



Report to City Council

TO: Mayor and City Council

FROM: Marshall Eyerman, Chief Financial Officer

AGENDA DATE: February 7, 2017

TITLE: APPROVE AND ADOPT THE FUND BALANCE AND FINANCIAL RESERVES POLICY

RECOMMENDED ACTION

Recommendation:

1. Approve and Adopt the Fund Balance and Financial Reserves Policy.

SUMMARY

The City of Moreno Valley is dedicated to maintaining the fiscal stability of the City. It is essential that adequate levels of unrestricted funds be maintained to mitigate financial risk that can occur from unforeseen revenue fluctuations, unanticipated expenditures, and/or other similar circumstances. This policy will provide guidance on establishing and maintaining reasonable levels of reserves in both governmental and proprietary funds.

This report was presented to the Finance Subcommittee on February 2, 2017 for their review and comment. The Subcommittee has recommended the policy to presented to the City Council for review and approval.

DISCUSSION

The City of Moreno Valley is dedicated to maintaining the fiscal stability of the City. It is essential that adequate levels of unrestricted funds be maintained to mitigate financial risk that can occur from unforeseen revenue fluctuations, unanticipated expenditures, and/or other similar circumstances. This policy will provide guidance on establishing and maintaining reasonable levels of reserves in both governmental and proprietary funds.

In addition, this policy will improve financial reporting by establishing fund balance classifications that create a hierarchy based on the extent to which the City is bound to observe spending constraints that govern how the City can use amounts reported in the

governmental fund balance sheet.

Following the great recession, through the direction of the City Council the City has been able to re-establish the prior reserve fund balances. The proposed policy will create a structure where the City's current General Fund unassigned reserve funds are further identified for purposes such as cash flow needs, economic uncertainty, and emergency funds. The use of these funds along with requirements for the replenishment of the minimum reserve levels will provide greater stability for the City in the future and support additional financial controls.

The General Fund's unassigned fund balance at the end of Fiscal Year 2015/16 was \$37 million. The amount is equal to approximately 40% of the FY 2016/17 amended budget expenses. Based on current operations of the City, it is necessary to further identify the potential use of these funds.

Unassigned Fund Balance

The City currently has a policy to maintain a minimum 15% fund balance to meet annual operational cash flow needs. The City's largest revenue source is property taxes, with the first payments not being received until January and the second payment received in May. With the City's fiscal year starting on July 1, this results in up to seven months (or 58% of the year) of operational expenses without any offsetting revenues. Due to the timing of revenues, it is necessary for the City to maintain an unassigned fund balance to meet the cash flow needs of the City. The minimum level of reserves is proposed to be increased to 17% based on historical actual cash flow within the General Fund.

Assigned to: Economic Uncertainty Reserve Fund Balance

The City's three primary revenue sources are property taxes, sales taxes, and utility users taxes. During the last recession, two of these revenue sources were impacted significantly in a short period of time. Although the City Council was able to respond quickly to the changes in revenues through actions such as the Deficit Elimination Plan, there may still be some contractual expenses which may not be reduced in a timely manner. To support the General Fund operations during this period of reduced revenues and until such time as the expenses can be reduced, the Economic uncertainty Reserve fund will provide financial coverage for the City.

Committed to: Reserve Stabilization Fund Balance

The purpose of this reserve is to provide funds for urgent catastrophic events or major disasters that affect the safety of residents, employees, and property. The State of California along with the City may be affected by many events such as earthquakes, fire, and floods which could impact the infrastructure (roads, bridges, utilities) of the City. When certain events occur, the City should have funds available to provide assistance to the public to repair the City's infrastructure in a timely manner. In cases where the City may be eligible for Federal Emergency Management Agency (FEMA) grants, there is still a need for the City to pay for repairs today and then wait (sometimes multiple years) for any eligible reimbursements.

Based on this current fund balance, the General Fund currently meets the minimum

reserve fund requirements as follows:

	Minimum Reserve Requirement (%)	FY 2016/17 Minimum Reserve Requirement (\$)	Current Fund Balance
Committed Reserve ("Emergency Fund")	12.00%	\$11,399,152	\$11,399,152
Assigned Economic Uncertainty Reserve ("Rainy Day Fund")	10.00%	\$9,499,294	\$9,499,294
Unassigned ("Cash Flow")	17.00%	\$16,148,799	\$16,631,081
		\$37,047,246	\$37,529,527

ALTERNATIVES

1. Approve Fund Balance and Financial Reserves Policy. This alternative is recommended so that the City’s policies are formally updated to reflect current operational practices and to provide guidance for the future use of reserves.
2. Not approve Fund Balance and Financial Reserves Policy. This alternative is not recommended since it will limit guidance for the future use of reserves.

FISCAL IMPACT

No current fiscal impact

NOTIFICATION

Public Notice

PREPARATION OF STAFF REPORT

Prepared By:
Dena Heald
Financial Operations Division Manager

Department Head Approval:
Marshall Eyerman
Chief Financial Officer/City Treasurer

CITY COUNCIL GOALS

None

CITY COUNCIL STRATEGIC PRIORITIES

1. Economic Development
2. Public Safety

3. Library
4. Infrastructure
5. Beautification, Community Engagement, and Quality of Life
6. Youth Programs

ATTACHMENTS

1. Moreno Valley Fund Balance and Financial Reserves Policy v3 (2)

APPROVALS

DRAFT

Fund Balance and Financial Reserves Policy

PURPOSE: The City of Moreno Valley is dedicated to maintaining the fiscal stability of the City. It is essential that adequate levels of unrestricted funds be maintained to mitigate financial risk that can occur from unforeseen revenue fluctuations, unanticipated expenditures, and/or other similar circumstances. This policy will provide guidance on establishing and maintaining reasonable levels of reserves in both governmental and proprietary funds. In addition, this policy will improve financial reporting by establishing fund balance classifications that create a hierarchy based on the extent to which the City is bound to observe spending constraints that govern how the City can use amounts reported in the governmental fund balance sheet.

SCOPE: As referencing governmental funds, this policy in conjunction with Resolution 2011-62 (adopted June 14, 2011) satisfies the requirements of Governmental Accounting Standards Board (GASB) Statement No. 54.

DEFINITIONS:

- I. Capital Projects Funds:** are used to account for all financial resources restricted, committed or assigned to expenditures for acquisition or construction of capital assets.
- II. Debt Service Funds:** are used to account for all financial resources restricted, committed or assigned to expenditures for principal and interest.
- III. Fund Balance:** is the excess of total assets as compared to total liabilities in a governmental fund.
- A. Fund Balances are listed under five categories:
1. Non-spendable: Amounts that cannot be spent because they are either not in the spendable form or are legally and contractually required to be maintained intact.
 2. Restricted: Amounts that are constrained on the use of resources by external creditors, grantors, contributor, or laws or regulations of other governments; or, by law through constitutional provisions or enabling legislature.
 3. Committed: Amounts that can be used only for the specific purposes pursuant to constraints imposed by formal action of the government's highest authority, City Council.
 4. Assigned: Amounts that are constrained by the government's intent to be used for specific purposes, but are neither restricted nor committed.
 5. Unassigned: the residual amounts that have not been restricted, committed, or assigned to specific purposes.
- IV. General Funds:** are used to account for all financial resources not accounted for and reported in another fund.
- V. Permanent Funds:** are used to account for resources restricted to the extent that only earnings, and not principal, may be used for purposes that support the City's purposes.
- VI. Special Revenue Funds:** are used to account and report the proceeds of specific revenue sources that are restricted or committed to expenditures for specific purposes other than debt services or capital projects.

Fund Balance and Financial Reserves Policy

POLICY:

I. Fund Balance Classification in Governmental Funds

- A. GASB 54 outlines the requirement to report the fund balance for governmental funds in specific classifications which create a hierarchy primarily based on the extent to which the City is bound to the constraints on the specific purposes for which funds can be spent.
1. The Fund Balance consists of the following five categories:
 - a. Non-spendable
 - b. Restricted
 - c. Committed
 - d. Assigned
 - e. Unassigned
- B. An individual governmental fund could include non-spendable resources and amounts that are restricted, committed, assigned, unassigned, or any combination of those classifications.
- C. Restricted amounts are to be considered spent when expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available and committed or assigned.
- D. Unassigned amounts are considered to have been spent when expenditure is incurred for purposes which amounts in any of these unrestricted fund balance classifications can be used.
- E. Commitments may be changed or lifted only by the government taking the same formal action that imposed the constraint originally.
- C. The general fund is the only fund that may report a positive unassigned fund balance.
1. In other funds, the unassigned classification should be used only to report a deficit balance from overspending for specific purposes for which amounts had been restricted, committed, or assigned.
- D. Stabilization Arrangements
1. Per GASB 54, governments have the option to formally set aside unrestricted fund balance amounts to use for budget or revenue stabilization, working capital needs, and contingencies or emergencies.
 - a. The authority to set aside such amounts can be established by statute, ordinance, or resolution.
 - b. These amounts are subject to controls that dictate the circumstances under which they can be spent.
 - c. The formal action that imposes the parameters for spending should identify and describe the specific circumstances under which a need for stabilization arises.
 - i. Those circumstances should be such that they would not be expected to occur routinely.

Fund Balance and Financial Reserves Policy

- d. Stabilization amounts should be reported in the general fund as restricted or committed if they meet the criteria of restricted or committed fund balance.
- e. A stabilization arrangement would satisfy the criteria to be reported as a separate special revenue fund only if the resources derive from the specific restricted or committed revenue source.

II. Committing Fund Balance

- A. For the City of Moreno Valley, the City Council is the highest level of decision making authority.
- B. The formal action that is required to be taken to establish, modify, or rescind a fund balance commitment is a resolution approved by the Council at a City Council meeting.
 - 1. The resolution must either be approved or rescinded, as applicable, prior to the last day of the fiscal year for which the commitment is made.
 - 2. The amount subject to the constraint may be determined in the subsequent period.

III. Assigned Fund Balance

- A. The City Council has authorized the City Manager as the official authorized to assign fund balance to a specific purpose as approved by this fund balance policy.
 - 1. Such assignments cannot exceed the available (spendable, unrestricted, uncommitted) fund balance in any particular year.

IV. Reporting Encumbrances

- A. Encumbering amounts in governmental funds for specific purposes for which resources have already been restricted, committed, or assigned should not result in separate display of encumbered amounts.
- B. Encumbered amounts for specific purposes for which amounts have not been previously restricted, committed, or assigned, will be classified as committed or assigned, as appropriate, based on the definitions and criteria set forth in GASB Statement No. 54.

V. Hierarchy of Fund Balance Use

- A. When multiple categories of fund balance are available for expenditures, the City will spend the most restricted funds first before moving down the category with available funds in the following order:
 - 1. Restricted
 - 2. Committed
 - 3. Assigned
 - 4. Unassigned

VI. Minimum Level of Fund Balance/Net Assets

- A. General Fund

Fund Balance and Financial Reserves Policy

1. It is the goal of the City to achieve and maintain a minimum unrestricted (committed, assigned and unassigned) fund balance in its General Fund.
 - a. Committed Fund Balance for Financial Stabilization Arrangement
 - i. The City's General Fund balance committed for Operating Reserve Stabilization is established at a minimum goal of 12% of the General Fund's current operating expenditures.
 - 1) These funds are to be used for catastrophic events, major emergencies, or in periods of severe fiscal crisis.
 - ii. An Operating Reserve Stabilization Fund Balance in the General Fund is established for the purpose of providing funds for an urgent catastrophic event or major disaster that affects the safety of residents, employees, or property (e.g. earthquake, wildfires, terrorist attack, etc.)
 - 1) The recognition of an urgent event must be established by the City Council by adoption of a resolution explaining the nature of the fiscal crisis and requires approval by a majority vote of the City Council.
 - 2) A budget revision must be approved by the City Council. A maximum of 50% of the prior fiscal year ending balance in the Operating Reserve Stabilization Fund may be drawn.
 - 3) The City Council must approve and adopt a plan to restore the fund balance per Section VII, if the fund balance falls below the minimum requirement.
 - b. Assigned Fund Balance
 - i. The City's assigned fund balance for Economic Uncertainty Reserve is established at a minimum of 10% of the General Fund's current operating expenditures.
 - 1) These funds are to be used during times of severe economic distress such as recessionary periods, State raids on local resources, or other impactful unforeseen events which greatly diminish the financial ability of the City to deliver core services.
 - 2) The Economic Uncertainty Reserve will be used during periods of economic distress as measured by one of the following triggers:
 - a) Consumer Price Index exceeds the index for the previous year by more than five percent for two consecutive years.
 - b) Local unemployment rate exceeds 9% for three consecutive quarters.

Fund Balance and Financial Reserves Policy

- c) The rate of inflation exceeds the growth in property tax revenue by 5% for two consecutive fiscal years.
 - d) Significant State take-aways of revenue totaling more than 5% of total revenue in a given fiscal year.
 - e) Sales Tax revenue falls by 5% over the previous quarter.
 - ii. Once the City Council or their designee (City Manager or Chief Financial Officer) has determined that it is necessary to draw down fund balance, a resolution approving the additional appropriation shall be made at the next City Council meeting accompanied by a formal report explaining the nature of the fiscal crisis and the plan to restore the fund balance per Section VII..
 - c. Unassigned Fund Balance
 - i. The City will achieve and maintain a minimum unassigned fund balance in its General Fund of no less than two months (17%) of regular general fund operating expenditures.
 - 1) The minimum fund balance is to protect against cash flow shortfalls related to timing of projected revenue receipts and to maintain budgeted level of services.
 - ii. The City Council must approve and adopt a plan to restore the fund balance per Section VII, if the fund balance falls below the minimum requirement.
- B. Special Revenue Funds
 - 1. Special revenue funds are created to account for the proceeds from specific revenue sources that are legally restricted for specific purposes (e.g. CSD zones, grants, gas tax).
 - 2. Each fund is unique based on the timing of revenue receipts.
 - a. No specific minimum fund balance requirement is created by this policy.
 - b. Each fund must adhere to any underlying guidelines attached to that revenue source.
- C. Debt Service Funds
 - 1. The minimum fund balance requirement for any outstanding issue will be consistent with the bond covenants.
- D. Capital Projects Funds
 - 1. Capital projects funds are created to account for resources set aside to construct or acquire fixed assets or improvements.

Fund Balance and Financial Reserves Policy

2. These projects may extend beyond one fiscal year.
3. No specific amount for minimum fund balance is required per this policy.

E. Enterprise Funds

1. Enterprise funds should strive for positive net operating income to provide for necessary operating and capital expenses while maintaining sufficient debt service coverage ratios.
2. A specific percentage or dollar amount will vary due to the considerations for working capital, debt coverage, asset replacement, rate stabilization, and revenue volatility.
3. Moreno Valley Utility shall develop a separate Financial Reserves Policy.

F. Internal Service Funds

1. Internal Service Funds, by nature are designed to operate on a break even basis for operations, while, if applicable, accruing additional funds to finance future capital costs or potential liabilities.
 - a. Compensated Absences
 - i. This fund should allocate all of the costs related to maintaining a highly functioning full-time and part-time work force.
 - ii. The major expenses allocated to each Department and Program through this fund is compensated absences/annual leave.
 - iii. The minimum reserve level is set at 25% of the current liability for compensated absences, with a maximum of 100%.
 - iv. This policy states that the fund balance level for the compensated absences fund will be calculated using the total amount of compensated absences, as noted in the CAFR "Statement of Net Position."
 - 1) This amount represents the total outstanding liability of all accrued employee annual leave that is eligible to be paid to the employees at separation.
 - a) While the CAFR "Statement of Net Position" lists this liability as that "due within one year" vs. "due beyond one year," it is prudent to establish a fund balance level based on the total amount of compensated absences, regardless of when the liability can reasonably be expected to be converted to an expense.
 - v. Using "compensated absences" as a measurement for appropriate fund balance allows for one type of liability to be covered.
 - 1) Being able to show how the "compensated absences" liability could be fully covered, if in the highly unlikely scenario the

Fund Balance and Financial Reserves Policy

entire amount needed to be converted to an expense, is a useful metric upon which to base a reserve level policy.

- b. Equipment Maintenance and Replacement
 - i. The City has equipment that is maintained and replaced through the equipment internal service fund.
 - ii. This fund receives operating resources from Departments in order to provide for equipment maintenance (annual ongoing costs) and to fund the regular replacement of major pieces of equipment at their economic obsolescence.
 - iii. This policy establishes a minimum reserve level of 75%, with a maximum of 150% of the recorded purchase price for the current assets. The maximum reserve level exceeds 100% to allow for the cost increases related to future replacement value for the equipment.

- c. Fleet Maintenance and Replacement
 - iv. The City has a fleet of rolling stock and other equipment that is maintained and replaced through the equipment internal service fund.
 - v. The City's Public Works and Parks and Community Services Departments comprise the largest users of and contributors to the equipment internal service fund.
 - vi. This fund receives operating resources from Departments in order to provide for fleet maintenance (annual ongoing costs) and to fund the regular replacement of major pieces of equipment (primarily rolling stock) at their economic obsolescence.
 - vii. This policy establishes a minimum reserve level of 50%, with a maximum of 100% of the recorded purchase price for the current assets.
 - 1) The definition of rolling stock includes such equipment as Public Works utility trucks, and Parks and Community Services utility vehicles.
 - 2) The replacement value shall be that updated and used annually as part of the budget development process.

- d. Facilities Maintenance and Replacement
 - i. The facilities internal service fund is responsible for costs related to routine maintenance (i.e., custodial services) and major rehabilitation (i.e., roof replacement) of City buildings.
 - ii. The City maintains a long-term, facilities master plan that is utilized to guide long-range budgeting for major building expenses.

Fund Balance and Financial Reserves Policy

- iii. This policy establishes a minimum reserve level of 3.5%, with a maximum of 10% of the recorded purchase price for the current assets.
 - 1) The lower reserve levels are established based on the longer life of the facilities and the potential of available financing for these types of assets.

- e. Technology Maintenance and Replacement
 - i. The City's computer network, communications systems, desktop and peripheral hardware, and technology software expenses are accounted for in the technology internal service fund.
 - ii. This fund is utilized for periodic replacement of desktop computers, the annual expense related to enterprise-wide software licenses, upgrades to servers and networks, and maintenance and upkeep of the communicationssystem.

This policy establishes a minimum reserve level of 75%, with a maximum of 150% of the recorded purchase price for the current assets. The maximum reserve level exceeds 100% to allow for the cost increases related to future replacement value for the equipment.

VII. Replenishing Minimum Reserve Balance Deficiencies

- A. When the General Fund's minimum fund balance falls below the required thresholds, the City Council must approve and adopt a plan to restore this balance to the target minimum level within five years using the following budget strategies:
 - 1. The City will use budget surplus or,
 - 2. The City will reduce recurring expenditures to eliminate any structural deficit or,
 - 3. The City will increase revenues or pursue other fund sources, or,
 - 4. A combination of the three options above.
- B. Unless a repayment plan is pre-established at the time reserves are allocated, Staff shall bring for Council consideration a replenishment plan, within 90-days of allocation from the reserve.
 - 1. It would be Council's expectation that every effort would be made to replenish the reserve as soon as it is financially feasible and practical to do so.
- C. If the reserve cannot be replenished by the next annual budget, a repayment plan not to exceed five years should be approved by Council by a majority vote.

VIII. Deficit Unassigned Fund Balance

- A. If the General Fund fund balance or net asset balance is not positive at any year end, the City shall develop a funding plan and a timeframe to bring it into a positive state.

Fund Balance and Financial Reserves Policy

The unassigned fund balance deficit in General Fund will be restored through the same steps as set forth in Section VII.

IX. Surplus Unassigned Fund Balance

- A. Unassigned fund balance in General Fund will be considered a surplus if over 35% of the budgeted expenditures and outgoing transfers of future budget year.
 - 1. If unassigned fund balance of the General Fund ever exceed 35%, the City will consider such fund balance surpluses, in conjunction with the annual budget process, to be used, in no particular order of priority, for:
 - a. Provide additional funding for other assigned or committed fund balance requirements.
 - b. Capital projects and equipment
 - c. Payment of long term obligations
 - d. One-time expenditures that are non-recurring in nature and which will not require additional future expense outlay for maintenance, additional staffing or other recurring expenditures
- B. Appropriation from General Fund's unassigned fund balance to fund reserves shall require the approval of City Council.

X. Implementation and Review

- A. Upon adoption of this policy the City Council authorizes the Financial and Management Services Department to establish standards and procedures which may be necessary for its implementation.
- B. The City Council shall review and approve this policy via resolution at a minimum of every four years to ensure it continues to meet the needs of the City given economic factors and the current financial status at that time interval.

Moreno Valley Fund Balance and Financial Reserves Summary

General Fund

	<u>Minimum</u>	<u>Maximum</u>
Committed to: Reserve Stabilization (“Emergency Fund”)	12%	
Assigned to: Economic Uncertainty Reserve (“Rainy Day Fund”)	10%	
Unassigned (“Cash Flow”)	17%	35%

Debt Service

Reserve Set by Covenants

Enterprise (MVU)

See MVU Financial Reserve Policy

Internal Service Funds

	<u>Minimum</u>	<u>Maximum</u>
Compensated Absences *	25%	100%
Fleet **	50%	100%
Equipment **	75%	150%
Technology **	75%	150%
Facilities **	3.5%	10%

* Based on accrued liability

** Based on recorded purchase price