

Enterprise Funds: A Best Practice

Introduction	
Purpose	<p>This guide will help you understand:</p> <ul style="list-style-type: none"> • The definition of “Enterprise Fund”. • Why enterprise funds are important to your utility. • How to implement enterprise funds.
Target Audience	<p>This guidance is intended for owners, managers, and operators of water, sewer, and stormwater systems, local officials, technical assistance providers and state personnel. The primary focus of this guidance is for Massachusetts’ water, sewer and stormwater systems.</p>

Enterprise Funds
<p>An enterprise fund is considered the best practice to promote and maintain long-term financial sustainability for water, sewer and stormwater activities. An enterprise fund is a separate accounting and financial reporting mechanism for which revenues and expenditures are segregated into a fund with financial statements separate from all other governmental activities. An enterprise fund identifies the total direct and indirect costs to provide the service and the sources and amounts of revenues that support the service for which a fee is charged in exchange for service. Direct costs generally consist of personnel services, expenses and capital outlay, which are budgeted and accounted for in the enterprise fund. Indirect costs are expenditures budgeted and accounted for in the general fund on behalf of the enterprise fund, which are allocated to the enterprise fund for funding. Examples of indirect costs are central service department costs (accounting, treasury, collections, law and the like), insurances and fringe benefits that are not budgeted and accounted for in the enterprise fund.</p>

Challenges faced by Utility Systems	Benefits of Enterprise Funds
<ul style="list-style-type: none"> • Lack of timely and complete financial data. • Rising cost to produce and treat water • Decreasing revenues. • Increasing pressure to conserve water. • Encouraging the efficient use of water. • Depletion of groundwater. • Degradation of water quality • Aging infrastructure. • Maintaining long-term financial sustainability. 	<ul style="list-style-type: none"> • Identifies a total cost of service and related revenues for a service. • Provides management information to analyze the extent to which revenues are covering expenditures. • Retains and maintains investment income and surplus. • Provides useful information to make decisions on user charges and other financing items. • Provides the value of the enterprise fixed assets and infrastructure and recognizes the cost of the annual depreciation of these assets. • Provides long-term liabilities in the financial statements thus provides both short and long-term financial perspectives.

Implementing Enterprise Funds: The Core Framework

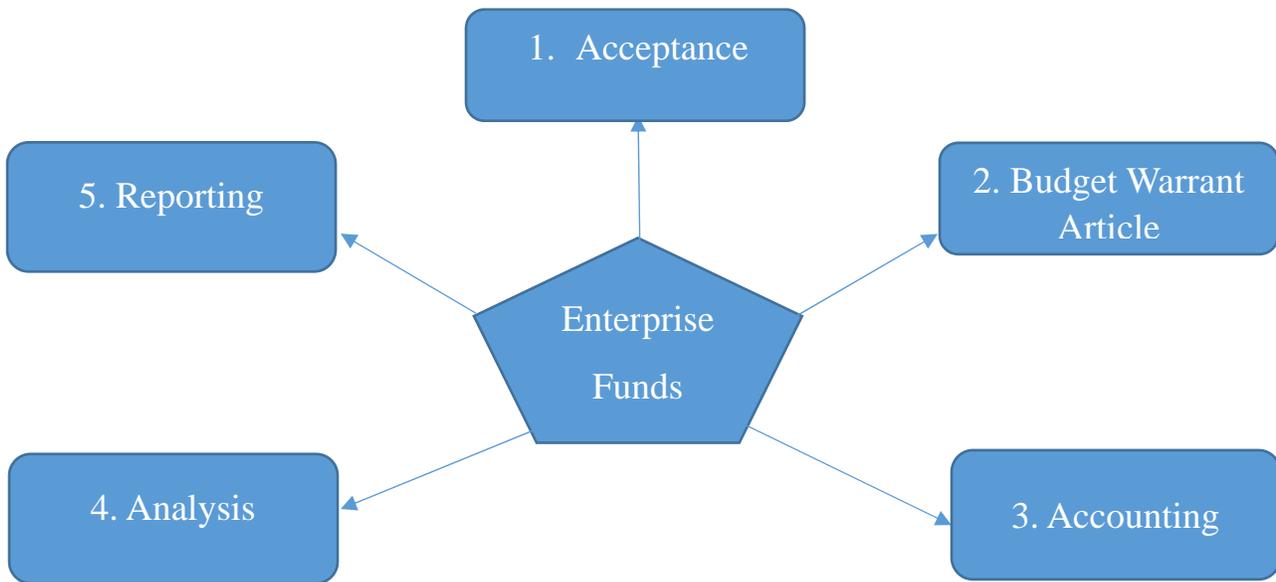
The following framework should be followed to implement enterprise funds. This framework includes:

- (1) Establishment of the enterprise fund by the appropriating authority,
- (2) Establishment of the enterprise fund budget,
- (3) Establishment of the enterprise fund accounting system,
- (4) Analysis of current year revenues and expenditures, and
- (5) Establishment of the enterprise fund reporting system.

Several enterprise fund best practices are listed for each framework element.

While M.G.L. allows for other general laws and special acts, enterprise funds are considered to be the best practice for water, sewer and stormwater activities.¹

Flow Chart: The Five Core Elements of Enterprise Funds



¹ For example, M.G.L. Chapter 41, Section 69B allows for the establishment of a water (but not sewer or stormwater) surplus account.

1. Enterprise Fund Acceptance

The first step in establishing an enterprise fund is for the appropriate government body to accept the provisions of M.G.L. Chapter 44, Section 53F½.² The enterprise fund is established by vote of the city council with the approval of the mayor, by town council or by town meeting. Only Massachusetts cities and towns may adopt an enterprise fund pursuant to M.G.L. c.44, § 53F½.

Best practices include:

- Adopting each enterprise fund separately with its own vote. (Note that water and sewer may be combined; but the better practice is to separate water and sewer into their own enterprise fund).
- Using the following language: “To see if the (city or town) will accept the provisions of Chapter 44, § 53F½ of the Massachusetts General Laws establishing (the service) as an enterprise fund effective fiscal year (year).”³
- Ensuring that the language of the vote clearly states what the service is and when the fund will commence which is recommended to begin at the start of a fiscal year.
- Ensuring that when converting from a special revenue fund to an enterprise fund, the fund balance in the special revenue fund may be transferred to the fund balance of the enterprise fund by vote of the legislative body. Any fund balance not so transferred must close to the general fund on June 30. Any fund balance transferred will become retained earnings only after certification.

² See Exhibit 1.

³ For additional enterprise fund guidance, refer to the Department of Revenue Enterprise Fund Manual, <http://www.mass.gov/dor/docs/dls/publ/misc/enterprisefundmanual.pdf>

2. Enterprise Fund Budgeting and Warrant Article

The second step in establishing an enterprise fund is to develop and have the appropriating body approve a budget. The budget is subject to the appropriation process.

The community should:

- Determine the appropriate indirect costs incurred by the general fund on behalf of each enterprise fund; do not charge the fund costs that are not truly associated with its purpose.
- Determine the direct enterprise fund costs.
- Forecast revenues and expenditures for the upcoming fiscal year.
- Determine if any balances are to be brought forward from the general fund or a restricted fund. If so, the appropriating body must approve the transfer of the balance(s). Refer to language in Exhibit 2.
- Develop a balanced revenue and expenditure budget to include direct and indirect costs. The enterprise fund budget may be one of three scenarios in any fiscal year.
 - Estimated revenues (including any appropriations of enterprise retained earnings) are equal to planned expenditures
 - Estimated revenues exceed planned expenditures where the surplus is budgeted as a reserve
 - Estimated revenues are less than planned expenditures where the difference is subsidized by the general fund or is otherwise provided by another fund.
- Submit to the local executive authority a proposed line item budget no later than one hundred and twenty days prior to the beginning of each fiscal year (March 1), in accordance with Massachusetts General Law.⁴

Best practices include:

- Developing an enterprise fund budget that includes the direct costs of personal services, expenses, and capital outlay.
- Revising user charges prior to setting the tax rate.
- Identifying indirects costs for central services and other costs incurred by the general fund on behalf of the enterprise fund(s) that are allocated to the enterprise fund for funding.
- Requesting an appropriation for direct enterprise fund expenditures.
- Ensuring that indirect costs already included for appropriation in the General Fund operating budget are not to be included for appropriation in the enterprise fund budget.
- Developing a revenue budget that provides for both the direct enterprise fund budget and the indirect costs appropriated in the general fund on behalf of the enterprise fund.
- Including appropriate reserves as part of the budget process, for more information please see Bureau of Accounts Informational Guideline Release (IGR) 08-101.

Refer to Exhibits 2 - 4 for best practice budget formats and language.

⁴ Massachusetts General Law Chapter 44, Section 53 F ½.

3. Enterprise Fund Accounting

The third step in establishing an enterprise fund is to develop an accounting system. Once adopted, the process of establishing the enterprise fund should begin using accounting records and identifying the assets (capital items and infrastructure), liabilities and equity. Related funds in other restricted funds should be identified and transferred to the enterprise fund if voted by the legislative body.

You should work with the finance department to:

- Establish asset, liability, equity, revenues and expenditures accounts consistent with the Uniform Massachusetts Accounting System (UMAS) chart of accounts.⁵
- Ensure that revenues include user charges, utility liens added to taxes, connection fees, betterment assessments, miscellaneous fees, interest earnings, and other financing sources.
- Ensure that expenditures are known.
- Periodically reimburse the general fund during the year for indirect costs.

Best practices include:

- Accounting for enterprise funds on a cash basis.
- Accounting for related capital projects in the capital projects fund.
- Accounting for related fixed assets in the general fixed assets account group.
- Accounting for related long-term debt in the general long-term debt account group.
- Establishing the budget warrant article to be consistent with Schedule A-2 of the Tax Recapitulation Sheet.
- Using budget control accounts to post the enterprise fund revenues and other financing sources and expenditures and other financing uses budget consistent with Schedule A-2.
- Considering the establishment of a special purpose stabilization fund (See IGR 08-101)
- Establishing a separate interest bearing account for the enterprise fund where interest on retained earnings and fund balances remain within the fund (or allocate the interest earnings that would be due on enterprise fund balances and transfer that amount to the enterprise fund on a periodic basis).

⁵ Uniform Massachusetts Accounting System (UMAS) published by the Massachusetts Department of Revenue, Bureau of Accounts. <http://www.mass.gov/dor/docs/dls/publ/misc/umas.pdf>

4. Enterprise Fund Analysis

The fourth step in establishing an enterprise fund is to analyze the data provided to (a) monitor that actual revenue is on target to estimated revenue and (b) that your expenditures are on track to appropriations. This is an important step to ensure that the budget, both revenues and expenditures, are realized based on the annual budget.

You should work with the finance department to:

- Review the budget to actual revenue reports on a monthly basis.
- Reconcile actual revenues to the municipal ledgers.
- Review budget to actual expenditure reports.
- Reconcile actual expenditures to the municipal ledgers.
- See if revenues and expenditures are on track to their respective budgets.
- Analyze variances.
- Discuss the results of the analysis with your enterprise fund team.
- Develop corrective action plans including potential rate increases or expenditure decreases.
- Implement corrective action plans on an as needed basis.

Best practices include:

- Reconciling the budget on a monthly basis.
- Analyzing budget variances on a monthly basis.
- Developing and implementing corrective action plans on a monthly basis.

5. Enterprise Fund Reporting

The fifth step in establishing an enterprise fund is to develop reconciliation procedures and financial reports. General and subsidiary ledgers and balance sheets will need to be reconciled. The accounting officer will need to prepare reports to the Commonwealth and audited reports consistent with proper accounting standards.

You should work with the accounting officer and/or external independent auditors to:

- Reconcile subsidiary ledger(s) to the general ledger(s).
- Reconcile balance sheet accounts receivables to related deferred revenue accounts.
- Reconcile accounts receivables on the general ledger to the collector's records.
- Reconcile Schedule A-2 of the Tax Recapitulation Sheet to the vote by the appropriating authority.
- Review and understand the balance sheets and the methodology to certify retained earnings.

Best practices include:

Reconciliations

- Assist the accounting officer to ensure that ledger and balance sheet reconciliations are performed monthly but no later than quarterly.
- Review debt transactions with your treasurer or chief financial officer to ensure that short and long-term debt has been recorded.
- Review capital transactions with the accounting officer to ensure that fixed assets have been properly accounted for.

Financial Reporting to the State

- Work with the accounting officer to submit the balance sheet including the enterprise fund(s) to the Bureau of Accounts by September 15 of each year for certification of retained earnings.
- Work with the accounting officer to submit the Schedule A including the enterprise fund(s) to the Bureau of Accounts by November 30 of each year.
- Report/accrued revenues consistent with instructions contained in the year-end reporting letter issued by the Director of Accounts. For UMAS accounting purposes, enterprise funds are reported using a "UMAS modified accrual" basis meaning that revenues are recorded on a cash basis during the fiscal year and year-end adjusting entries for certain late payments may be recorded in accordance with the Director's annual year-end guidance to Accountants and Auditors.
- Report expenditures on the modified accrual basis of accounting where goods or services received by June 30 but not paid are to be recorded as an expenditure and a liability.
- Report goods or services ordered at June 30 but not received by June 30 as encumbrances and reserve the amount in the Fund Balance Reserved for Encumbrances account.
- Retained earnings have to be certified by the Bureau of Accounts prior to being spent.

GAAP Financial Reporting

- Report enterprise funds on the accrual basis of accounting.
- Work with the accounting officer and external auditors to understand these reports.

CHAPTER 44 MUNICIPAL FINANCE

Section 53 F1/2 Enterprise funds

Notwithstanding the provisions of section fifty-three or any other provision of law to the contrary, a city or town which accepts the provisions of this section may establish a separate account classified as an "Enterprise Fund", for a utility, health care, recreational or transportation facility, and its operation, as the city or town may designate, hereinafter referred to as the enterprise. Such account shall be maintained by the treasurer, and all receipts, revenues and funds from any source derived from all activities of the enterprise shall be deposited in such separate account. The treasurer may invest the funds in such separate account in the manner authorized by sections fifty-five and fifty-five A of chapter forty-four. Any interest earned thereon shall be credited to and become part of such separate account. The books and records of the enterprise shall be maintained in accordance with generally accepted accounting principles and in accordance with the requirements of section thirty-eight.

No later than one hundred and twenty days prior to the beginning of each fiscal year, an estimate of the income for the ensuing fiscal year and a proposed line item budget of the enterprise shall be submitted to the mayor, board of selectmen or other executive authority of the city or town by the appropriate local entity responsible for operations of the enterprise. Said board, mayor or other executive authority shall submit its recommendation to the town meeting, town council or city council, as the case may be, which shall act upon the budget in the same manner as all other budgets.

The city or town shall include in its tax levy for the fiscal year the amount appropriated for the total expenses of the enterprise and an estimate of the income to be derived by the operations of the enterprise. If the estimated income is less than the total appropriation, the difference shall be added to the tax levy and raised by taxation. If the estimated income is more than the total appropriation, the excess shall be appropriated to a separate reserve fund and used for capital expenditures of the enterprise, subject to appropriation, or to reduce user charges if authorized by the appropriate entity responsible for operations of the enterprise. If during a fiscal year the enterprise incurs a loss, such loss shall be included in the succeeding fiscal year's budget.

If during a fiscal year the enterprise produces a surplus, such surplus shall be kept in such separate reserve fund and used for the purposes provided therefor in this section.

For the purposes of this section, acceptance in a city shall be by vote of the city council and approval of the mayor, in a town, by vote of a special or annual town meeting and in any other municipality by vote of the legislative body.

A city or town which has accepted the provisions of this section with respect to a designated enterprise may, in like manner, revoke its acceptance.

Breakeven Budget

Exhibit 2, below, presents the first scenario where estimated revenues are equal to planned expenditures budget format, and the town meeting or city/town council approval language.

SEWER ENTERPRISE BUDGET	
Moved that \$1,700,000 be appropriated for the sewer enterprise fund that \$300,000 be included from Retained Earnings for indirect costs and be allocated to the sewer enterprise fund for funding, and that \$2,000,000 be raised as follows:	
Departmental Receipts	\$ 1,700,000
Retained Earnings	\$ 300,000
Total Revenues	\$ 2,000,000
and that the fund balances within the sewer special revenue fund at June 30, XXXX be transferred to the Sewer Enterprise Fund effective July 1, XXXX.	
Revenues	
User Charges	\$ 1,398,000
Connection Fees	\$ 200,000
Interest Earnings	\$ 2,000
Miscellaneous Fees	\$ 100,000
Total Current Revenue	\$ 1,700,000
Retained earnings	\$ 300,000
Total Revenues	\$ 2,000,000
Enterprise Fund Expenditures	
Personal Services	\$ 600,000
Expenses	\$ 1,000,000
Capital Outlay	\$ 100,000
Total Enterprise Fund Expenditures	\$ 1,700,000
Indirect Expenditures	
Health Insurance	\$ 110,000
Pension	\$ 70,000
Central Services	\$ 120,000
Total Indirect Expenditures	\$ 300,000
Total Sewer Expenditures	\$ 2,000,000

Surplus Budget

Exhibit 3 presents the second scenario where estimated revenues exceed planned expenditures budget format, and the town meeting or city/town council approval language.

SEWER ENTERPRISE BUDGET	
Moved that \$1,900,000 be appropriated for the sewer enterprise fund that \$300,000 be included in appropriations from the general fund for indirect costs and be allocated to the sewer enterprise fund for funding, and that \$2,000,000 be raised as follows:	
Department receipts	\$ 2,100,000
Retained Earnings	\$ 100,000
Total Revenues	\$ 2,200,000
and that the fund balances within the sewer special revenue fund at June 30, XXXX be transferred to the Sewer Enterprise Fund effective July 1, XXXX.	
Revenues	
User Charges	\$ 1,798,000
Connection Fees	\$ 200,000
Interest Earnings	\$ 2,000
Miscellaneous Fees	\$ 100,000
Total Current Revenue	\$ 2,100,000
Retained earnings	\$ 100,000
Total Revenues	\$ 2,200,000
Enterprise Fund Expenditures	
Personal Services	\$ 600,000
Expenses	\$ 1,000,000
<i>Surplus Reserve</i>	<i>\$ 200,000</i>
Capital Outlay	\$ 100,000
Total Enterprise Fund Expenditures	\$ 1,900,000
Indirect Expenditures	
Health Insurance	\$ 110,000
Pension	\$ 70,000
Central Services	\$ 120,000
Total Indirect Expenditures	\$ 300,000
Total Sewer Expenditures	\$ 2,200,000

Subsidy Budget

Exhibit 4 presents the third scenario where planned expenditures exceed estimated revenues budget format which requires a subsidy, and the town meeting or city or town council approval language.

SEWER ENTERPRISE BUDGET	
Moved that \$1,700,000 be appropriated for the sewer enterprise fund that \$300,000 be included in appropriations from the general fund for indirect costs and be allocated to the sewer enterprise fund for funding, and that \$2,000,000 be raised as follows:	
Department receipts	\$ 1,600,000
General Fund Subsidy	\$ 300,000
Retained Earnings	\$ 100,000
Total Revenues	\$ 2,000,000
and that the fund balances within the sewer special revenue fund at June 30, XXXX be transferred to the Sewer Enterprise Fund effective July 1, XXXX.	
Revenues	
User Charges	\$ 1,298,000
Connection Fees	\$ 200,000
Interest Earnings	\$ 2,000
Miscellaneous Fees	\$ 100,000
Total Current Revenue	\$ 1,600,000
General Fund Subsidy	\$ 300,000
Retained earnings	\$ 100,000
Total Revenues	\$ 2,000,000
Enterprise Fund Expenditures	
Personal Services	\$ 600,000
Expenses	\$ 1,000,000
Capital Outlay	\$ 100,000
Total Enterprise Fund Expenditures	\$ 1,700,000
Indirect Expenditures	
Health Insurance	\$ 110,000
Pension	\$ 70,000
Central Services	\$ 120,000
Total Indirect Expenditures	\$ 300,000
Total Sewer Expenditures	\$ 2,000,000