

POLICY BULLETIN NO. 112

SUBJECT:

Financial and Equity Management

OBJECTIVE:

The purpose of this Financial and Equity Management Policy is to provide guidelines and direction from the Board of Directors (“Board”) to Management to maintain a sound financial position and provide for the security of the financial resources of the Cooperative.

The Cooperative is organized under the laws of the State of Montana and will always be operated on a cooperative not-for-profit basis for the mutual benefit of its members. In addition to these legal requirements, the Cooperative is guided in its operations by regulations and operational practices prescribed by various regulatory agencies and lenders. Beyond these legal, regulatory, and lending requirements, the Cooperative has an obligation to its members to ensure the financial integrity of the Cooperative so that it can provide affordable and reliable electric service now and long into the future.

POLICY:

Summary of Key Financial Policy Elements

Financial Policy Components	Range or Guidance
Operating TIER	1.10 minimum
MDSC Ratio	1.35
Equity to Total Assets Ratio	40% minimum
Cash (General Funds)	30 days cash on hand
Capital Credit Policy	Maximum of 7% – Reference Policy 102

Financial Coverage Ratios

To minimize liquidity and insolvency risk, management shall strive to achieve the following coverage ratio(s):

1. OTIER – Operating Times Interest Earned Ratio

Operating TIER measures the cooperative’s ability to generate sufficient earnings from electric operations to repay the interest on its long-term debt. Following is the formula as provided in KRTA Ratio 8: Patronage Capital & Operation Margins + Interest on Long Term Debt + Long Term Lease



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Date Adopted: 03/22/18
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*Calculation + Total Cash Received from Electric Suppliers and Financial Institutions Divided by (/)
Interest on Long Term Debt + Long Term Lease Calculation*

2. MDSC – Modified Debt Service Coverage Ratio

MDSC- Modified Debt Service measures the cooperative's ability to generate sufficient operating funds to cover the cash requirements of its long-term debt service (principle & interest), but adjusted to eliminate non-cash amounts such as G & T capital credit allocations. Following is the formula as provided in KRTA Ratio 10: Patronage Capital & Operating Margins + Interest on Long Term Debt + Long Term Lease Calculation + Depreciation Expense + Non-Operating Margins Interest + Patronage Capital Cash Calculation Divided by (/) Total Billed Debt Services (CFC loan invoices)+ Long Term Lease Calculation

For purposes of this financial policy, the Cooperative shall strive to maintain a minimum of 1.35 on 12-month basis to meet this financial goal.

3. Equity to Total Assets Ratios

Operating above this ratio as directed by the Cooperative's Board of Directors, assures the Board's direction on the ratio of debt from lenders to equity from members is achieved and/or maintained. Following is the formula as provided in KRTA Ratio 16:

Total Margins and Equity / Total Assets and Other Debits

For purposes of this financial policy and to minimize the risks associated with insolvency and to maintain an optimal cost of capital, management shall strive to achieve an equity to total assets ratio of 40% or higher.

4. Distribution Equity to Total Assets Ratios

Operating above the ratio as directed by the Cooperative's Board of Directors, assures the Board's direction on the ratio of debt from lenders to equity from members, less any Associated Organization's Patronage Capital, is achieved and/or maintained. Following is the formula as provided in KRTA ratio 17:

Total Margins and Equity– Investment in Associated Organization's Patronage Capital / Total Assets and Other Debits– Investment in Associated Organization's Patronage Capital –

For purposes of this financial policy and to minimize the risks associated with insolvency and to maintain an optimal cost of capital, management shall strive to achieve a distribution equity to total assets ratio of 30% or higher.

5. Cash (General Funds)

Management shall strive to maintain a cash (General Funds) balance of no less than 30 days of general expenses on hand.

This will be calculated monthly based on the month end General funds compared to the average monthly general expenses for the prior 12-months. General expenses will include (but are not limited to) the following: Purchase Power, Payroll, Benefits, Payroll Taxes, Interest Payments, Principal Payments.

6. Short Term Borrowing/Line of Credit

The Cooperative shall maintain one or more lines-of-credit for short-term operating purposes, interim or bridge financing, and/or to support emergency capital and operating needs of storm or fire recovery efforts.

7. Utility Plant Investment

Maintaining the high reliability standards that the Cooperative's members have come to expect will require annual investments in the transmission and distribution system. From time to time there will be significant utility plant investment projects that occur above and beyond routine system growth and maintenance. This policy recognizes that these investments will impact the financial position of the Cooperative.

8. Capital Credits

The Cooperative shall allocate and retire patronage capital dividends in a manner that: (1) is consistent with all legal and regulatory requirements; (2) is consistent with operating on a cooperative basis under federal tax law; (3) is fair and reasonable to the Cooperative's members and former members; (4) provides the Cooperative with sufficient equity and capital to operate effectively and efficiently; (5) is in compliance with debt covenants; and (6) protects the Cooperative's financial integrity. The Cooperative shall not retire any patronage dividends until the Board first determines that the retirement will not adversely impact the Cooperative's financial condition. Subject to applicable law, the Cooperative's Articles of Incorporation, and the Cooperative's bylaws, the allocation and retirement of patronage dividends are at the sole discretion of the Cooperative's Board.

The Cooperative shall strive to retire distribution patronage capital based on a maximum of 7% of outstanding patronage capital revolvment approach. **Board Policy 102** discusses and provides direction on the specific allocation and retirement guidelines for patronage capital dividends.

9. Depreciation Rates and Guidance

A review of the depreciation rates and schedules utilized by the Cooperative should be reviewed annually by the cooperative auditors.

10. Financial Forecast

Management shall prepare or cause to be prepared a 5 or 10-year financial forecast. This forecast shall be updated every 2 years, or more frequently as dictated by economic or financial conditions and reported to the Board of Directors as close to the completion of the update as practicable.

The financial forecast shall include and comply with all the financial goals and parameters identified by the Board in this policy, plus include significant assumptions utilized in its preparation. To comply with typical lender requirements, the 5 or 10-year financial forecast shall, at a minimum, contain the following sections:

- Ratios
- Balance sheet
- Statement of operations
- General funds
- Load projections
- Determination of operating revenue
- Plant investment
- Determination of debt and debt service
- Cash flow

11. Conflicts with financial goals

If the financial goals conflict with each other to such a degree that the financial forecast cannot reasonably achieve all of them at the same time, management shall communicate the conflict(s) to the Board. The Board shall, with Management's guidance, discuss and resolve these conflicts.

12. Operating Budget, Capital Budgets and Work Plan

Annually, management will prepare operating and capital budgets for the upcoming year. Revisions of the annual budget will be made as required. The annual budget and formal revisions thereof will be presented to the Board of Directors for their review and action.

A work plan will be developed by management and provided to the board. At a minimum, the workplan will be developed or updated every 2 years.

The Board of Directors will authorize expenditures for capital additions either by its approval of the annual budget, or by its approval of individual projects which are reviewed subsequent to the annual budget process. The Cooperative will utilize its long-range financial plan in the process of preparing its annual budget.

13. Rate Policies



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Management shall recommend to the Board retail electric rates and rate adjustments necessary to meet the financial goals and objectives established in this policy.

RESPONSIBILITIES:

1. The Board is responsible for:
 - a. Reviewing, discussing, and evaluating recommendations for the Financial and Equity Management Policy.
2. The CEO is responsible for:
 - a. Implementing this Policy.
 - b. Overseeing development of the practices and procedures necessary to maintain the financial integrity of the Cooperative.
 - c. Recommending revisions of this Policy to the Board as circumstances warrant.
3. Board and CEO are responsible for assuring compliance with this Policy.