

## BETTER UTILITY BUDGETING AND FINANCIAL PLANNING

For more information, visit [tncot.cc/guidance](https://tncot.cc/guidance)

*Financial oversight of public utilities is essential to ensuring citizens have access to affordable water, sewer, gas, and other utility services. This oversight must be intentional and planned. The following sections outline several basic best practices in utility budgeting and financial planning.*

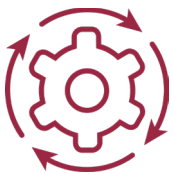
### REVIEW THE AUDIT

Analyze the previous year's audited financial statements to understand revenue sources and types of expenses. Identify significant changes since the audit (capital additions, issuance of debt, new customers, etc.). Take note of any audit findings or recommendations and ensure they are addressed.



### CURRENT YEAR OPERATIONS

Evaluate the current year's operations and consider factors such as changes in customer demand, service levels, and operational efficiency. Identify any unforeseen challenges or opportunities that may impact the budget. Understand the key drivers of costs in the current year, such as personnel expenses, maintenance, and ongoing capital projects. Evaluate whether any cost-saving measures or efficiency improvements can be made.



### REVENUE, EXPENSE, AND CASHFLOW PROJECTIONS

Consider revenue and expense trends from previous years and project future operations based on factors like customer growth, rate adjustments, and changes in service demand. Forecast cash flows to ensure your utility maintains adequate cash to pay for bills as they become due without the need for operating loans.



### CAPITAL PLANNING

Based on the audit and operational assessment, note any critical infrastructure needs or capital projects for the current year. Incorporate these into the budget and consider funding options. Develop a long-term capital improvement plan that aligns with the utility's strategic goals and will address infrastructure challenges over time. Understanding the current state of assets, planning for their replacement or improvement, and identifying appropriate funding sources, all contribute to the long-term sustainability and reliability of utility services.



By integrating the insights from the previous year's audit and the current year's operational data, the utility can develop a more accurate and informed budget that reflects the financial reality and goals of the utility. Regular monitoring and adjustments throughout the year are also necessary to respond to changing conditions and ensure financial stability.

### RATE SETTING

Rates, fees, and any other charges must be reasonable and justified, but they should also be enough to make your utility self-sufficient. Rates and fees should be reviewed regularly to ensure your utility remains financially self-sufficient. Rates and charges should be sufficient to cover all reasonable operating expenses, as well as depreciation, interest on debt, and any other nonoperating expenses. Rates should generate enough cash to pay both principal and interest on debt. Each utility should have rates sufficient to have a positive change in net position separate from grant proceeds and contributions. Utilities that report a decrease in net position, without regard to grant proceeds or contributions, for two consecutive years will be referred to the oversight of the Tennessee Board of Utility Regulation (TBOUR). *Continued.*



A policy for periodic rate studies is a proactive and strategic approach to managing the financial health of a utility. Conducting thorough internal reviews during non-rate study years allows utilities to proactively address challenges, optimize operations, and lay the groundwork for informed decision-making in subsequent rate studies. Some utility systems have an annual cost-of-living rate increase that is adopted once, and then rates adjust at an inflationary percentage each year.



(GAAP). A GAAP format that reconciles to statutory and cash bases helps ensure your rate structure is sufficient to support operations, comply with state law, and have needed cash flow.

Columns for the prior audit year, estimated current year, and upcoming budget year, with clearly defined sections assist management and the governing body as they prepare, adopt, and monitor the budget.

## DEPRECIATION

Depreciation is often one of the largest operating expenses of a utility system. Depreciation is the allocation of the cost of a capital asset (such as equipment and facilities) over its estimated useful life. It helps to accurately reflect the wear and tear on these assets over time and allocate associated costs to the periods in which the asset provides service. Depreciation is crucial in financial reporting, rate-setting, asset management, and decision-making for utilities.



## POLICIES

Sound financial policies lay the foundation for good financial decisions. At a minimum, you should have policies for internal controls, budget adoption, cash flow management, billing, rate increases/adjustments, asset management, and debt management.



## MONITORING



Once you have the annual budget adopted and long-term financial plans in place, they should be reviewed and updated as needed to make sure your utility system remains on track.

## BUDGET FORMAT

State law requires the budget to be adopted on a basis consistent with generally accepted accounting principles

### WHEN PREPARING THE BUDGET, ASK YOURSELF:

- Have we reviewed the most recent audit?
- What changes from the current year impact our financial planning?
- Are our financial projections based on reasonable assumptions?
- Is our capital improvement plan up to date?
- When was our last rate study? Are rates sufficient for the upcoming year?
- Have we remembered to budget for depreciation?
- Does our budget follow the accrual basis of accounting?
- Will our budget produce a positive statutory change in net position?
- Do we have enough cash available to pay for operations without an operating loan?
- Have we reviewed and updated financial policies?
- Do we have steps in place to keep watch on operations throughout the year?