

# Bear Valley Community Services District BUDGET AND FISCAL POLICIES

The following budget and fiscal policies are presented to provide guidance and consistency in decision-making for the District's management team and Board of Directors. These policies will assist the District in achieving overall financial planning and rate setting processes from year-to year for District operations. The proposed policies are guidelines that should be reviewed at the beginning of each fiscal period to determine if they are still relevant and appropriate. The budget and fiscal policies framework is shown below:

## ***Budget and Fiscal Policies Framework***

1. Financial Reporting/Management Policies
2. Budget Policies
3. Revenue Policies
4. Capital Improvement Policies
5. Debt Policies
6. Reserve Policies
7. Rate Setting Policies
8. Capacity and Connection Fee Policies

# Bear Valley Community Services District BUDGET AND FISCAL POLICIES

## **1. Financial Reporting/Management Policies**

Accounting practices shall conform to state law and to Generally Accepted Accounting Principles (GAAP) established by the Governmental Accounting Standards Board (GASB). The District should apply all current standards issued by the Financial Accounting Standards Board (FASB) not in conflict with standards issued by the Governmental Accounting Standards Board.

### **1.1 Accounting, Auditing and Financial Reporting**

- 1.1.1 The District is to maintain a uniform system of accounts that conforms to the California Budgeting Accounting and Reporting Systems (BARS) established by the State Auditor's Office.
- 1.1.2 All financial and budgetary documents shall be produced in accordance with Generally Accepted Accounting Principles (GAAP) as outlined by the Governmental Accounting Standards Board (GASB) in addition to being in conformity with the accounting systems prescribed by the State Controller's office and the state regulations governing special districts.
- 1.1.3 The District is to account for the post office, water, wastewater, and solid waste utilities as separate enterprise funds that are intended to be primarily self-supporting through user charges.
- 1.1.4 The District's governmental funds which are general, emergency, supplemental law enforcement, roads, and SUI reserve will provide information on near-term inflows, outflows and balances of spendable resources. Such information is useful in assessing the Bear Valley Community Services District's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.
- 1.1.5 The District will strive to receive the Certificate of Achievement for Excellence in Financial Reporting from the Governmental Financial Officer's Association.
- 1.1.6 The District will employ an independent accounting firm to perform an annual audit of the District's financial statements. The completed and accepted audit shall be available to all required and interested parties.

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- 1.1.7 Procedures will be followed that will ensure that proper authorization has been obtained for all transactions of a financial nature as per the District's purchasing policy.

### 1.2 Cash Management

- 1.2.1 Idle cash in all accounts and funds will be kept invested to the benefit of the fund in amounts varying in their term to maturity, which will maximize return on investment consistent with the need for liquidity and the investment policy of the District along with any arbitrage limitations.
- 1.2.2 Procedures will be followed that will ensure that proper authorization has been obtained for all cash and investment transactions as per the District's investment policy.
- 1.2.3 Cash reserves should be maintained and monitored as outlined in the operating cash reserves policies (Section 6).
- 1.2.4 Cash reserves for bond reserve accounts shall be fully funded in the time line reflected in current and future bond covenants. Cash reserves shall be formally transferred and restricted in accordance with all legal requirements.
- 1.2.5 During the budget process, a five (5)-year cash forecast with annual updates will be projected for governmental and enterprise funds. This will provide the District with insight to unanticipated shortages of cash for operations, capital maintenance and debt requirements.

### 1.3 Investment Policies

- 1.3.1 The District shall annually review and update, or modify as appropriate, the District's investment policy. This review shall take place at a public meeting and the policy shall be adopted by resolution of the Board of Directors.
- 1.3.2 Reports on the District's investment portfolio and cash position shall be developed and presented to the District Finance Committee and the Board of Directors on a quarterly basis.

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- 1.3.3 District Funds will be managed in a prudent and diligent manner with emphasis on safety, liquidity, and yield, in that order.

### **1.4 Asset Inventory**

- 1.4.1 Finance staff shall be accountable for tracking all District assets. Each Department shall be responsible for ensuring all such assets are used only for District purposes and notifying Finance staff of any changes in use.
- 1.4.2 Fixed assets should be maintained in good operating condition and should be systematically replaced as they become obsolete or if the cost of repair is more than replacement value.
- 1.4.3 Finance staff, on a yearly basis, will track and maintain asset records for all additions, replacements or retirements of assets. This will be reported to the General Manager in a yearly asset record report. Appropriate actions will be taken to assure assets are safeguarded and maintained.
- 1.4.4 Fixed Asset Capitalization Policy – In accordance with the District's capitalization (accounting and reporting) policy, all fixed assets with a unit cost of over \$5,000 and a normal life of more than one year, will be included in the inventory.

### **2. Budget Policies**

Bear Valley Community Services District, like any other business, should strive to maintain financial stability over time, as it has done in the past. Financial stability is not only a prudent financial management goal; it can also minimize financial costs in the long-term (e.g. unnecessary borrowing). Above all, financial stability will provide the community with the confidence of knowing a strong, consistent management team is managing the District. The approved annual budget document provides the spending limits by fund for the fiscal year. The District will follow administrative policy and state regulations on all expenditure line items. Management and staff will follow the philosophy of cost control and responsible financial management. The goal will be to balance annual expenditures with the annual revenues. The District will not use short-term borrowing to finance current operating needs without a financial analysis showing impacts to the District as a whole.

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- 2.1 The primary budget objective is to provide the highest possible level of service to the residents of Bear Valley without impairing the District's sound financial condition. Continual efforts will be made to improve productivity, lower costs and enhance services.
- 2.2 The District will prepare an annual budget document each fiscal year (July 1 to June 30) that provides a basic understanding of the District's planned spending for the coming fiscal year. Copies of the proposed and final budget will be made available to all interested parties and opportunities will be provided for public input prior to final adoption of the budget.
- 2.3 The budget will be based on generally accepted accounting principals as promulgated by the Governmental Accounting Standards Board (GASB) and the interpretations contained in the Governmental Finance Officers Association publication *Governmental Accounting, Auditing and Financial Reporting*.
- 2.4 Laws and regulations limiting use of revenue sources must be explicitly addressed in the budget process.
- 2.5 The District's annual budget will be presented for each governmental and enterprise fund with a logical breakdown of programs and line-item detail. The budget document for each fund will also be presented for discussion and review by the Board of Directors and the public. This document will focus on policy issues and will summarize expenditures at the personnel, operating and maintenance, project and capital improvement levels. Where practical, the District's annual budget will include standards of workload, efficiency and effectiveness.
- 2.6 Joint or common costs of the District shall be allocated between governmental and enterprise funds based upon a "fair" methodology that utilizes appropriate criteria (e.g. labor ratios, number of customer, asset value, work stations, square footage, FTE's, etc.). The specific allocation method for the joint/common cost should be the method that the District deems to be most appropriate and equitable. The joint/common cost allocation should be reviewed during the annual budget process.
- 2.7 The District will endeavor to keep current expenditures less than current revenues. Current expenditures are defined as operating expenses, debt payments, and project and capital improvement expenditures. Except

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under extraordinary circumstances approved by the Board, the District will strive to operate within the approved budgetary amounts to avoid deficit spending.

- 2.8 The District should have annual net income (total revenue less O&M, debt service and capital projects funded from rates) greater than or equal to zero.
  - 2.9 The District will maintain a budgetary control system to ensure adherence to the overall budget for each governmental and enterprise fund and will prepare regular reports comparing actual revenues and expenditures/expenses for each fund.
  - 2.10 The District will not establish a program without also providing the necessary funding to accomplish those objectives. All new operating programs or initiatives submitted for policy decision should include a five-year estimate of anticipated annual operating costs, revenues and their associated impacts on rates.
  - 2.11 At mid-year, there shall be a comprehensive review of the operations to date in comparison to the existing budget. Projections of revenues and expenditures through the end of the fiscal year will be prepared and reviewed by management staff with a report to the Board of Directors by January of the operating fiscal year.
  - 2.12 The operating budget will be prepared to fund current year expenditures with current year revenue. However, surplus fund balances may, in the Board's discretion, be used to increase reserves, fund capital improvement projects, or be carried forward to fund future year's operating budgets when necessary to stabilize services.
  - 2.13 The District will avoid budgetary and accounting procedures that balance the current budget at the expense of future budgets. Budget items requiring Board action:
    - a) Appropriation of reserves
    - b) Transfers between funds
    - c) Appropriation of any unanticipated revenues
    - d) Inter-fund loans
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- e) Creation of new CIP projects and appropriation increases in existing CIP projects
- 2.14 Budget items delegated to the General Manager: transfers between budgeted activities or departments within a fund.
- 2.15 Budget items delegated to Department Heads: Within the budgeted category, line item transfers are the responsibility of the Department Heads, subject to approval of the Finance Director and the General Manager. Transfers of line item budgets will be documented in a report provided to the General Manager and Board of Directors at such times as deemed appropriate by the Finance Director.
- 2.16 The District will annually submit its budget to the Government Finance Officer's Association for consideration of the Distinguished Budget Presentation Award and to the California Society of Municipal Finance Officers for its Excellence in Operational Budgeting award.

### 3. Revenue Policies

Annual revenues should be estimated during the budget preparation. All revenue forecasts are to use generally accepted forecasting techniques.

- 3.1 The District will continue to maximize the availability of revenue through aggressive collection of receivables, prudent investments and proper timing of cash disbursements.
- 3.2 For the District to maximize revenue, all fees and charges for services shall be routinely reviewed to ensure that rates are equitable and cover the total cost of service for that particular service.
- 3.3 The District will estimate revenues using an objective, analytical process; in the case of assumption uncertainty, forecasts shall be conservative.
- 3.4 The District will seek federal and state grants and reimbursements for mandated costs whenever possible.

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- 3.5 Interest earnings shall be allocated monthly to all funds based on month-end cash balances. Funds with negative cash balances shall not be credited with interest earning or charged an interest expense.
- 3.6 Special tax revenues shall be used only to pay for costs as authorized by the tax.
- 3.7 Revenues of a limited or definite term will be used only for one-time expenditures. The District will avoid using temporary revenues to fund program services.

### **4. Capital Improvement Policy**

- 4.1 The District staff will construct all capital improvements in accordance with an adopted Capital Improvement Program.
- 4.2 The District will coordinate preparation of the Capital Improvement Budget with preparation of the Operating Budget. Future operating costs associated with new capital improvements will be projected and included in the Operating Budget forecasts.
- 4.3 The District prefers a “pay as you go” strategy whenever possible. When appropriate, capital improvements will be paid through current revenue/reserve sources rather than financing capital projects over a period of time.
- 4.4 The District staff will identify the estimated costs and potential funding sources for each proposed capital project before it is submitted to the Board for approval. If potential funding source is not available and Staff recommends a loan to fund the CIP Project, Staff will identify where the loan proceeds will come from prior to submitting to the Board for approval.
- 4.5 Changes or deviations from the approved Capital Improvement Program should be accounted for and reported directly to the Board before proceeding on the project. The report should include an analysis of long-term financial costs and the overall impact to the current Capital Improvement Program due to the change or deviation. With Board

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approval, unexpended project appropriations will be carried forward as continuing appropriations to future fiscal years as required to complete the intent of the original budget. This request will take place in October of each year following the completion of the prior year's annual audit.

- 4.6 The District shall attempt to determine the least costly financing method for all new projects.
- 4.7 The District will actively pursue grant and other outside funding sources for all capital improvement projects.

### **5. Debt Policies**

- 5.1 The District will limit the use of debt so as not to place a burden on the fiscal resources of the District and its residents.
- 5.2 The District will use debt financing when it is judged to be appropriate based on the long-term capital needs of the District, and the District's ability to repay the indebtedness has been evaluated in light of all sources and uses of cash.
- 5.3 The first preferred source of debt is to utilize interfund "loans."
- 5.4 When capital projects are financed, the District will amortize the debt within a period not to exceed the expected useful life of the project.
- 5.5 The District will not use long-term debt for current operations.
- 5.6 The District will generally conduct debt financing on a competitive basis.
- 5.7 The District will strive to maintain the best possible bond rating on all debt issuances.
- 5.8 The District will publish and distribute an official statement for each revenue bond issue.
- 5.9 The District will at a minimum meet the debt service coverage requirements stated in the bond covenants.

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- 5.10 When financially feasible, in the interest of securing the best interest rate, the district may target a higher debt service coverage ratio than what is stated in the bond covenants (e.g. 1.50).
- 5.11 The District will annually review the status of all outstanding and potential debt obligations and incorporate this information into their financial planning.

### 6. Reserve Policies

The District will establish, dedicate and maintain, as appropriate, reserves annually to meet known and estimated future obligations. If reserves are depleted, the reserves should be replenished over a five (5) year period to re-establish targets.

- 6.1 **Emergencies:** Money set aside for (1) repair, restoration or replacement of district facilities damaged as the result of natural disasters, (2) matching fund assistance for cost sharing required under federal or state disaster assistance programs and (3) district personnel overtime costs and supplies used during eligible disaster response and recovery activities, including the cost of administering those activities.

Resolution 03-1065 (12/13/03) established a minimum Emergency Fund balance of \$123,000 on 7/1/03 with adjustments for inflation each June 30 thereafter.

- 6.2 **Capital improvements:** Money set aside for the construction or acquisition of new infrastructure to increase system capacity, typically pertaining to water and wastewater funds. These monies can be used only for improvements that increase capacity; they cannot be used for simple replacement of an existing asset or for ongoing operations. Two funds have monies designated for capital improvements, the Water Development Fund and the Wastewater Development Fund. Monies in these funds are designated for projects that increase the capacity of the District's water and wastewater systems. Designated fund balances should be sufficient to construct the capital improvements budgeted for the following fiscal year or the multi-year capital improvement plan if financing has already been secured.

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- 6.3 **Asset replacements:** Money set aside to replace, rehabilitate, improve or acquire infrastructure or other fixed assets, typically pertaining to water, wastewater and road funds and the general fixed assets account group.

Resolution 06-1246 (12/9/06) dedicates 7% of the Water Enterprise Fund's annual expenditure budget to the Water Reserve Fund each year for ten years, plus 20% annual replenishment of expended amounts. The target is the cumulative annual contribution.

Resolution 06-1248 (12/9/06) dedicates 7% of the Solid Waste Enterprise Fund's expenditure budget to the Solid Waste Reserve Fund each year for ten years, plus 20% annual replenishment of expended amounts. The target is the cumulative annual contribution.

In the General Fund, the asset replacement reserve is any amount remaining after its contingency reserve and police contingency reserve targets are met.

- 6.4 **Debt service:** Money set aside to make scheduled principal and interest payments on long-term debt.

The Water Bond Redemption Fund must pay principal and interest each August 31 and interest only each February 28 on \$4,530,000 in general obligation bonds that were issued in 2002 for water system improvements and to refund prior bonds. The cash balance target on July 1 is the full payment due on August 31 plus 10% for uncertainties.

The Assessment District 95-1 Bond Redemption Fund must pay \$108,598 each January 13 for the State Revolving Fund loan that was used to rebuild and expand the wastewater treatment facility. Since the district receives approximately 52% of the assessment revenue by that date each fiscal year, the cash balance target on July 1 is 50% of the payment.

Inter-fund loans are permitted with Board approval. Unless otherwise restricted by law, the fund borrowing the cash must repay the loan with interest at the current Local Agency Investment Pool /Kern County Investment Pool average interest rate.

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- 6.5 **Contingencies (a.k.a. working capital):** Money set aside for (1) cash flow requirements, (2) unforeseen operating expenses, such as new regulatory requirements, (3) revenue shortfalls, (4) economic uncertainties including downturns in the local or national economy and (5) other financial hardships that may arise. **“Police Contingencies”** is money set aside in the general fund to ensure the continued “full-force” operation of the district’s police department, which can be severely impacted by state property tax shifts. Targets for various funds are as follows:

**Governmental Fund Types:**

General Fund: 50% of next fiscal year’s expenditure budget

Road Fund: 40% of next fiscal year’s budget (excluding road contract)

**Enterprise Funds:**

Water Enterprise Fund: 25% of next fiscal year’s operating budget

Wastewater Enterprise Fund: 20% of next fiscal year’s operating budget

Solid Waste Enterprise Fund: 20% of next fiscal year’s operating budget

Post Office Enterprise Fund: Zero net assets (Resolution 06-1249, 12/9/06)

- 6.6 **Rate stabilization:** Money set aside to normalize fluctuations in revenues so that rates for water, sewer and solid waste services will be more stable. This money is used as a “buffer” to reduce the frequency of changes to the District’s water, sewer and refuse rates, with the intent that annual cost-of-living rate increases will be sufficient for continued operations.

To the extent possible, Board-designated fund balances and net assets are fully funded at the beginning of each fiscal year based on the formulas found in the appropriate ordinances, resolutions or approved budget.

The various reserved and/or designated fund balances and net assets are funded in the following priority:

First priority: emergency, capital improvement, asset replacement, debt service, self-insurance;

Second priority: contingency, police contingency;

Third priority: rate stabilization.

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Resolution 97-899 (3/8/97) designated a portion of each enterprise fund's net assets for rate stabilization. The amount is set at a maximum of 5% of each fund's operating budget. By maintaining a rate stabilization reserve balance rate increases should never need to be greater than the annual cost-of-living adjustment equal to the inflation rate.

### 7. Rate Setting Policies

When reviewing rates, it is important to use a methodology that is "generally accepted" in the financial and rate setting community as well as the water, wastewater and solid waste utility industry. This will assure a legally defensible approach as well as consistency of the analysis over time.

#### Rate Setting Methodology

##### 7.1. Revenue Requirements Analysis:

Revenue requirements will be established on a "cash basis" approach. The "cash basis" approach includes operation & maintenance (O&M) expenses, transfer payments, debt service (P&I), and other capital improvements funded from rates. The revenue requirements, as defined herein, are the basic components. Revenue requirements should also include any other cost items requiring funding (e.g. bond reserves) or needed to operate the utility on a financially stable basis (e.g. accumulation or reduction in working capital).

- O&M expenses will incorporate the budgeted fiscal year costs.
- Debt Service requirements will incorporate appropriate debt schedules (include principal and interest). In addition, the revenue requirement will ensure sufficient funding to meet target debt service coverage ratios.
- Capital Improvements financed from Rates will be consistent with the District's annual asset management program.

7.1.2 At a minimum, revenues and costs will be projected for a five-year test period during the preparation of the annual budget.

7.1.3 Costs associated with mandated program requirements will be identified and included within the "cash basis" approach.

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### **7.2 Cost of Service Analysis:**

- 7.2.1 A cost of service study will be utilized to allocate costs equitably to customer classifications of service.
- 7.2.2 The cost allocation methodology will utilize techniques that are “generally accepted” by the industry (e.g. American Water Works Association, American Public Works Association and the Water Environment Federation).
- 7.2.3 The cost of service for each utility will consider the specific circumstances and unique characteristics of the District in the cost allocation methodology.

### **7.3 Rate Calculation Analysis:**

- 7.3.1 Rate designs will be reflective of utility needs and also reflect the specific goals and objectives of the District.
- 7.3.2 Rates will recognize and attempt to incorporate a fixed charge for the up-front fixed costs associated with serving customers and a usage or volumetric charge that attempts to recover the variable costs of operating the utility.
- 7.3.3 Rates will be set at a level that recovers the revenue requirement, by classification, yet flexible enough to accomplish the District’s objectives (e.g. public purpose programs, regulatory surcharge).
- 7.3.4 Rates should be designed to be equitable, and detailed to a level to reflect the service provided (e.g., single family, multi-family services, commercial, etc.).
- 7.3.5 Bear Valley Community Services District views itself as a regional utility. As such, water rates do not factor in the pressure zone for individual customers.
- 7.3.6 Rates should be set at a level high enough to achieve a 1:50 ratio of reserves to operating expenses in the water fund (2:00 in the wastewater fund) by the year 2020 (reserve policy currently under review by the finance committee).

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### **7.4 Rate Stability**

Financial stability of a utility also provides rate stability. Rate stability reinforces that costs are being managed and controlled, thereby gaining customers' confidence of the management team's credibility. Rates should be stable in their ability to generate sufficient revenues.

- 7.4.1 As part of the budget process, the District should review rates, on an annual basis, to assure that they provide sufficient revenues. This does not imply that rates must be adjusted each year, simply that the rates are reviewed in the context of these policies to assure that they are adequately funding each enterprise fund.
- 7.4.2 Small annual rate adjustments are preferable when compared to large single adjustments for multi-year periods.
- 7.4.3 Annual rate reviews will consider a five-year projected period to attempt to stabilize and minimize rates over time.
- 7.4.4 Any needed rate adjustments will attempt to minimize impacts to customers by phasing-in large rate adjustments over time.

### **7.5 Rate Impacts**

Utility rates are the primary communication the District has with its customers. Whenever possible, the District's rates should be easy to understand, stable from year-to-year and minimize the overall impacts to customers.

- 7.5.1 Rates will be easy to understand and the District will attempt to keep rate increases to a minimum.
- 7.5.2 Rates for each utility will be structured to promote understanding by the District's customers (e.g. bills that are easy to hand calculate and understand).
- 7.5.3 Rate adjustments will be phased-in, over time, when large financial impacts to customers are anticipated (e.g. eliminate rate shock).

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- 7.5.4 In establishing final utility rates, the District shall balance the needs of the utility, and the policies established herein, with the varying impacts to the District and the community as a whole.
- 7.5.5 When deemed necessary, the Board may invite the public to review and provide input into the rate setting process.

### **8. Capacity and Connection Fees**

Customer growth and system expansion as a result of new development has direct impacts upon a utility's infrastructure requirements, the financing of the "growth related" infrastructure, and customer rates. Through the establishment of specific financial/rate policies, the District will shelter the District's existing customers from the financial/rate impacts of growth and system expansion.

- 8.1 The financing of growth-related capital projects may be funded from any of the available funding resources of the District. When priority projects cannot be funded from reserves or cannot be built in increments, the use of long-term debt may be used.
- 8.2 The District shall analyze and determine cost-based capacity and connection fees (C&CF). The District Board will establish and maintain a C&CF that balances the goal of sheltering existing customers from the cost of growth, while supporting that growth.
- 8.3 Capacity and connection fee revenues will only be used for two purposes – to directly pay for growth-related capital improvements or to pay for growth-related debt service.