

## IPL Unrestricted Cash Fund Policy

Independence Power & Light is a capital intensive enterprise and needs to provide adequate reserves to support capital needs and unanticipated expenses.

IPL has historically used Sawvel and Associates to provide assistance in developing rates and is currently using the firm on a new rate study.

In October 2013, Sawvel provided IPL a detailed report plan which included several recommendations. **(2013 Cost of Service and Rate)**

One specific recommendation was the formal adoption of an “Unrestricted Cash Fund Balance” policy by the City Council.

The Sawvel report states:

*“IPL should also consider having an unrestricted cash fund balance policy with a cash balance target calculated using the IPL Pro Forma ... The methodology takes into account the reserve requirements for power supply related expenses, other operating expenses, recurring additions and capital improvements, and an amount for unanticipated emergencies. The financial community often considers whether an unrestricted cash fund policy is in place, and the level of such fund balances. As shown in Appendix B worksheet, the targeted unrestricted cash fund balance to be maintained by IPL is approximately \$24 to \$26 million.” (Pages 3-4, Oct. 9, 2013 report)*

The Sawvel report provides a detailed methodology (Appendix B) on how that fund balanced could be calculated on an annual basis.

IPL currently shows a “target working capital” in its annual budget, but does this is a matter of practice rather than a formally adopted policy. *(See Figure 1 following page).*

## Undesignated Fund Balance – General Fund

Establishing a fund balance policy is nothing new.

The City Council by policy (Resolution #4948) has established an **Undesignated Fund Balance Policy** of 5% of annual revenues.

The policy purpose is to meet emergencies arising from the loss of revenues, unexpected expenditures from natural disasters, non-budgeted items related to

Description	2008-09	2009-10	2010-11	2011-12	2012-13	Projected 2013-14
<b>Net Income (Loss)</b>						
<b>Net Income (Loss)</b>	\$ (6,076,082)	\$ (1,700,900)	\$ (616,514)	\$ 1,807,024	\$ (2,821,422)	
Capital Contributions	1,323,998	1,413,624	1,905,706	154,564	585,916	
<b>Change in Net Assets</b>	<b>\$ (4,752,084)</b>	<b>\$ (287,276)</b>	<b>\$ 1,289,192</b>	<b>\$ 1,961,588</b>	<b>\$ (2,235,506)</b>	<b>\$ 3,083,000</b>
<b>Net Available Resources</b>						
<b>Net Available Resources-</b>						
Total Current Assets	\$35,995,866	\$41,310,513	\$46,415,386	\$60,588,681	\$72,227,861	
Less:						
Inventories	(11,534,291)	(10,306,056)	(12,939,459)	(12,759,050)	(12,505,713)	
Prepaid Items	(62,699)	(91,666)	(140,101)	(281,935)	(234,783)	
Current Liabilities	(10,655,920)	(14,278,809)	(12,139,397)	(13,849,277)	(16,249,323)	
Capital Budget	(3,316,108)	(1,996,521)	(1,715,415)	(2,368,086)	(3,270,885)	
Appropriations						
Carryover Outstanding	(3,191,849)	(4,727,993)	(2,715,447)	(4,835,350)	(3,900,873)	
Encumbrances						
<b>Net Available Resources</b>	<b>\$ 7,234,999</b>	<b>\$ 9,909,468</b>	<b>\$ 16,765,567</b>	<b>\$ 26,494,983</b>	<b>\$ 36,066,284</b>	<b>\$ 44,200,000</b>
<b>Target Working Capital</b>	<b>\$21,000,000</b>	<b>\$21,000,000</b>	<b>\$21,000,000</b>	<b>\$21,000,000</b>	<b>\$21,000,000</b>	<b>\$21,000,000</b>

Figure 1 shows there has been no adjustment in the Target Working Capital line item in the budget for the past several years.

Sawvel provides a clear methodology for making this determination as shown in the included pages.

This policy, if adopted, would provide that IPL have sufficient funds to meet its needs and provide a way to make annual adjustments that might be warranted.

### **Summary**

The City Council should adopt this policy and implement it in the 2015-16 budget which is under development.

## **Independence Power & Light**

# **Electric System Fund Balance and Reserve Policy**

*The purpose of the Electric System Fund Balance and Reserve Policy is to maintain an adequate amount of reserves to protect Independence Power & Light (IPL)'s ability to provide reliable electric service during periods of power supply cost uncertainties, reductions in sales due to weather or a sluggish economy, volatile energy prices, and rising capital improvement costs while maintaining stable rates. It is important for IPL to maintain the financial flexibility to smooth rate increases and stagger rate adjustments for customers of the electric utility. Rating agencies often examine fund balance when considering the overall economic health and credit quality of IPL and the City of Independence, Missouri (the City).*

This Fund Balance and Reserve Policy addresses the unrestricted cash fund balance requirements for IPL. IPL may hold more money than the established cash reserve guidelines based on an assessment of uncertainties and other financial policies such as:

- Financial risk facing the electric system
- Rate setting policies
- Variability in power supply costs
- Debt policies
- Future capital improvements needed by the electric system
- Line Extension policies

The adequacy of the Fund Balance and Reserve Fund guidelines may be reviewed each year, and if appropriate, revised guidelines may be adopted. The cash reserve calculation shall be updated every year with the budget process and the updating of IPL's Pro Forma. Any changes in expenses, debt and capital improvements will impact the unrestricted cash fund balance requirements.

### **Methodology:**

The methodology used to calculate unrestricted cash fund balance requirements for IPL is based on certain assumptions related to percent of power supply costs, other operating expenditures (excluding depreciation), recurring addition and cash funded capital improvements, and large unexpected emergency expenditures. The establishment of unrestricted cash fund balance requirements is the sum of the following four factors:

- 11.0% of annual fuel and purchased power energy costs.
- 12.5% of annual O&M expenses (cash basis) less annual fuel and purchased power energy costs.
- 50.0% of the sum of the current budget year and the next year's recurring routine system additions and any capital improvements not funded through debt borrowings and/or the issuance of bonds.

- \$2,000,000 for emergency contingency reserves.

The above methodology attempts to quantify the amount of cash IPL should keep in reserve. The above cash reserve calculation considers IPL's requirement "in total" and is not intended to represent the limit of cash reserves that can be used for events occurring in each individual category.

**Other Policy Matters:**

- a. If certain events occur that result in IPL's cash reserves falling below the above cash reserve levels, the City Council shall take action to restore the cash reserves to the above required levels over not more than the subsequent five years. These actions may include a combination of a number of options, including:
  - 1. Rate Adjustments
  - 2. Cost Reductions
  - 3. Issuance of bonds to fund capital improvement programs
  - 4. Modification of the assumptions used to determine the cash reserve levels
- b. The City shall maintain Debt Service Reserves for IPL according to the requirements as outlined in the bonding documents at any time that bonds are issued for capital projects and for which the debt service shall be paid from the revenues of IPL.
- c. Any unrestricted cash fund balance in excess of the amounts set forth above shall be available for transfer into a designated rate stabilization fund, or for funding capital improvements that otherwise would be funded by debt. The actual amount of transfer shall be determined by the IPL Director in concurrence with the City Manager and upon approval by City Council. Due diligence shall be taken to leave sufficient funds available to cover anticipated expenditures at the beginning of the following fiscal year.
- d. Unrestricted cash fund balance shall be available for use in acquisition of equipment and capital projects as outlined in the five year IPL Pro Forma. Funds may also be made available for use during unanticipated emergencies and disasters.

*Adopted by the Governing Body of the City of Independence, Missouri \_\_\_\_\_, 2013.*

Independence Power & Light  
Reserve Fund Balance Guidelines and Policies

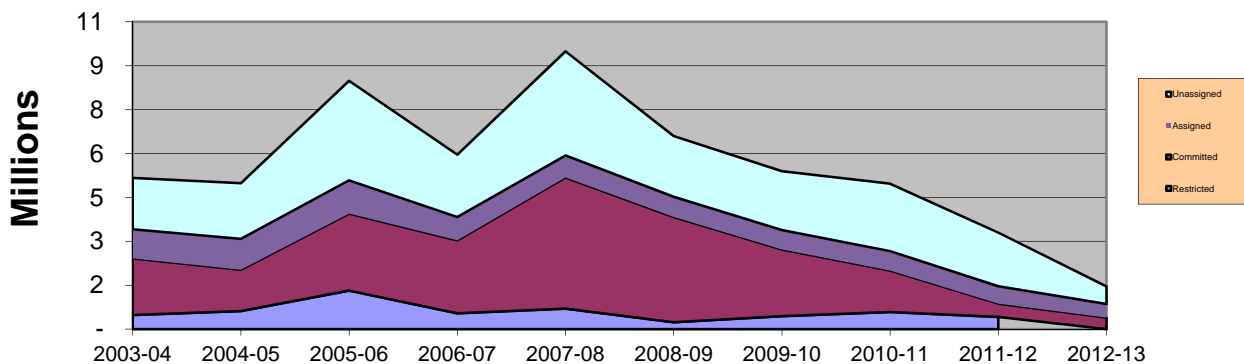
Worksheet - Calculation of Unrestricted Cash Fund Balance Target

Line No.	Description	Budget		Projected				
		2012/13		2013/14	2014/15	2015/16	2016/17	2017/18
1	<b>Fuel and Purchased Power Energy Costs</b>							
2	Starting Point - No. of Days	\$ 29,365,000	45	\$ 27,833,000	\$ 29,057,000	\$ 30,398,000	\$ 33,110,000	\$ 30,622,000
3	Reduction for Fuel-Energy Cost Adjustment							
4	Reconciles Cost Incurred with Billings to Customer (insert -2 days)		(2)					
5	Is forward looking, and can anticipate changes (insert -3 days)		(3)					
6			40					
7	No. of Days Percent		11.0%					
8	Fund Balance Target for Fuel and Purch Power Costs	\$ 3,218,082		\$ 3,050,192	\$ 3,184,329	\$ 3,331,288	\$ 3,628,493	\$ 3,355,836
9	<b>Other Operating Expenditures</b>							
10	Starting Point - No. of Months	\$ 69,577,000	1.50	\$ 78,362,000	\$ 81,912,000	\$ 83,819,000	\$ 83,780,000	\$ 86,477,000
11	Add if IPL Electric Rates:							
12	Do Not Have Demand Charges to Com/Ind Customers (insert 2 mo.)		-					
13	Have Seasonal/Inverted Rates (insert 1 mo.)		-					
14			1.50					
15	No. of Months Percent		12.5%					
16	Fund Balance Target for Other Operating Expenditures	\$ 8,097,125		\$ 9,795,250	\$ 10,239,000	\$ 10,477,375	\$ 10,472,500	\$ 10,809,625
17	<b>Recurring Routine System Additions (not debt funded)</b>							
18	Starting Point - 50% of Current Year plus Subsequent Year	\$ 8,866,000		\$ 8,755,000	\$ 9,018,000	\$ 9,286,000	\$ 9,567,000	\$ 9,567,000
19	<b>Emergency Fund Allowance</b>							
20	Insurance Deductible	\$ -		\$ 8,886,500	\$ 9,153,000	\$ 9,427,500	\$ 9,567,000	\$ 9,283,500
21	Largest Piece of Equipment (example - substation transformer)	\$ -						
22	Judgement - Amount of Emergency Funds to Have Available	\$ 2,000,000		\$ 2,000,000	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000
23	<b>Fund Balance Target</b>	\$ 22,725,707		\$ 23,731,942	\$ 24,576,329	\$ 25,236,163	\$ 25,867,993	\$ 25,448,961

City of Independence, Missouri  
2014-15 Operating Budget  
**Fund Balance Summary - General Fund**  
For the Fiscal Years Ending June 30, 2009 through June 30, 2014

Description	Actual 6/30/09	Actual 6/30/10	Actual 6/30/11	Actual 6/30/12	Actual 6/30/13	Projected 6/30/14
<b>Fund Balance Components</b>						
<b><u>Restricted:</u></b>						
Protested Revenues	\$ 268,153	\$ 42,030	\$ 24,351	\$ 65,702	\$ 5,608	
Police Forfeitures	209,456	180,545	418,205	519,215	411,753	
Other	223,610	13,790	-	-	-	
Total Restricted	\$ 701,219	\$ 236,365	\$ 442,556	\$ 584,917	\$ 417,361	
<b><u>Committed:</u></b>						
Capital Projects	\$ 229,322	\$ 111,852	\$ 120,851	\$ 48,581	\$ 48,581	
TIF Distributions	762,205	620,198	-	-	-	
City Council Strat. Goals	161,717	207,596	243,646	281,630	218,337	
Other	2,440,656	1,337,832	1,048,795	123,074	124,481	
Total Committed	\$ 3,593,900	\$ 2,277,478	\$ 1,413,292	\$ 453,285	\$ 391,399	
<b><u>Assigned:</u></b>						
Encumbrances	\$ 689,667	\$ 662,882	\$ 667,065	\$ 593,561	\$ 464,633	
<b>Unassigned</b>	2,073,982	2,012,374	2,302,039	1,831,406	600,662	3,326,172
Total Fund Balance	\$ 7,058,768	\$ 5,189,099	\$ 4,824,952	\$ 3,463,169	\$ 1,874,055	\$ 3,326,172
Fund Balance Target (a)	3,315,706	3,325,177	3,749,104	3,587,498	3,577,438	3,790,687
Actual over (under) Target (a)	(1,241,724)	(1,312,803)	(1,447,065)	(1,756,092)	(2,976,776)	(464,515)
(a) based on 5% of Annual Revenues less one-time non-reoccurring items						

## Ten Year Fund Balance Comparison





City of Independence, Missouri  
2014-15 Operating Budget  
**Fund Balance Summary - General Fund**

**Unassigned Projected Fund Balance for 2014-15**

Unassigned Fund Balance at June 30, 2014 (Projected)	\$ 3,326,172
--	--------------

**Transfers from Other Fund Balance Components:**

Proposed Operating Budget (Net Sources and Uses) 2014-15	-
--	---

Falls at Crackerneck Creek TIF Debt Refinancing	- <sup>1</sup>
---	----------------

Projected Unassigned Fund Balance at June 30, 2015	<u>\$ 3,326,172</u>
--	---------------------

Projected Unassigned Fund Balance Target (5% of Estimated Revenues)	<b>\$ 3,775,963</b>
---	---------------------

<sup>1</sup> Outstanding debt obligations of the Falls at Crackerneck Creek TIF Redevelopment Area were refinanced in March 2013. One of the terms and conditions of that debt refinancing was to add up to one half of the projected net cash flow savings from the refinancing to the General Fund Unassigned Fund Balance Account until it is fully funded at the City's Fund Balance Target amount of 5% of Annual Revenues. This Proposed Budget meets this condition of the debt refinancing.