Form 2-C, Section 2
Water System Capacity Assessment Indicators

SECTION 2: FINANCIAL CAPACITY REVIEW QUESTIONS

Overall financial capacity for a water system can be assessed by examining both the fiscal condition and the financial management of the system. The fiscal condition describes the ability of the water system to raise the resources necessary for proper operation.

Questions 1-6 focus on the fiscal condition of the public water system, primarily related to the user charge system (also referred to as rates or fees).

These six questions address the following fiscal capacity components:

- total user charge revenues versus total system expenses
- other revenue sources (if applicable)
- affordability of customer user charges
- cash budgeting
- frequency of rate setting

For the purpose of determining whether the state could confidently loan its funds to the system, the questions are designed to address the critical issue of whether or not the system has the ability to meet its obligations in a timely manner.

The first step in assessing capacity is to determine whether capital investment will make a difference in bringing a system into long-term compliance. Determining whether the water system can afford to pay back what it borrows is the second step.

While the technical capacity questions utilize a series of yes/no questions, the fiscal capacity questions are often answered by providing data that can be analyzed using common equations. Please refer to the "Note" box that accompanies most questions to see how the answers to the questions might be utilized.

Fiscal capacity is generally a self-assessment exercise. The water system operator and/or management team should be able to provide the answers for many of the questions. For purposes of the DWSRF, there must be assurance that the water system will have the financial capacity to be able to maintain compliance with the 1996 Safe Drinking Water Act (sec. 1452(a)(3)(B)) requirements. Fiscal capacity and financial management capacity information provided by the water system can meet this assurance requirement when accompanied by standard financial management documents such as audited financial statements.

Financial Management Review Questions

Financial review questions 7-10 address the following financial management components:

- development and use of an annual budget
- development and use of a capital budget
- development and use of a capital improvements plan
- periodic financial audits

For the purpose of determining whether the state could confidently loan its funds to the system, the questions are designed to address the critical issue of whether or not a public water system

has financial management controls that enhance its ability to return DWSRF principal and interest payments.

How to Use the Results of the Analysis

This section asks the water system to provide documents that can be reviewed to verify financial management practices. These documents will also provide support for information provided in the fiscal capacity measurement section.

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FINANCIAL CAPACITY REVIEW QUESTIONS

EDU = Equivalent Dwelling Unit, also known as equivalent residential unit (ERU)

O & M = Operations and Maintenance

PWS = Public Water System

Question 1. System Revenues

What is the number of EDUs in the PWS?

What is the expected revenue per EDU per month?

What are the annual system expenses (O&M, debt service, and capital replacement)?

Do water system revenues from user charges, based on the existing population base and a conservative growth projection, meet or exceed expenses (O&M, debt service, and capital replacement)?

☐ Yes

Go to question #3, Water System Rate Affordability Index.

☐ No

Go to question #2, Other Funds.

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FINANCIAL CAPACITY REVIEW QUESTIONS

Question 2. Other Funds

If total system expenses exceed total user charge revenues, are other funds contributed to offset system expenses?

☐ Yes ☐ No or N/A

What is the source(s) of additional revenue funds?

Go to question #3, Water System Rate Affordability Index.

What is the total amount of additional revenue funds in the current year water system budget?

Go to question #3, Water System Rate Affordability Index.

NOTE: In some cases, water systems may supplement user charges with other revenues. This practice is usually discouraged because the full costs of operations should be met by revenues. However, where user fees are supplemented, DEQ should obtain information regarding the specific situation and the dependability of the supplemental resources.

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FINANCIAL CAPACITY REVIEW QUESTIONS

Question 3. Water System Rate Affordability

O&M = Operations and Maintenance

For residential customers only, fill in the the following boxes, using the most current information available:

Frequency of water system billing:

Average median household income within the PWS (include source of data and year data was compiled [e.g.,U.S. Census, 2000]):

Average residential water system user charge (should include O&M, debt service, and capital replacement):

List new debts anticipated to be entered into by the PWS during the next five years:

Go to question #4, Cash Budget.

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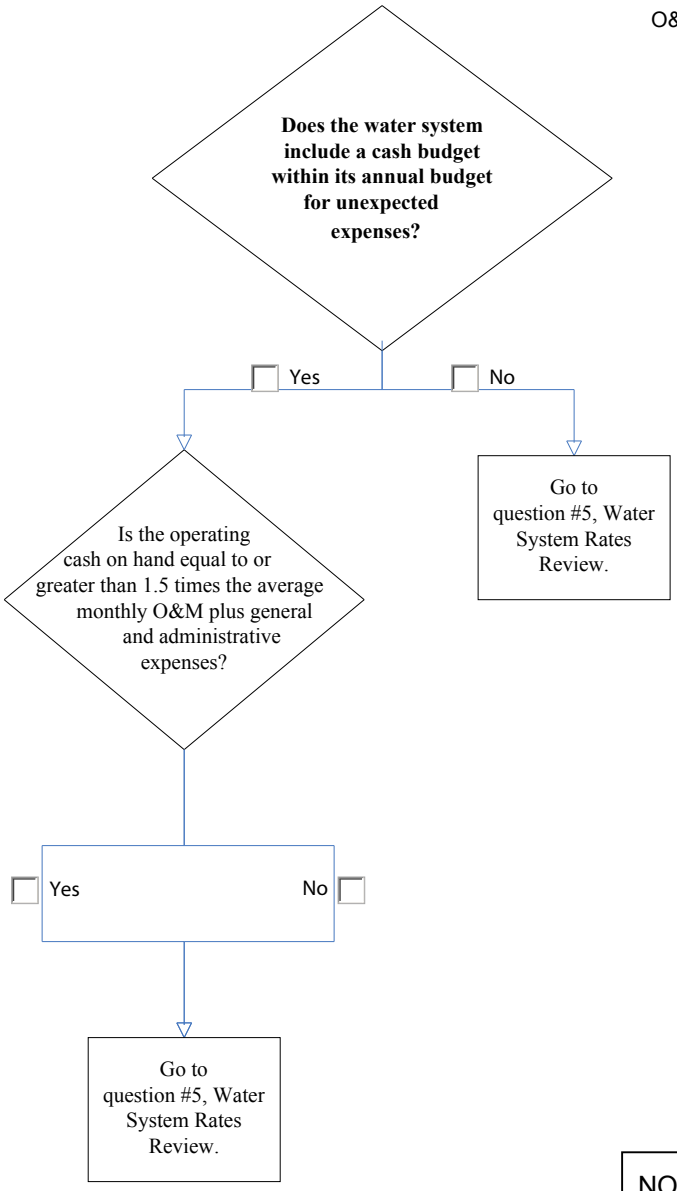
FINANCIAL CAPACITY REVIEW QUESTIONS

Question 4. Cash Budget

O&M = Operations and Maintenance



NOTE: A water system budget that incorporates a cash budget equivalent to 1.5 times the monthly O&M, general, and administrative expenses is conscious of the need to be prepared for emergencies, payment delinquencies, and other short-term cash flow problems.

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FINANCIAL CAPACITY REVIEW QUESTIONS

Question 5. Water System Rates Review

Does the water system management review the user fee, user charge, or rate system at least once every two years?

☐ Yes

Go to question #6, Setting Rates.

☐ No

When was the most recent review of water system rates (user fees and charges)?

Go to question #6, Setting Rates.

NOTE: It is good practice for a water system to review its rates on an annual basis. When a system reviews its rates infrequently, it will be less able to adjust to significant changes in operating expenses. When a system reviews its rates frequently, it can more easily raise user charges to meet expenses related to new or amended drinking water rules.

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FINANCIAL CAPACITY REVIEW QUESTIONS

Question 6. Setting Rates

What resources and guidance does the water system use for setting water user rates, fees, and charges?

Go to question #7, Annual Budget.

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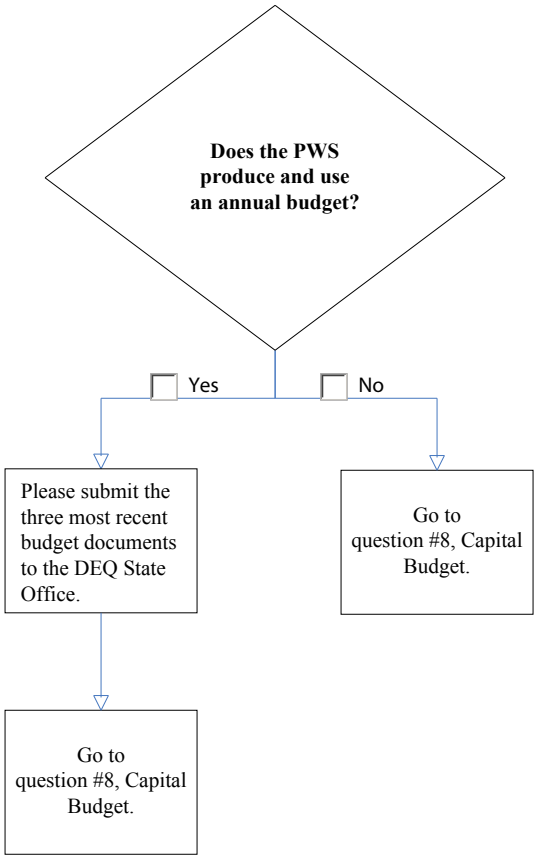
FINANCIAL CAPACITY REVIEW QUESTIONS:
Financial Management

Question 7. Annual Budget

DWSRF = Drinking Water State Revolving Fund
PWS = Public Water System



NOTE: The lack of an annual budget document is a serious deficiency and should be a stopping point for DWSRF application review.

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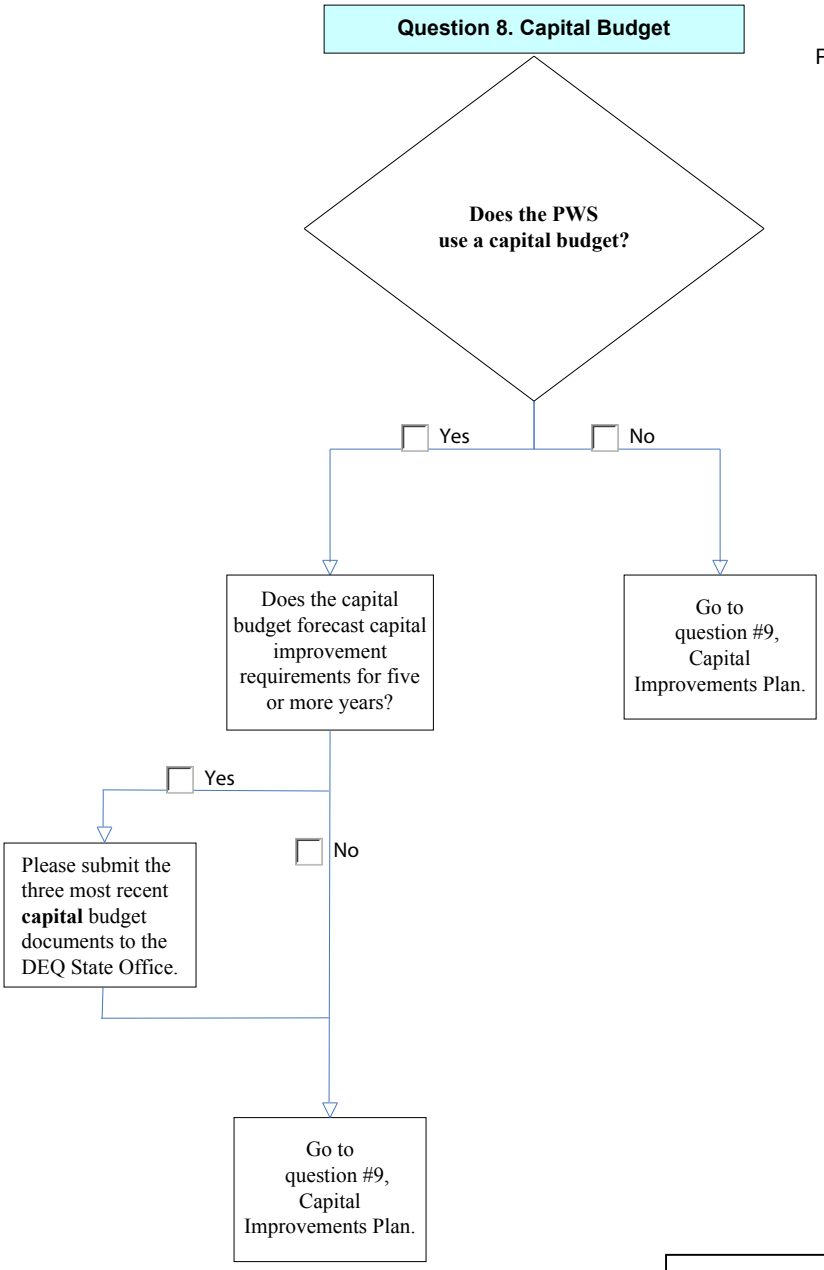
FINANCIAL CAPACITY
REVIEW QUESTIONS:
Financial Management



PWS = Public Water System

NOTE: The use of five-year capital budget is a positive indicator of financial management and supports the assessment of technical capacity conditions. A capital budget is an indication that the PWS is aware of the need for financing infrastructure upgrade and/or replacement.

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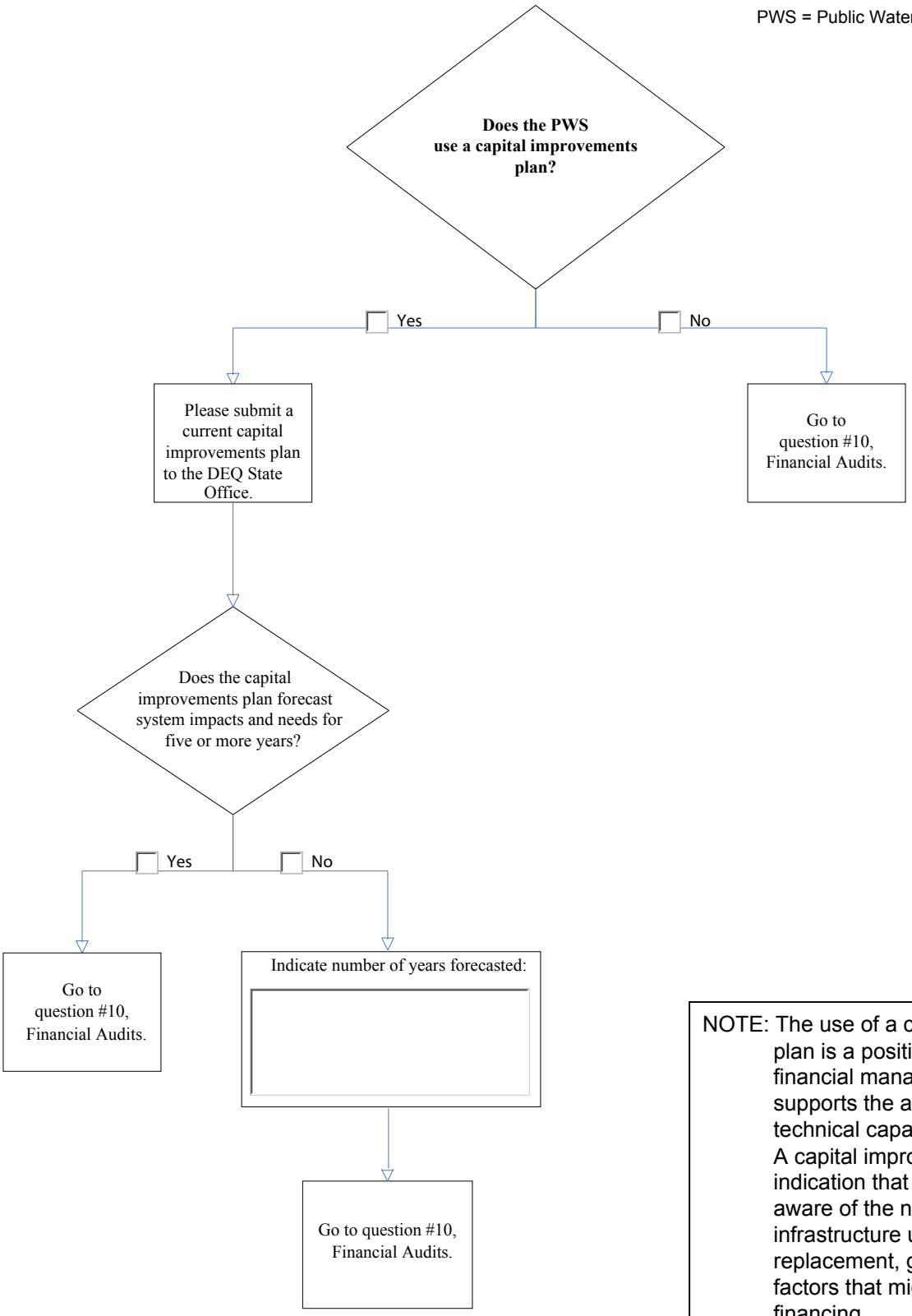
FINANCIAL CAPACITY REVIEW QUESTIONS:
Financial Management

Question 9. Capital Improvements Plan

PWS = Public Water System



NOTE: The use of a capital improvement plan is a positive indicator of financial management and supports the assessment of technical capacity conditions. A capital improvement plan is an indication that the PWS is aware of the need to plan for infrastructure upgrade and/or replacement, growth, and other factors that might require financing.

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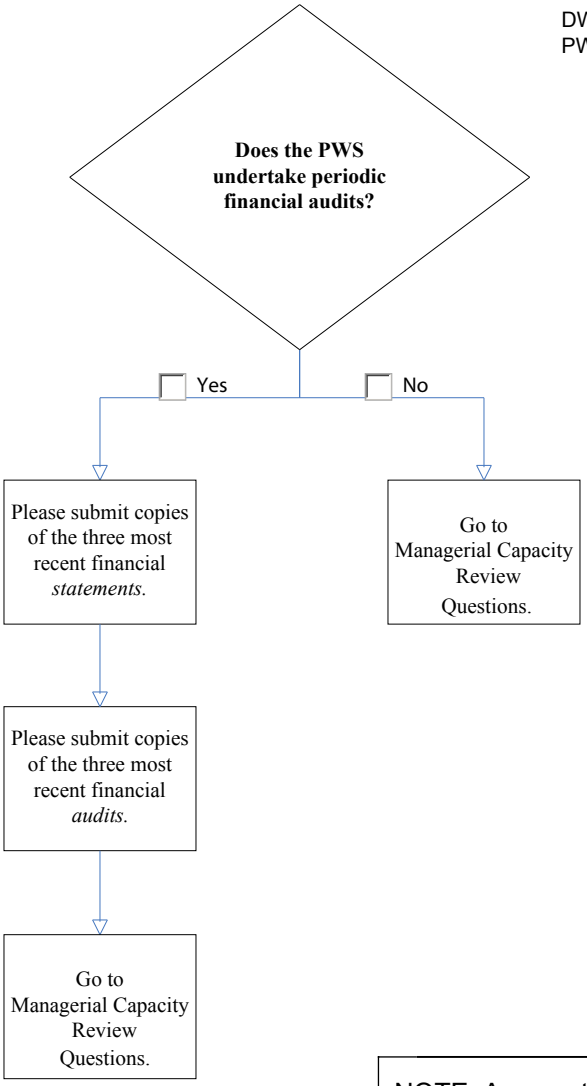
FINANCIAL CAPACITY REVIEW QUESTIONS:
Financial Management

Question 10. Financial Audits

DWSRF = Drinking Water State Revolving Fund
PWS = Public Water System



NOTE: As a matter of good business practice, water systems should undergo financial audits, which allow for verification of financial condition. The review of consecutive financial audits allows DEQ to observe whether auditor recommendations (if any) in one audit were indicated as accomplished in the subsequent audit. If a loan applicant cannot produce a recent audit document, a detailed review of existing financial reporting documents will be performed to determine the water system's financial condition.