



MEMORANDUM

To: Kurt Triplett, City Manager

From: Michael Olson, Director of Finance & Administration
Sri Krishnan, Deputy Director of Finance & Administration
Maggie Eid, Accounting Manager
George Dugdale, Financial Planning Manager

Date: October 19, 2022

Subject: SEPARATE WATER AND SEWER UTILITY FUNDS

This issue paper discusses the option of creating separate funds for the Water and Sewer utilities. The City currently treats Water and Sewer as a single utility and has three funds to account for Water and Sewer revenues, expenditures, and reserves:

Water/Sewer Operating Fund
Water/Sewer Debt Service Fund
Water/Sewer Utility Capital Projects Fund

Separating the funds would require the creation of six new funds as noted below. The existing funds would be kept for historical purposes but closed to prevent further use:

Sewer Operating Fund	Water Operating Fund
Sewer Debt Service Fund	Water Debt Service Fund
Sewer Utility Capital Projects Fund	Water Utility Capital Projects Fund

While developing the City's 2023-2024 budget, the benefits of creating separate funds for Water and Sewer utilities was raised as a way of increasing transparency and easing the tracking and reporting of activities associated with each utility.

This memo presents the current structure along with the benefits, concerns, process, and timeline for establishing separate funds for Water and Sewer utilities.

BACKGROUND & DISCUSSION:

The City's 2021-2022 Budget has 24 separate funds. The Preliminary 2023-2024 Budget will include 25 separate funds with the addition of the Development Services Fund. Of the 25 funds in the Preliminary 2023-2024 Budget, three of them are used to account for the Water/Sewer Utility:

- **Water/Sewer Operating Fund (Fund 411)** – Accounts for revenues from the City’s water and sewer customers; and expenditures related to: purchase of water from the Cascade Water Alliance, sewage treatment from METRO/King County, and all maintenance and administrative costs.
- **Water/Sewer Debt Service Fund (Fund 412)** – Accounts for principal and interest payments on water and sewer utility debt. Currently there are 2 Public Works Trust Fund Loans.
- **Water/Sewer Utility Capital Projects Fund (Fund 413)** – Accounts for water and sewer capital projects revenues and expenditures. Included in the fund are the Water/Sewer Capital Improvement Program (CIP) Contingency and Water/Sewer Construction Reserve.

During the development of the Preliminary 2023-2024 Budget, the topic of creating separate funds for each utility, Water and Sewer was raised. As the City explores establishing separate funds for Water and Sewer, it is important to note that while creating separate funds for Water and Sewer would make it easier to monitor the financial health of each utility, the current structure is in compliance with all accounting and reporting requirements. The following section discusses the current structure of the Water/Sewer funds.

Current Structure

While the City operates Water and Sewer as two separate utilities in many ways, the two utilities also share assets and resources. For example, the City conducts separate rate studies and charges rates based on each utility’s total cost of service. Most revenues and expenditures can be directly tracked to Water or Sewer, however, certain revenues and expenditures are not allocated to each utility because they are accounted for in the same fund. The following is a summary of the current structure of the three Water/Sewer-related funds:

1. Water/Sewer Operating Fund

- **Revenues** – While most are split into separate Water and Sewer categories, those which are not include investment interest, miscellaneous utility revenue, general government services, final bill fee, gain/loss on insurance recoveries, other miscellaneous revenue, other judgements, sales of surplus, unrealized gains and interfund general revenue. For these accounts, in separating the funds, individual transactions would need to be reviewed to categorize as water or sewer.
- **Expenses** – Most expenses are split into separate Water and Sewer categories. The items which are not currently split include utility administration, maintenance supervision, customer service, and reimbursable work.
- **Liabilities** – These are not currently split between Water and Sewer.
- **Assets** – These are not currently split between Water and Sewer with the exception of capital assets which are split between Water and Sewer.

2. Water/Sewer Debt Service Fund

Each year the amount required to pay principal and interest on outstanding utility debt is budgeted and placed in the Water/Sewer Debt Service Fund. The transfers are made from the Water/Sewer Operating Fund. The funds are not split into separate Water and Sewer categories.

3. Water/Sewer Utility Capital Projects Fund

The Water/Sewer Capital Improvement Program (CIP) Contingency and Water/Sewer Construction Reserve included in this Fund are not split between Water and Sewer.

Benefits, Concerns, Process, and Timeline

As noted earlier, creating separate funds for Water and Sewer would offer greater transparency, make it easier to track the financial performance of each utility, more closely tie the data used for rate modeling to data in the City's financial system, and avoid mixing rate revenues intended for each utility.

However, depending on the fund balance that is ultimately allocated to each utility and the projects that each utility plans to undertake in the future, we would need to more closely track future anticipated reserves and cash flows to ensure stability in the separated funds.

The topic of separating the Water/Sewer Fund arose as staff were working on the Preliminary 2023-2024 Budget. With the budget production staff have not had time to explore in detail the time and effort needed to accomplish this task. Based on the effort to create the Development Services Fund, staff estimate that it might take six months or more to analyze the issues and develop an implementation plan. As of this writing, staff anticipates undertaking this effort in the third quarter of 2023 after the 2022 audit process is completed. The goal would be to implement this change as part of the development of the 2025-2026 Budget.

Creating Separate Utility Funds

Since the City has operated with a combined Water and Sewer Fund for many years the creation of separate funds will require among other things a detailed analysis of revenues, expenses, transfers to and from reserves over the last 10 years or more, to determine the fund balances for each new fund. In addition to the detailed analysis, staff anticipates that the following actions will be required to implement this change:

1. Evaluation of current revenue and expense codes and determination of general ledger structure required for new funds.
2. Set up new fund structures including creating general ledger organization structure and then mapping all organization codes to object codes individually.
3. Adding the new general ledger fund structures to all payroll deduction codes individually (no mass options available).
4. Creation and set-up of new cashier charge codes in Munis for the new funds.
5. Review of all revenue codes in Energov in terms of the structure to which they currently post and where they should be posting in the future and update as appropriate.
6. Creation of journals to move ending assets and liabilities to the new funds.
7. Review and update all paperwork and forms (such as cashier forms, journal forms) with the new structure.

8. Updating financial statement spreadsheets/templates for year-end reporting with the new funds.
9. Update position control for all the affected positions.
10. Transfer all employees to new general ledger organization structure using Personnel Action Forms (PAFs).
11. Review affected contracts and purchase orders. Create change orders on all contracts and purchase orders to move encumbrances to new fund structure.
12. Update Springbrook, the City's utility billing software to map to the new Funds.
13. Update all labor distribution spreadsheets to reflect the new fund structure.
14. Update Lucity, the City's maintenance management software to map to the new Funds.
15. Update Payroll module in Munis to accurately capture and report employee cost allocations.
16. Update the project ledger to map the existing capital projects to the new general ledger structures.

As noted earlier, based on the effort to create the Development Services Fund, staff estimate that it might take six months or more to analyze the issues and develop an implementation plan. If the City decides to separate the funds after the analysis of balances, the goal would be to implement this change in the 2025-2026 Budget.

NEXT STEPS:

Staff will update Council on this item as part of the mid-bi process in 2023, providing the results of the analysis and a detailed timeline for the process.