and Disposal, and Irrigation Distribution. The Finance Department's Utility Services Division bills individual users of each service, for approximately 60-days (2 months) of usage after the service has been provided, and tracks collection. This means that the City pays for the cost of the service and for 75 days or so is at risk of not recovering the cost. The most recent 1st Quarterly Report shows that the amount awaiting payment, the ending balance at the moment the quarter ended on March 31st, is \$5.8 million in these four Enterprise Funds, of which \$2.6 is overdue by 120 days (an accumulation of several years since accounts aren't written off until 7 years have transpired). In other words, though the total Enterprise Operating Funds balance shown above is \$18,327,906, this includes the \$5.8 million that the City is owed, but hasn't actually received.

	Quarterly Activity				Status		
	Beginning Balance	Billed	Payments/Write-offs	Ending Balance	Current to 90 Days	Over 90 Days	Over 120 Days
Enterprise Receivables							
Wastewater	\$ 2,631,662	\$ 5,098,626	\$ 4,826,577	\$ 2,903,711	\$ 1,548,177	\$ 47,269	\$ 1,308,265
Water	895,488	2,091,950	1,848,321	1,139,117	643,397	7,020	488,700
Refuse	1,164,859	1,838,050	1,876,538	1,126,370	555,809	23,645	546,916
Irrigation	461,147	901,662	767,615	595,193	319,668	3,436	272,089
Total Enterprise Receivables	\$ 5,153,156	\$ 9,930,288	\$ 9,319,051	\$ 5,764,391	\$ 3,067,051	\$ 81,370	\$ 2,615,970

A receivable is an asset, so can be misleading when looking at an enterprise fund with a large positive fund balance. When paid, receivables become cash, reducing the receivable and increasing cash. Since Fund Balance by definition is Assets minus Liabilities, this simply shows that of the Fund Balance reported on the balance sheet, these receivables may contribute to the Fund having a positive Fund Balance but aren't spendable or available for any purpose, since the City hasn't yet actually received these funds.

Utility Services Billing. The Finance Department's Utility Services Division bills customers for Water, Wastewater, Irrigation and Refuse for the services provided to each customer. Not all city addresses are served by City of Yakima Water because some are within the service area of Nob Hill Water. Nob Hill Water does not benefit from and is not subject to the authority of City Council actions. A regular billing cycle is for about 60 days, so there are six invoices per year and approximately eight sectors of the city, one each week, are billed sequentially throughout the month. Payment on account is due fifteen business days after bill date, at that point bill is considered late. Seven days after bill due date a late/reminder notice which informs customer of date service is eligible to be disconnected is generated and mailed. Seven days after the late notice generates an automated reminder call is sent to the phone number on file for the account letting the customer know payment has not been received as of the date of the call. Three days after the first reminder call a second call notifying customer that service is scheduled to be terminated on a specific date. Three days after the second reminder call an order to disconnect service is produced.

Utility Services – Payment Arrangements. Customers are encouraged to call the Utility Services Division when unique circumstances arise so that staff can make payment arrangements. Payment arrangements are based on a review of account history i.e. amount in arrears, & past payment history. Standard procedure is half of past due amount is to be paid and arrangements can be made on remaining balance. If payment arrangement extends beyond due date of next billing the new/current charges of that bill must be paid in full on or before their due date for pay arrangement to remain in effect. Utility bills can be made online, using the city's website, automatic debit, mailed or put into one of two drop boxes (City Hall and the Harman Center).

Utility Services – Rate-setting for a class of customers. Should Council choose to offer reduced utility rates, staff would need policy direction on specific rates being reduced, the beginning and ending dates of the rate reduction, and how Utility Services staff would verify eligibility. Rates could be reduced for a set percentage or dollar amount for water, wastewater and/or refuse. Eligibility would need to be specified so staff could document compliance in a manner that could be documented for the annual independent audit by the State Auditor's Office. Staff recommends a finite, or limited, time frame unless council wants to require both documentation for loss of income and restoration of income. The timeframe selected would draw down the utility reserves and, if done permanently, would require the remaining users of the utility to bear the increased cost through rate increases.

Recommendation. Recognizing that Council is balancing its fiduciary role in safeguarding City assets with deploying City assets to assist utility payers in need:

1. Only the portion of Fund Balances that are available may be drawn down, using the most-recent full-accrual audited financials, which eliminates capital assets and receivables.
2. The projects that Public Works is planning should be considered and prioritized while considering reducing revenue that funds utility capital projects.
3. Should council wish to consider identifying residents requiring assistance, staff would require sufficient policy direction to identify the criteria staff would need to document relief eligibility to be audit-ready post-implementation.
4. Council will also want to consider that some water customers inside the city are Nob Hill Water customers.
5. Keep in mind that revenue is pledged for debt sufficient to meet payments.
6. Payment deferrals is another alternative council might consider. *Staff recommends that, since shutoffs are currently discontinued, watching the growing uncollectable balances over the next 60 days may help quantify the upper limit of the amount being discussed.*