

MONEY MATTERS: BASIC ACCOUNTING FOR THE UTILITY PROFESSIONAL

TAUD Administrative Professionals
Conference

December 9, 2010



Chad Milom, CPA

Senior Manager, Accounting and Assurance
Lattimore Black Morgan and Cain, PC



Objectives

- ▣ Understand the basics of accounting principles for utility districts.
- ▣ Understanding the elements of a financial statement and significant areas of importance for utility districts.
- ▣ Basic financial statement analytics for utility districts.
- ▣ Understanding internal control

Accounting

- ▣ The process of analyzing, recording, reporting and interpreting financial transactions and related information.

Generally Accepted Accounting Principles (GAAP)

Accounting rules used to prepare, present, and report financial statements for a wide variety of entities.

- ▣ GASB - Governmental Accounting Standards Board
- ▣ FASB - Financial Accounting Standards Board
- ▣ AICPA - American Institute of Certified Public Accountants

Uniform Accounting Manual for Tennessee Utility Districts

- ▣ Developed by the Tennessee Division of Municipal Audit, Department of Audit, in order to ensure that Tennessee utility districts' books and records are kept in accordance with the generally accepted accounting principles.

Basis of Accounting

- ▣ Cash Basis – Revenues are not recorded and expense are not recognized until cash is received or paid.
- ▣ Accrual Basis – Revenues are recorded when earned (regardless of when received) and expenditures are recorded when incurred (regardless of when paid).

All utility district accounting should be on the accrual basis.

Double Entry Accounting

- **Double-entry bookkeeping** is a set of rules for recording financial information in a financial accounting system in which every transaction or event changes at least two different accounts. For the accounts to remain in balance, a change in one account must be matched with a change in another account. The sum of all debits made in any transaction must equal the sum of all credits made.

- Debits and credits are then defined as follows:
 - **Debit:** A debit is recorded on the left hand side of an account. Debits can also be defined as an increase in assets and expenses while a decrease in liabilities, revenue and capital.

 - **Credit:** A credit balance is recorded on the right hand side of an account. Credits can also be defined as increases in liabilities, revenue and capital and a decrease in assets and expenses.

 - **Debit accounts** = Asset and Expenses

 - **Credit accounts** = Gains (income) and Liabilities

The Accounting Process

Transactions

```
graph TD; A[Transactions] --> B[Subsidiary Ledgers (AR, Payroll, Revenues, etc...)] --> C[General Ledger (Accounts)] --> D[Financial Statements]
```

Subsidiary Ledgers (AR, Payroll, Revenues, etc...)

General Ledger (Accounts)

Financial Statements

Financial Statements

- ▣ Balance Sheet
- ▣ Statement of Revenues, Expenses and Changes in Net Assets
- ▣ Statement of Cash Flows
- ▣ Notes to the Financial Statements
- ▣ Supplemental Information:
 - Schedule of Long Term Debt Principal and Interest Requirements
 - Schedule of Utility Rates in Effect
 - Schedule of Unaccounted for Water

Balance Sheet



Assets

- Cash
- Accounts receivable
- Inventory
- Prepays
- Capital Assets



Liabilities

- Accounts Payable
- Accrued expenses
- Debt (current vs. long term)



Net Assets

- Invested in capital assets, net of related debt
- Restricted for debt service
- Unrestricted

Statement of Revenues, Expenses and Changes in Net Assets

Operating Revenues

- Water sales
- Fees

Operating Expenses

- Production and distribution (or other departmental such as lighting, waste, etc.)
- General and Administrative
- Depreciation

Nonoperating revenues and expenses

- Interest income (expense)
- Gain (loss) on disposal of assets

Capital Contributions

- Tapping privilege fee in excess of costs

Cash Flows

Cash Flows from Operating Activities

- Cash received from customers
- Cash paid to suppliers for goods and services
- Cash paid to employees for services

Financing Activities

- Acquisition of capital assets
- Payments/receipts related to long term debt
- Capital contributions

Investing Activities

- Interest income
- Investment activities

Notes to the Financial Statements

- ▣ Summary of significant accounting policies
- ▣ Roll forward of capital assets (in footnotes or supplemental schedule)
- ▣ Information about restrictions on assets (such as cash or capital assets) or significant commitments or contingencies (such as legal proceedings, commitments under construction contracts, etc...).
- ▣ Other significant information that is informative to the user of the financial statements.

Significant Accounts

- ▣ Cash:
 - Restrictions?
 - Bank overdrafts (netted with all accounts at one institution) should be classified as a liability.
 - Reconciled monthly
 - Strong controls over custody.

- ▣ Accounts receivable:
 - Need for an allowance for doubtful accounts

Significant Accounts

- ▣ Inventory:
 - Recorded at lower of cost or market. Consider need for a reserve for any potential obsolescence.

- ▣ Capital Assets:
 - Recorded at cost (includes certain construction or installation charges such as interest, certain licenses, etc..)
 - Management responsible for determining reasonable lives and depreciation methods (generally the straight-line method). Land not depreciated.
 - Consider for impairment at least annually.

Significant Accounts

- ▣ Accounts payable – should include all expenses for services rendered or products received that have been billed by vendors.
- ▣ Accrued expenses – should include all expenses for which services provided or product received but vendors have not billed. Also includes other expenses incurred in accounting period but not paid (wages and related withholdings, vacation time, bonuses, pension contributions, rent, legal, interest, etc...).
- ▣ Debt – classified as current (payable within the next year) vs. long term (due in excess of one year).

Significant Accounts

▣ Net Assets:

■ Invested in capital assets, net of related debt

- ▣ This component of net assets consists of bond issuance costs and capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

■ Restricted for debt service

- ▣ This component of net assets consists of constraints imposed by creditors through debt covenants reduced by accrued interest on related long term debt.

Significant Accounts

- ▣ Operating revenues should be reported net of any bad debt expense or returns.
- ▣ Expenses – If the district provides several utility services and accounts for all of those activities in a single fund, a detailed schedule of revenues and expenses and net assets related to each division must be included in supplemental information. If sufficiently detailed information is included in the notes to the financial statements, these additional schedules are not required. This information is necessary to demonstrate compliance with state laws regarding utility operations.

Users of the Financial Statements

- ▣ Management
- ▣ Customers
- ▣ Lenders (most require submission of financial statements)
- ▣ State of Tennessee (Comptroller of the Treasury) – reporting through CARS system

Basic financial statement analysis for utility districts

- ▣ Debt compliance requirements (restrictions of net assets for debt compliance, financial covenants, etc...)
- ▣ Key ratios (revenue per customer, change in net assets, depreciation as a percentage of average capital assets)
- ▣ Unaccounted for Water
- ▣ Working capital (current assets less current liabilities)

Internal Controls

Internal control is defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), in standards adopted by the American Institute of Certified Public Accountants and by the Federal Office of Management and Budget as follows:

- ❑ Internal control is a process – affected by those charged with governance, management and other personnel designed to provide reasonable assurance regarding the achievement of objectives in the following categories:
 - ❑ Effectiveness and efficiency of operations
 - ❑ Compliance with applicable laws and regulations
 - ❑ Reliability of financial reporting

Management and the governing body are responsible for the government's performance, compliance and financial reporting. Therefore, the adequacy of internal control to provide reasonable assurance of achieving these objectives is also the responsibility of management and the governing body.

Components of Internal Control

- ▣ Control environment
- ▣ Risk assessment
- ▣ Information and communication
- ▣ Control activities
- ▣ Monitoring

Internal Control

- ▣ Segregation of Duties
- ▣ Custody of cash vs. recording cash transactions
- ▣ Management oversight
- ▣ Board oversight

Links/Resources

Tennessee Comptroller of the Treasury
Division of Municipal Audit

<http://www.comptroller1.state.tn.us/>

Tennessee Association of Utility Districts

<http://www.taud.org/>

Questions



cmilom@lbmc.com

615-309-2315