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April 25, 2016

Ms. Laura Chavez-Nomura, CPA
Assistant General Manager – Finance
Riverside Public Utilities

Via email

Dear Laura:

Please find enclosed the following report on the gap analysis of Riverside Public Utilities' (RPU) 2001 Fiscal Policy and industry best practices, as well as recommendations on all areas that should be incorporated into RPU's revised fiscal policies.

Based on the results of the gap analysis, we were able to work with RPU staff to create a powerful document that establishes and outlines the guidelines for managing the fiscal health of RPU.

We look forward to presenting the new proposed fiscal policy at the May 23rd Board meeting. In the meantime, don't hesitate to contact me at (608) 240 2361 or at russ.hissom@bakertilly.com with any questions you may have regarding the policies or this report.

We appreciate the opportunity to serve you.

Sincerely,

BAKER TILLY VIRCHOW KRAUSE, LLP

A handwritten signature in black ink, appearing to read "R. Hissom", is written over a light blue horizontal line.

Russell A. Hissom, Partner

RIVERSIDE PUBLIC UTILITIES

Report on Fiscal Policies

April 25, 2016



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1.0 Executive summary

Baker Tilly was engaged to review Riverside Public Utilities' current fiscal policies, perform a gap analysis of RPU's current fiscal policy and industry best practices, provide recommendations on all areas that should be included in a fiscal policy and prepare a draft fiscal policy for RPU.

The following section of this report contains an overview of the gaps between current fiscal policies of RPU and a recommended updated draft policy. Working together with RPU Finance staff to understand process flow, procedures and current policies of the City of Riverside and RPU, we were able to refine the proposed draft policies to meet best practices and the needs of RPU.

We greatly appreciate the help and assistance of RPU for this project and the opportunity to assist with this process.

2.0 Current policy and gap analysis

Baker Tilly reviewed the RPU policy prepared in June, 2001 for this engagement. The policy goals of the 2001 policy included:

- > Enhance short and long-term financial credit ability by helping to achieve the highest credit and bond ratings possible
- > Promote long term financial stability by establishing clear and consistent guidelines
- > Direct attention to the overall financial picture of the Utilities as well as single issues
- > Promote the linking of long term financial planning with day-to-day operations and
- > Provide the Board and Council a framework for measuring fiscal performance of the Utility against established parameters and guidelines

These goals are best practices and these goals are incorporated into the proposed fiscal policy in this document.

While the policy was effective in covering many areas needed for effective fiscal policies, there were some gaps and omitted areas in that policy compared to current best practices in the utility industry and with RPU's peer utility group. A number of the areas in the 2001 policy are incorporated into the proposed 2016 fiscal policy.

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The following table compares the areas in the 2001 RPU policy to best utility practices.

Table 1 – Comparison of 2001 RPU Fiscal Policies to Best Utility Practices

#	RPU Policy Area	2001 Policy Areas and Overview	GAP between RPU and Best Utility Practices or Comments on RPU Policies
1	Operating Budget Policies	1. Prepare annual operating budget, submitted to City Council for approval. 2. Include performance measures where possible to be used in identifying performance improvement areas. 3. Operating budgets should consider financial implications, service and reliability goals and the overall mission of the Utility. Amounts over targets will require adequate justification for approval.	The policy discusses the budget process and monitoring processes at a high level. Best practices would provide more detailed information that can be used for fiscal policy evaluation and approval, such as: 1. Developing a balanced budget to meet RPU goals. 2. Budget shortfalls should be funded with specific reserves. 3. The approval and monitoring process should be detailed with responsibilities noted. 4. The budget transfer process should be detailed. 5. The delegation of authorities should be detailed and approval levels for expenditures noted.
2	Risk Management Policies	1. Utility assets will be protected by adequate commercial insurance and self-insurance reserves. 2. Investment risks shall be mitigated via the investment policy of the city. 3. Power supply risk is under a separate policy. 4. A separate form credit risk policy shall be approved by the Board and City Council to cover the risks associated with the purchase and selling of resources.	The policy discusses at a high level the RPU insurance coverage, wholesale market risk, and regulatory risk. Risk should encompass insurance risk but also other risks such as: 1. Debt portfolio risk. 2. Wholesale power market risk (in the 2001 policy this is covered as a separate policy) including an Energy Risk, Wholesale Counterparty and Energy Transaction Policy.
3	Debt Policies	1. Current operations will not be funded with debt (except capital leases). 2. No less than 10% of current year capital improvement plan will be funded through rates or customer contributions. 3. Maximum debt maturities will not exceed 30 years or life of financed property. 4. Average life of debt issue will be based on market conditions.	The RPU policy is very specific as to the type of debt that can be issued, the limits on the type of debt in the RPU portfolio. These policies reflect best practices but a more comprehensive policy should be developed including: 1. Outline goals of debt management. 2. Provide metrics comparing similarly sized or rated utilities.

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#	RPU Policy Area	2001 Policy Areas and Overview	GAP between RPU and Best Utility Practices or Comments on RPU Policies
		- Loans to other funds can be made for prudent reasons at not less than average market yield of RPU current investment portfolio. - RPU will maintain good communications about financial condition with bond rating agencies. - Prudent care shall be made in the issuance of any long-term debt. - Bonds may be issued with fixed or variable rates with approved City Council Resolutions. - Short-term borrowing for cash flow purposes is allowed but not encouraged. - Refunding bonds may be issued only if debt service savings exceed five percent of refunded bonds.	- Outline procedures and approval process for debt financings. - Prohibited use of debt proceeds or Interfund loan requirements. - The impact of debt in utility rates and the setting of rates to meet debt service coverage required by bond covenants. - More specifics on the issuance of variable vs. fixed rate debt, taxable vs. tax-exempt, etc. - The use of derivatives to hedge interest rate risk. - Investment vehicles of bond proceeds. - More detailed procedures on issuing debt, including approvals. - More guidelines for interacting with ratings agencies. - More specifics for maintaining or improving RPU's bond rating; compliance requirements, etc.
4	Revenue Policies	- Annual revenue estimates will be prepared. - A cost allocation plan will be updated annually for charges to user Divisions. - Fees and charges for services shall be based on operational, overhead, capital and debt service costs. Electric and water rates shall be cost based. - Internal controls will be established for timely collection of revenues. - Revenues shall be collected in compliance with internal and State collection procedures. - Revenues shall be allocated in accordance with bond covenants. Surplus revenues shall be placed in a reserve fund.	The policy describes revenue distribution and rates at a high level. More detail could be added to the existing policy, for example: - Ratemaking principles to not only achieve cost recovery but be competitive, encourage efficiency, provide rate stability, simple to understand, etc. - Rate components should be established using a cash basis revenue requirement, these components include operation and maintenance expense, routine capital improvements, debt service, contributions to the City and any other obligations. - This section should include revenue monitoring and reporting to oversight bodies.

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#	RPU Policy Area	2001 Policy Areas and Overview	GAP between RPU and Best Utility Practices or Comments on RPU Policies
5	Investment Policies	1. RPU will utilize the investment policy of the City. 2. Overall investment strategy for RPU shall be to maximize the rate of return while maintaining a low level of investment risk.	The RPU policy discusses at a high level the investment policy and refers to a separate City investment policy. Best practices incorporate this document into the fiscal policies. The overriding principles should be: 1. Compliance with State requirements for investments. 2. Safety of principal. 3. Liquidity. 4. Return on investment in keeping with the RPU risk profile. 5. The policy should contain the policy for oversight and the parties that have the authority to invest RPU funds or the consultation process that should be followed in determining allowable investments.
6	Accounting, Auditing and Financial Reporting Policies	1. RPU will prepare monthly financial reports in keeping with requirements of City. Charter Section 1202 2. Utility shall undergo an annual audit by independent auditors.	The RPU policy discusses the chart of accounts used and reporting requirements of accounting standards and regulatory reporting. These are generally addressed as best practices. The policy should also include the use of internal auditors and requirements for audits of jointly owned generating projects.
7	Capital Budgeting Policies	1. RPU will prepare a six-year Capital Improvement Plan. 2. The CIP shall be approved by the Board and Council annually. 3. Source of funding will be included in CIP.	The RPU policy discusses the RPU capitalization policy as well as the finding requirements for RPU capital expenditures. These areas meet best utility practices. Areas that could be added for improvement include: 1. Budget monitoring. 2. Carryover of unencumbered balances for capital projects.
8	Reserves Policies	1. Cash reserves in addition to those required by bond covenants, self-insurance, worker's compensation and catastrophic events should be established and reviewed annually as part of budget process.	The RPU policy discusses reserves at a high general level. Best practices are specific to the funding of various reserves and other accounts. This policy should detail the name and funding requirement of each fund, use of each fund and required/recommended funding level, monitoring and reporting of these accounts and use of surplus funds. We understand that a new cash reserve

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#	RPU Policy Area	2001 Policy Areas and Overview	GAP between RPU and Best Utility Practices or Comments on RPU Policies
		2. Reserve levels will be established based on a five year forecast of contingencies. 3. Minimum reserves shall be at least three months operating expenses and maximum reserves shall be set at 100% of annual operating revenues. 4. Reserves over excess shall be disposed of after consideration of RPU Board and City Council.	policy was approved by the City Council on March 22, 2016. This policy should be included in the revised Fiscal Policy.

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3.0 Recommendations

In summary, the existing policy is written at a high level in some areas and in deep detail in others. We recommend:

1. Preparing a document that is consistent in its depth would be more appropriate. While the existing policy provides good information and guidelines, updating it in detail and for a move towards best practices would be appropriate.
2. In addition to the goals of the 2001 policy more specific and comprehensive goals should be established. The 2001 policy goals are as follows:
 - Enhance short and long-term financial credit ability by helping to achieve the highest credit and bond ratings possible.
 - Promote long term financial stability by establishing clear and consistent guidelines.
 - Direct attention to the overall financial picture of the Utilities as well as single issues.
 - Promote the linking of long term financial planning with day-to-day operations.
 - Provide the Board and Council a framework for measuring fiscal performance of the Utility against established parameters and guidelines.
3. The goals as taken from the proposed 2016 policy utilize a combination of the 2001 goals with more specific and accountable areas. The goals in the proposed 2016 policy are:
 - Promote long term financial stability by establishing clear and consistent financial reporting guidelines.
 - Ensure that RPU will maintain its financial health in order to meet its strategic goals.
 - Development of cash reserve and budgeting policies.
 - Provide guidelines for capitalization of RPU assets.
 - Provide funds to maintain and invest in its utility infrastructure.
 - Enhance short and long-term financial credit quality by helping to achieve the highest possible credit and bond ratings.
 - Provide guidance and controls for effective investment of RPU funds in accordance with City investment policies and State law.
 - Provide the Board and City Council with a framework for measuring fiscal performance of RPU against established parameters and guidelines.
 - Link long-term financial planning with day-to-day operations.
 - Document the Board and City Council philosophy for effective ratemaking and recovery of RPU costs of electric and water service.
4. Additional areas that could be included in a new fiscal policy include:
 - Debt service coverage guidelines
 - Cost allocations in more detail
5. These recommendations are very general in nature, but as of the date of this gap analysis a draft fiscal policy has been written to be presented to the Board that incorporates many of the best practices in the industry and the best portions of the existing fiscal policy. The basis for the proposed 2016 policy was industry best practices and incorporating current policies and procedures of the City and RPU.

The combination of the existing and proposed RPU fiscal policies is a powerful document that will aid RPU in its fiscal approach.