BELLA VISTA WATER DISTRICT - FINANCIAL POLICY

PURPOSE

The purpose of this policy is to provide a financial framework for decision making to assure the financial viability of the District and to make rates equitable. The policy will help prevent bumps in the financial road of the District.

The policy is meant to be a guide, not a hard and fast requirement. It is the intent of management that this financial policy not drive revenue requirements in any given year, rather, that it be used to guide the District's financial program over the longer period. This flexibility is to help stabilize rates.

POLICY

It is the policy of the Bella Vista Water District that:

- Rates shall be fair, equitable, and cost based.
- Rate setting will be done on a cash basis.
- Customer classifications shall be residential, commercial, public/institutional, rural, agricultural, and aquaculture.
- The Board of Directors shall receive a monthly financial statement.
- The Board of Directors shall review and adjust rates annually.
- The District shall prepare a cost based rate study every five years to determine rates.
- An audit will be performed annually.
- The District will attempt to fund an amount annually from rates for improvements to the system equal to annual depreciation.
- The debt service ratio be maintained at 1.5 or above.
- 45 days (1/8 of O&M expenses) shall be maintained as a working capital reserve.
- Reserves shall be maintained in the amount of at least 10% of annual budget.
- Inventory shall be maintained at 0.6% of system value.

- The cost of services over which the District has no control shall be passed on to the rate payers in a manner consistent with sound fiscal policy.

DISCUSSION

Rates shall be fair, equitable, and cost based.

If the rates can meet the above test, they can be defended. Each rate paying group should pay their own way based on the cost of providing that service.

Rate setting will be done on a cash basis.

The District will use the cash basis as the method of rate setting as opposed to the utility method typically used by private water systems. The cash basis takes into account: 1) O&M expenses; 2) taxes and transfer payments; 3) debt service requirements; and 4) capital projects funded from rate revenues. The utility basis substitutes return on investment (rate base) and depreciation expense in place of 3 and 4 above.

Customer classifications shall be residential, commercial, public/institutional, rural, agricultural, and aquaculture.

Previously, the District's Directors determined to phase out the rural water rate. These rate classes were set by the Board of Directors on February 10, 1998 to provide an equitable method of charges and a way to provide for incentive water pricing.

Board of Directors shall receive a monthly financial statement.

The Board currently receives a monthly financial statement which provides a progress report on District finances through the year, as well as information on where the money is being spent and its location in the budget. This practice will continue.

Review and adjust rates annually.

Rates should be reviewed annually to reflect inflation, construction goals, maintain debt service ratios, etc. This requirement is to enable the District to make small adjustments on a timely basis to avoid large rate increases at one time. The customer generally understands the need to increase rates to keep up with inflation, but has little tolerance when asked to participate in a large rate increase.

Prepare a cost based rate study every five years.

A cost based rate study should be accomplished every five years to support the relative amounts of charges to each rate class and to support the reasonableness of the rates. The rates should provide adequate revenue to meet the utility's financial, operating, and regulatory requirements.

Perform an annual audit.

The purpose of the District's annual financial audit is to verify the accuracy of accounting records and other evidence supporting those financial records. The annual financial audit shall be performed by an outside, independent auditor using Government Auditing Standards issued by the Comptroller General of the United States.

Attempt to fund an amount annually from rates for improvements to system equal to the annual depreciation.

This program assures that current rate payers contribute toward the depreciation and eventual replacement of the system from which they are currently benefitting. This approach helps reduce rates over the long term by reducing the amount of capital improvements financed by debt and will assure that the system does not deteriorate over time since it is being improved on a continual basis under this plan.

Debt service ratio to be maintained at 1.5 or above.

The District's loan covenant for its existing loan from Sanwa Bank requires a 1.2 debt service coverage, or 20% more than actual debt service to be available to pay debt service. This ratio assures that the District can continue to pay its debt obligations should revenue shortfall occur. Tax dollars, special assessment money, capital improvement fees, water revenues, interest payments, and miscellaneous fees and charges shall be used in calculating the funds available to meet the debt service coverage ratio.

This approach can help maintain a good standing with bonding agencies by adopting a strong financial position. In the mid-nineties, the District experienced a significant slowdown in the amount of development within the District boundaries with a corresponding reduction in the annual revenue from capital improvement fees which are used to pay debt service. Having a higher ratio will help ease concerns that adequate funds to make debt service payments may not be available to repay District obligations.

Use 45 days (1/8 of O&M expenses) as a working capital reserve.

Working capital reserves, or ending fund balances as they are also called, are to assure that the utility has operating revenue in case unanticipated expenses or situations (such as cash flow problems) should arise during the course of the year. It assures that ongoing expenses of operations can be paid without an emergency surcharge on the rates.

If for any year it appears that this policy alone would increase rates, the recommendation is to have a 30-day minimum worth of O&M expenses with 45 days equivalent being the target.

Maintain total reserves in the amount of 10% of annual budget.

The total amount of reserve funds on hand should be sufficient to handle unforeseen emergencies such as major line breaks, etc., as well as provide funds for debt service. The amount recommended is 10% of the annual budget excluding any reserve funds set aside for specific loans.

Inventory shall be maintained at 0.6% of system value.

This amount will generally assure that adequate parts will be on hand to make most routine repairs and smooth out expenditures on a day-to-day basis.

BELLA VISTA WATER DISTRICT

FINANCIAL POLICY

ADOPTED BY THE BOARD OF DIRECTORS

FEBRUARY 10, 1998