Financial Viability for Rural and Small Systems

Now that you have completed your *Rural and Small Systems* "Self-Assessment" exercise and determined that Financial Viability is important to your utility, this handout can help you get started on improving your Financial Viability practices. It describes some of the key "Building Blocks" of financial success for small utilities, giving you a starting place to improve utility financial practices. The handout also includes specific suggestions on how to measure a utility's financial viability, and lists a number of free resources with practical information on how to improve practices. For more information on the Financial Viability management area, please refer to the *Rural and Small Systems Guidebook to Sustainable Utility Management*.

> FINANCIAL VIABILITY: **The system establishes and maintains an effective balance between long-term debt, asset values, operations and maintenance expenditures, and operating revenues. Rates are adequate to pay its bills, put some funds away for both future capital expenditures and unanticipated issues, and maintain, repair, and replace its equipment and infrastructure as needed. The system discusses rate requirements with its customers, decision making authorities, and other key stakeholders.**
>
> *— Rural and Small Systems Guidebook to Sustainable Utility Management*

Additional Information

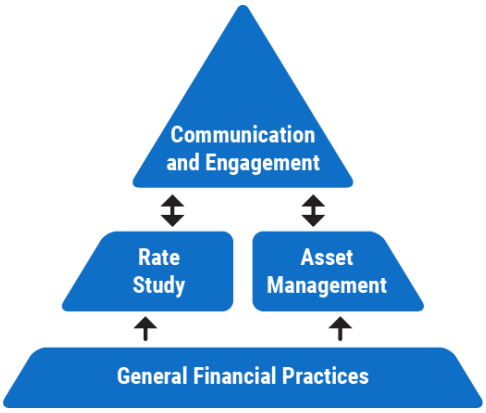
EPA website: https://www.epa.gov/sustainable-water-infrastructure/tools-effective-water-and-wastewater-utility-management
USDA website: https://www.rd.usda.gov/programs-services/services/sustainable-management-tools

USDA EPA

Building Blocks of Financial Viability

GENERAL FINANCIAL PRACTICES

Basic financial practices and management skills are necessary to maintaining a financially viable utility. These skills and practices provide the foundation for all the other building blocks. Foundational practices include book-keeping and regular, systematic monitoring of the utility's revenue and costs.



EXAMPLE ACTIVITIES

- Maintain a budget standard accounting and record-keeping practices
- Conduct regular budget reviews
- Prepare a "rainy day" reserve fund for unexpected obstacles

ASSET MANAGEMENT

An asset management plan is an important step in achieving financial viability. First, a utility must identify all the utility's assets and equipment (e.g., pumps, treatment systems, buildings, etc.) and assess the cost and condition of these assets. After identifying the value and condition of its assets, the utility predicts the lifespan of these assets, and creates a plan for funding the repairs, replacements, and upgrades to major assets as they age.

EXAMPLE ACTIVITIES

- Create an inventory of system assets, asset condition, and financial value of assets
- Estimate asset lifespans and identify priority assets for system improvements or repairs
- Plan for medium- and long-term expenses linked to asset upgrades and replacements

RATE STUDY

A rate study looks closely at the revenue needed to provide enough funding for operations and maintenance (O&M), capital investments, and debt service. The study will lay out the different options for rate design and rate structure for utility customers. A rate study also informs a utility's strategy for funding operations or major infrastructure investments.

EXAMPLE ACTIVITIES

- Review the utility's budget, along with water produced and sold
- Calculate utility's O&M costs and create a plan to adjust rates over time to meet these costs
- Design a system for automatic rate increases tied to cost of living increases
- Create incentives to reduce the number of outstanding bills or for early bill paying

COMMUNICATION AND ENGAGEMENT

Communication and engagement is necessary to explain the need for infrastructure investments and other operating needs of the utility to stakeholders (customers, community leaders, water utility governing boards). Creating an open discussion with stakeholders about the utility's operations and financial needs will help to gain support and public acceptance for rate increases or other forms of financial support. This building block will rely on the information and activities from the Rate Study and Asset Management building blocks.

EXAMPLE ACTIVITIES

- Continually promote the value of water and water services within the community to increase public support for the utility, which will pave the way for communicating future investment needs and rate adjustments
- Engage board members, decision makers, and other community stakeholders with financial viability information, including communicating reasoning behind rates and utility operating costs
- Solicit feedback from customers on their preferences or concerns about water infrastructure and water services

Measures

It is important to have a method of measuring and tracking the financial health of a utility. Below several measurement areas are described, with specific example metrics or activities for each area.

BUDGET MANAGEMENT EFFECTIVENESS

Short-term measures are common financial performance indicators, which can be recorded annually or quarterly. Long-term measures may focus more on a "big picture" assessment, looking at a wide range of factors to assess budget health over many years or decades. Consider the measures below, the first three are short-measures. The revenue to expenditure ratio helps a utility see if they need to increase revenue (such as raising rates) or find ways to lower expenses. Regularly recording the debt ratio will help a utility see debt levels, and if the debt is growing or shrinking. Bond rating is a long-term metric that can generally show a utility's overall financial health.

EXAMPLE METRICS

- Revenue to expenditure ratio: Total revenue ÷ total expenditures
- Debt ratio: Total liabilities ÷ total assets
  (USDA recommends that a facility have a debt coverage ratio of at least 1.1, or a current ratio of at least 1.5)
- Capital expenditures: capital expenditures ÷ total capital budget
- Bond rating

RATE ADEQUACY

This measure looks at a utility's rates, and how these rates are affected by outside factors. These outside factors could include: general economic trends; short-term financial management; changes to a utility's service population; and long-term financial goals. Since utilities operate in varied contexts (e.g., large or small, rural or urban) it is difficult to provide a "one size fits all" calculation for utility rates.

EXAMPLE METRICS

- Number of late or unpaid bills per billing period
- Number of annual shutoffs
- Comparison of rate changes to inflation and the Consumer Price Index (CPI). (Rate increases below inflation or CPI for very long may suggest rates are not keeping up with utility costs.)

FINANCIAL PRACTICES ASSESSMENT

An active effort to self-assess the quality of financial management and procedures in the utility—aiming to find areas in financial management where the utility could improve.

EXAMPLE QUESTIONS

- Does the utility have financial accounting policies and procedures (yes/no)?
- Are financial results and internal controls audited annually (yes/no)?
- Does the utility have a formal policy for the bill collection process (yes/no)?

Example Practices for Financial Viability at Rural and Small Systems

The practices listed below are drawn from the Rural and Small Systems Guidebook and the Moving Toward Sustainability Roadmap document. They are examples of practices that utilities have implemented to improve their performance in the area of Financial Viability.

Create policies for internal control procedures over financial management.	Conduct a financial feasibility analysis to identify funding and financing available for future infrastructure project needs.	Have a study on rate requirements conducted by third party (e.g., NRWA, RCAP).
Conduct quarterly budget reviews.	Create operating and capital "rainy day" funds.	Build in gradual, annual rate increases.

Resources

Highlighted below are several practical and free resources that provide information for utilities on how to improve financial practices. For a longer list of resources that provide more information on specific areas of utility management, please see the ***Rural and Small Systems Guidebook to Sustainable Utility Management: Appendix III***.
https://www.rd.usda.gov/files/RuralandSmallSystemsGuidebook2016.pdf

The Basics of Financial Management for Small-Community Utilities

This guide provides a review of basic financial management aspects of utility operations for board members and operators of drinking water and wastewater utilities in small communities. The guide addresses short- and long-term budgeting; how to develop a budget plan; systems for accounting and disbursing funds; and other general financial and record-keeping practices.
http://www.rcapsolutions.org/wp-content/uploads/2013/06/RCAP-Financial-Management-Guide.pdf

Check Up Program for Small Systems (CUPSS) Asset Management Tool

CUPSS is a free, easy-to-use asset management tool for drinking water and wastewater utilities. It can help you keep a record of your assets, schedule required tasks, better understand your financial situation, and create a tailored asset management plan.
https://www.epa.gov/dwcapacity/information-check-program-small-systems-cupss-asset-management-tool

Financial Planning: A Guide for Water and Wastewater Systems

This guide is designed as an introduction to general financial practices for any owner or manager of a water or wastewater system. The guide offers information on how to develop and monitor a utility budget; evaluate rate structures; and develop a 5-year financial plan. The guidebook provides details on exactly what information is necessary to do these activities, and includes worksheets walking through each step of the process.
http://www.nmenv.state.nm.us/dwb/Documents/Public%20Info/RCAC%20Financial%20guide_final_6.pdf

Moving Toward Sustainability: Sustainable and Effective Practices for Creating Your Water Utility Roadmap

This document helps utility leaders carry out successful practices to improve their operations and move toward sustainability, at a pace in line with community and utility needs. Level 1 practices highlighted in the “Financial Viability” section of this document are a good starting place for utilities looking to update their basic financial practices.
http://www.epa.gov/sites/production/files/2015-04/documents/sustainable_practices_utilities_roadmap_crwu.pdf

Water Infrastructure and Resiliency Finance Center

The Water Infrastructure and Resiliency Finance Center is an information and assistance center at the U.S. EPA, which helps communities make informed decisions for drinking water, wastewater, and stormwater infrastructure. The Center provides water infrastructure funding and financing information and assistance to local governments.
https://www.epa.gov/waterfinancecenter