

# Tennessee Regulatory Updates and Depreciation

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TENNESSEE COMPTROLLER OF THE TREASURY

# Roadmap

1. TBOUR Introduction
2. TBOUR Regulatory Oversight
3. Financial Distress
4. Customer Complaints
5. Depreciation
6. Impacts on Accounting Statements
7. Brief Note on Budgeting
8. Conclusion

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## Tennessee Board of Utility Regulation

PC0463 combined the:

Water and Wastewater Financing Board

Roughly 280 Utilities

Municipal, County, Authority Systems

Utility Management Review Board

Roughly 170 Utility Districts

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## Who makes up the Board?

Greg Moody, Chair- Comptroller or Comptroller Designee  
Tom Moss, Vice-Chair- TDEC Commissioner or Designee  
Edwin Carter, Comptroller Appointee  
Steve Stone, Middle TN Natural Gas UD, House Speaker Appointee  
David Purkey, Morristown Utility System, Senate Speaker Appointee  
6 Governor Appointees

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## Who makes up the Board?

Governor Appointees  
Michael Adams, Water Authority of Dickson County  
Bruce Giles, First UD of Knox  
Eugene Hampton, Metro Nashville  
Nick Newnan, Memphis Light, Gas, and Water  
Anthony Pelham, Warren County Utility District  
Vacant, Tennessee Municipal League Recommendation

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## What do we regulate?

Water, Sewer, and Natural Gas Local Government Utility Compliance  
with State Laws surrounding:

Financial Distress

Water Loss

Training

Managerial, Technical, and Financial Capacities

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## Financial Distress

Two Years of Loss

Deficit Net Position

Default on Debt

2 Years of Delinquent Audits\*

Illicit Transfer of Funds\*

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## Illicit Transfer of Funds

An employee or governing body member of a utility under the TBOUR has 15 days to report an unauthorized transfer after they become aware of the unauthorized transaction.

Board staff reviews audits to find transfers that have not been authorized.



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## Financial Distress Process

Questionnaire

Order Rate Study and Policy Review

Order Implementation

Update Cycle- 40 Entities

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## Customer Complaints

Must first be heard by the local board.

Board staff receives complaint first.

Complainant and Utility present case to TBOUR.

TBOUR can order corrective actions.

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## Informal Hearings

“The justness and reasonableness of a utility system's rates, fees, or charges”

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## Informal Hearings

“The justness and reasonableness of a utility system’s requirement that a customer or developer build infrastructure or fixtures to be dedicated to the utility system;”

“The failure of a utility system to adopt and enforce policies or rules necessary for the efficient and financially responsible operation of the utility system, including policies regarding ethics or financial controls, or for water loss, water leak adjustment, purchasing, or other industry standard policies;”



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## Informal Hearings

“The inadequacy of a utility system’s policies regarding ethics or financial controls, or for water loss, water leak adjustment, purchasing, or other industry standard policies;”



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## Failure to Extend Service

“The failure of a utility system to offer or extend utility service to a customer:

- (a) Located within the utility system’s covered area;
- (b) Located within an area in which the utility system offers similar services;
- (c) Located within an area in which the utility has the infrastructure to offer similar services; or ”



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## Failure to Extend Service

“The utility system has the affirmative burden to show that:

- (a) It does not have the capacity to serve the customer;
- (b) Service to the customer is not economically feasible;
- or
- (c) Service is not in the best interest of the utility and its existing customers.”

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## Depreciation

Recognition of a capital expense over time.

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## Balance Sheet Capital Assets

- Capital Assets are an Asset.
- The Asset loses value.
- Depreciation records that loss in value.



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## Income Statement

- Revenues- How much from **operations** increased your value?
- Expenses- How much from **operations** decreased your value?
- Revenues minus Expenses = Change in Net Position



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## Expenses

- Operating Expenses
  - Salaries, Supplies, Insurance, etc...
- Capital Expenses
  - Property, Plant, Equipment, etc...
- Why does the difference matter?



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## Income Statement Capital Expenses

- Where are capital expenses on the income statement?
  - They aren't there... sort of.
- Your capital assets don't lose all value in one year... why should you record the loss of value all in one year?



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# Depreciation

- Initial Cost
- Useful Life
- Salvage Value
- $(\text{Initial Cost} - \text{Salvage Value}) / \text{Useful Life} = \text{Annual Depreciation}$

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# Estimated Useful Life

- Pages C-6 and D-6 from the CoT Audit Manual

The Tennessee Water and Wastewater Financing Board and Utility Management Board have used the following guidelines to estimate the useful lives of assets of water and wastewater systems. The useful lives of assets should not exceed the appropriate guidelines listed below.

ASSET ACCOUNT	YEARS
<i>Water Systems</i>	
Buildings (Office and Plant)	30-50
Equipment and Tools	10-15
Furniture and Fixtures	5-10
Machinery, Equipment and Vehicles	5-15
Pumps and Treatment Equipment	15-20
Transportation Equipment	5-10
Water Lines and Storage	40-60
Well Pumps	Engineer's Estimate
ASSET ACCOUNT	YEARS
<i>Wastewater (Sewer) Systems</i>	
Buildings (Office and Plant)	30-50
Equipment and Tools	10-15
Furniture and Fixtures	5-10
Machinery, Equipment and Vehicles	5-15
Pumps and Treatment Equipment	15-20
Wastewater (Sewer) System	40-50

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### 3. Salvage Value

- What will the asset be worth at the end of its useful life?



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### Why is depreciation such a big deal?

- The Milkman started a company.
- Product cost of \$3 a gallon. This includes all costs other than the cost of his truck.
- His competitor sold 10,000 gallons for \$4 last year.
- The Milkman purchased his truck for \$50,000, with a salvage value of \$10,000. The depreciation expense for this is \$4,000 annually for 10 years.
- In year 2, the milkman wants to expand to another truck.



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## Three Financial Statements

- Balance Sheet: Assets and Liabilities
- Income Statement: How much did our bottom line change this year?
- Statement of Cash Flows: Let's follow the cash.



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## Depreciation

- Initial Cost: \$50,000 Truck
- Useful Life: Lasts 10 years
- Salvage Value: Will be able to be sold for \$10,000 after 10 years.
- $\$50,000 - \$10,000 = \$40,000 / 10 = \$4,000$  a year.



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## The milkman needs to cover the cost of his truck on his income statement in year 1.

- Option 1: No Depreciation
- \$3 a gallon cost
- 50,000 for the truck
- 10,000 gallons
- \$5 per gallon to pay for the truck
- \$8 a gallon to break even.
- Competitor sells for \$4.
- Option 2: Depreciation
- \$3 a gallon
- \$4,000 depreciation expense
- 10,000 gallons
- \$0.40 cents per gallon to pay for the truck
- \$3.40 a gallon to break even
- Competitor Sells for \$4.



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## Depreciation's Effect on Financial Health

- After Year 1 with no depreciation, the Milkman thought his poor performance first year was because he didn't have enough trucks.
- He went to the bank to seek a loan to purchase a new truck.
- He showed them a balance sheet with almost no assets, an income statement showing a loss, and statement of cash flows with a negative cash flow.
- He was denied his application.



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## Milkman Receives a Grant for \$50,000

	Cash	Equipment	Net Position	Revenue	Expense	Grant	Change in Net Position
Begin Small Business Grant	\$ 50,000.00	\$ -	\$ -50,000.00	\$ -	\$ -	\$ 50,000.00	\$ 50,000.00

Statutory Change in Net Position = GAAP Change in Net Position – Grants, Capital Contributions, and Transfers Out  
 Statutory Change in Net Position = \$50,000 minus \$50,000 = \$0  
 How did Cash go up?  
 Depreciation converted the capital asset into cash.

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## Milkman Receives a Grant for \$50,000

	Cash	Equipment	Net Position	Revenue	Expense	Grant	Change in Net Position
Begin Small Business Grant	\$ 50,000.00	\$ -	\$ -50,000.00	\$ -	\$ -	\$ 50,000.00	\$ 50,000.00

Statutory Change in Net Position = GAAP Change in Net Position – Grants, Capital Contributions, and Transfers Out  
 Statutory Change in Net Position = \$45,000 minus \$50,000 = -\$5,000  
 Why?  
 Revenues didn't cover your expenses.

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## Milkman Receives a Grant for \$50,000

Cash	Equipment	Net Position	Revenue	Expense	Grant	Truck Expense	Change in Net Position

Utility aims to break even. Without depreciation, the cash never changes while breaking even.



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## Use of Depreciation Funds

- Pay Debt Service
- Replace or Repair the Asset
- System Maintenance
- Or Anything Else



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## Point of Clarity: Not a mandatory restricted fund

- “Do we have to continue putting cash into this restricted depreciation fund while also putting the same amount into our regular cash balance?”



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## Budgeting Tip

- Take your audited income statement.
- Add a column for projected last year end.
- Add a column for projected budget.
- Budget for depreciation.
- Use our template!!!



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## Conclusion

- TBOUR
  - Financial Distress, Customer Complaints
- Depreciation
  - Why do we have to depreciate capital assets?
  - What can we use the depreciation funds for?
- Budgeting
  - Use our template
  - Follow the guidelines

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