



# AGENDA ITEM

Item Number:

9

**TO:** CITY COUNCIL  
**FROM:** CITY MANAGER

**Submitted By:**  
Michael Solorza,  
Finance Director

**Meeting Date:**

March 19, 2013

**Subject:** Reserve Policies Update

## RECOMMENDATION:

It is recommended that the City Council take the following actions:

- a) Receive Staff presentation on Proposed Update to and Establishment of General Fund and Internal Service Fund Reserve Policies
- b) Approve a Resolution Adopting the "General Fund and Internal Service Fund Reserve Policies"

## SUMMARY:

Fund balance is one of the many pieces of financial information that local public agency stakeholders utilized to gauge the relative health of an organization. Fund balance, whether expressed as a percentage of expenditures or in whole dollar amounts, is one of the most widely used and referenced elements of public agency financial statements. Generally speaking, having a large fund balance is viewed as better than having a small fund balance.

Technically, fund balance is the difference between assets and liabilities of a City's governmental funds balance sheet. By reviewing La Palma's financial statements (i.e., the Certified Annual Financial Statement [CAFR]) one can begin to gauge the City's relative health. For example, fund balance provides information to identify the available liquid resources available to finance capital improvements (one-time use) or address certain unfunded liabilities (e.g., retiree medical costs).

Currently, the City of La Palma has a very simple and straightforward reserve policy, as stated in the Financial Policy Statements included with each adopted budget:

*The City will establish an undesignated General Fund Reserve goal based on 100% of the City's General Fund yearly operating expenditures. Any excess*

*funds in the General Fund reserve should not be used to replace ongoing General Fund operating expenditures, new programs, or salary and benefits. Funds should only be allocated to projects that are one-time expenditures, capital in nature, and/or to replace the City's equipment, buildings and infrastructure.*

This policy covers only the General Fund, and indicates that reserves should be 100% of General Fund expenditures. The singular focus on the General Fund ignores the relatively robust fund balances in other funds, such as the City's five Internal Service Funds. Finally, the recent implementation of Governmental Accounting Standards Board (GASB) Statement No. 54, which introduced new reserve classifications, suggests a more comprehensive reserve policy is warranted.

Therefore, in an effort to create a more sophisticated and comprehensive reserve policy, Staff is recommending City Council adoption of the updated Reserve Policies (Attachment 1). The policies cover the General Fund and the five Internal Service Funds (Employee Benefits, Insurance, Vehicle Maintenance and Replacement, Facilities Maintenance, and Technology Maintenance and Replacement). The ultimate goal of updating the reserve policies is to create a set of guidelines that will help the City Council and Staff manage the City's reserves while maintaining them at sufficient levels to meet future needs and challenges.

The recommended reserve policies can be amended in the future should the need arise. For example, there could be a need to have policies governing our Special Funds or even our Enterprise Funds. This initial effort will govern the funds accounting for the largest share of total, citywide fund balance; hence the focus on the General Fund and the Internal Service Funds.

### **BACKGROUND:**

The City of La Palma first introduced the 100% General Fund reserve policy as part of the Fiscal Year 2009-10 budget. It had only been a few years prior to that when the City struggled to carry any "spendable" General Fund reserves from fiscal year to fiscal year. The 100% General Fund reserve policy was a conscious effort by the City Council at the time to establish a high minimum level of reserves in order to prevent ever being in a similar situation. Prior to FY 2009-10, there was no specific reserve goal amount stated in the Financial Policy Statements.

However, while setting a goal percentage amount is a necessity, it should not be the only piece of a reserve policy. A usable, robust reserve policy will not only set out a percentage or dollar goal, but layout specifics for when reserves can and should be used, and a process for replenishing them if and when utilized. La Palma's current policy is lacking in this next level of sophistication.

For example, many local agencies have multiple levels/categories of reserves, depending on their intended use. These reserves are called different things: Economic Uncertainties, General Fund Stabilization, Catastrophic Events, Contingency Reserves, Future Projects, etc.

Also, many cities set these reserves between 15% and 20% of either General Fund expenditures or revenues. The Government Finance Officers Association (GFOA) recommends maintaining a minimum General Fund reserve level of no less than 5% to 15% of ongoing General Fund revenue or no less than two months (or approximately 17%) of General Fund expenditures. A few local agencies (e.g., Twenty-Nine Palms, Mission Viejo) have reserve levels as high as 50% and research has only found one local agency, La Habra Heights, with a 100% policy.

Furthermore, many agencies have a process that outlines which reserves would be used and when (e.g., major loss of revenue, natural disaster, etc.). These agencies also couple the use of reserves guidelines with a specific plan for replenishing them when utilized for their intended purpose (e.g., within two fiscal years once reserves drop below a certain level).

In addition, accounting standards which apply to fund balances have been updated by the Governmental Accounting Standards Board (GASB) since the City's original policy was adopted. That is, until FY 2010-11, General Fund reserves were classified as designated or undesignated/unreserved. Beginning with the June 30, 2011, financial statements, GASB 54 classifications were required to be utilized for classifying fund balance in the General Fund. The City Council adopted a resolution (2011-24) approving the use of the GASB 54 fund balance designations on June 7, 2011, (Attachment 4). However, as the proposed reserve policy illustrates, it is important to utilize the GASB 54 designations in a holistic manner, as opposed to just a "stand alone" policy. By doing so, the full power of these updated designations can be utilized, further establishing the sophistication and usability of a City's reserve policies.

Finally, the City's financial situation is much different than when the 100% General Fund reserve policy was first adopted. Since then, the City has weathered the worst recession since the Great Depression, dealt with the dissolution of redevelopment, and continues to manage the loss of a major sales tax generator.

Recent City Council action to enter into a cooperative agreement with Tesoro to maintain a fuel sales desk within La Palma will certainly help La Palma regain its financial footing. However, recent experience with drafting proposals for a balanced budget shows why a more sophisticated reserve policy is needed. The recent budget study session provided additional direction on how future – potential – sales tax revenue could and should be utilized; using some for operating and putting some away for one-time infrastructure or economic development purposes.

A better roadmap is required when faced with a major financial catastrophe, as well as a more detailed guide that outlines when and how reserves can and should be used and replenished. Having a sound, fiscally responsible and detailed policy that outlines how, when and why reserves should be utilized is a necessity in such situations.

**ANALYSIS:**

The Finance Department conducted extensive research into reserve policies utilized by other public agencies, with the focus being on California cities. Several good examples were found and the proposed policy (Attachment 1) borrows heavily from a few local agencies.

The proposed reserve policies are intended to:

- Set reasonable and sustainable levels for General Fund reserves
- Fully utilize the power of the GASB 54 reserve classifications
- Establish guidelines and conditions for when portions of the General Fund reserve can and should be utilized
- Establish guidelines for returning General Fund reserves to their prescribed levels if and when utilized for the prescribed reasons and conditions
- Set reasonable and sustainable reserve levels for each of the City's five Internal Service Funds
- Provide information to City Council and Staff by which informed decisions can be made regardless of the economic or financial conditions the City faces

Ultimately, a good policy should help guide decisions, not constrain them. Staff believes the proposed policies (Attachment 1) will serve to guide financial decisions when it comes to establishing and using reserves, while not being so cumbersome or restrictive that decision making is paralyzed.

As noted, GASB Statement No. 54 allows for a robust classification of fund balance. This pronouncement, effective with FY 2010-11 financial statements, allows the City to recognize how fund balance is constituted and isolate funds that are needed for longer-term obligations, discern what funds are restricted for specified purposes, and classify those funds that are unavailable. To accomplish this goal, the City's financial statements for governmental funds can be comprised of up to five distinct fund balance classifications:

- Nonspendable Funds
- Restricted Funds
- Committed Funds
- Assigned Funds
- Unassigned Funds

Each of these classifications is defined more fully in Attachment 3. In short, each classification exists on a continuum of "spendability," beginning with the least available for spending (nonspendable) to unassigned which represents the category having the least restrictions on

spending. Currently, the City of La Palma uses three of the five classifications: nonspendable, assigned and unassigned. The recommended reserve policies would add committed to those classifications actively used.

Committed funds require City Council action (i.e., passage of a resolution) to set-aside and ultimately spend. The intent is to place a relatively high threshold on the ability to spend the funds. Not only must the City Council pass a resolution spelling out the purposes for establishing the commitment, but a subsequent resolution would need to be passed in order to use those funds for the intended purpose. Those funds denoted as assigned are done so by the Finance Director. Finally, the unassigned funds are essentially those “left over” once the fund balance is put into the other four categories.

The highlights of the proposed policy can be summarized as follows, as they impact the General Fund and the five Internal Service Funds. The proposed policies introduce a much needed level of sophistication to the policies, moving beyond the current “100% of General Fund expenditures” statement. The highlights of the policy are as follows:

### **General Fund**

- **Committed Funds**: Creates an Economic Uncertainties reserve established by City Council resolution as part of the annual budget adoption equal to 60% of General Fund expenditures
- **Assigned**: Creates a Capital Projects reserve equal to 40% of General Fund expenditures
- Establishes general reasons for when each of the reserves could and would be used
- Establishes a method for replenishing reserves if and when they drop below their respective levels (i.e., 60% or 40%)
- Creates guidelines for utilizing an excess General Fund reserves beyond the 60% Economic Uncertainties Commitment and 40% Capital Projects Assignment (i.e., use of funds in excess of 100% of General Fund expenditures)

### **Internal Service Funds**

- Establishes for the first time individual fund balance levels for each of the five Internal Service Funds
- Creates guidelines for how the fund balance level is to be calculated annually for each of the Internal Service Funds based on criteria unique to each fund
- Provides a process for adjusting annual cost allocations in order to maintain the reserve policy levels for each Internal Service Fund

**CONCLUSION:**

The proposed, updated General Fund and Internal Service Fund reserve policies (Attachment 1) significantly expand the breadth and sophistication of the City's financial policies. The proposed policies, for the first time, create a comprehensive set of guidelines that allow the City Council to better manage La Palma's current and future spendable assets.

These policies, once adopted, will allow for the City's assets to be set aside for very specific uses, while maintaining the General Fund reserve level at the current 100% level. The 100% reserve level is maintained, while simultaneously introducing flexibility and sophistication into the treatment of the reserves by utilizing the GASB 54 classifications of Committed and Assigned to further earmark reserves for specific purposes. These policies also present a general plan for replenishing the reserves in the event they are used and drop below their policy level amounts.

Finally, the proposed policies, for the first time, lay out reserve levels for the City's five internal service funds. The reserve policies for the Internal Service Funds will allow for sufficient fund balance in each fund while minimizing the risk of "over-allocating" to each fund.

**FISCAL IMPACT:**

The proposed reserve policies do not have an immediate fiscal impact. Only if the use of reserves, as outlined in the proposed policies, is triggered will there be a fiscal impact.

**Attachments:**

1. General Fund and Internal Service Fund Reserve Policies
2. Fund Balance Analysis, General Fund and Internal Service Funds, June 30, 2013
3. GASB 54 Fund Balance Classification Definitions
4. City Council GASB 54 Agenda Report and Resolution, June 7, 2011

**RESOLUTION NO. 2013-\_\_**

**A RESOLUTION OF THE CITY COUNCIL OF  
THE CITY OF LA PALMA APPROVING  
GENERAL FUND AND INTERNAL SERVICE  
FUND RESERVE POLICIES**

**WHEREAS**, the City Council has routinely adopted Financial Policy Statements as part of the annual budget adoption process, and

**WHEREAS**, it is prudent to have comprehensive policies which address the maintenance and use of reserves in general, and

**WHEREAS**, the City Council has determined that updated policies governing the treatment of reserves for the General Fund and the Internal Service Funds should be in place which supplement and compliment the Financial Policy Statement, and

**WHEREAS**, the reserve policies incorporate by adoption the requirements of Governmental Accounting Standards Board (GASB) Statement No. 54 – Fund Balance Reporting and Governmental Fund Type Definitions as first adopted on June 7, 2011.

**NOW, THEREFORE, BE IT RESOLVED**, that the City Council of the City of La Palma hereby approves the attached “General Fund and Internal Service Fund Reserve Policies” which are in compliance with Governmental Accounting Standards Board Statement No. 54, Fund Balance Reporting and Fund Type Definitions.

**APPROVED AND ADOPTED** by the City Council of the City of La Palma at a regular meeting held on the 19th day of March 2013.

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Steve Hwangbo  
Mayor

ATTEST:

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Laurie A. Murray, CMC  
City Clerk

STATE OF CALIFORNIA )  
COUNTY OF ORANGE ) SS.  
CITY OF LA PALMA )

I, LAURIE A. MURRAY, City Clerk of the City of La Palma, California,  
DO HEREBY CERTIFY that the foregoing Resolution was adopted by the City Council of  
said City at a regular meeting of said City Council held on the 19th day of March 2013, and  
that it was so adopted by called vote as follows:

AYES:

NOES:

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Laurie A. Murray, CMC  
City Clerk

## **CITY OF LA PALMA General Fund and Internal Services Funds Reserve Policies**

Fund balance refers to the difference between assets and liabilities in the city's governmental funds balance sheet. This information is one of the most widely used elements of state and local government financial statements. Financial statement users examine fund balance information to identify the available liquid resources that can be used to pay down unfunded liabilities, finance capital improvements, or enhance the overall financial position of the city.

### **PURPOSE**

The purpose of these policies is to provide guidance on maintaining reasonable levels of reserves in both governmental and proprietary funds, focusing exclusively on the General Fund and the City's five Internal Service Funds. In addition, these policies will help 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. In addition, the policies will help guide current and future allocation levels to the five Internal Service Funds in a manner that maintains reasonable fund balance levels in each, without the funds being "over-allocated" in any given fiscal year. As referencing governmental funds, this policy satisfies the requirements of Governmental Accounting Standards Board (GASB) Statement No. 54 and incorporates all previous City Council policies regarding GASB Statement No. 54.

### **POLICY**

It is the policy of the City of La Palma to identify the various classifications of the City's governmental and proprietary fund balances in its Comprehensive Annual Financial Report (CAFR). These classifications take into consideration the City's long-term infrastructure needs, non-current liabilities, funds necessary to mitigate economic uncertainties, funding that has spending constraints such as grants, and fixed assets that will not easily convert to cash.

The fund balance is a tool the City uses to have an effective long-term financial plan, as well as to ensure sufficient liquidity to meet its financial obligations in the short-term.

### **OBJECTIVES**

The City of La Palma's Reserve Policies have two primary objectives:

- 1. To determine the available liquid resources; and**
- 2. To provide the information necessary to make informed financial decisions.**

The fund balance classifications of the City's General Fund are designed to clarify the extent to which the City is bound to honor constraints on the specific purposes for which amounts in the fund can be spent, rather than to simply represent the financial resources available for appropriation. The reserve policies, as applied to the five Internal Service Funds, are designed

to provide guidance on maintaining a reasonable fund balance level in each fund. The goal of internal service funds is to provide enough liquidity in each to meet current as well as longer-term funding needs, while ensuring they are not overly funded to the extent ongoing operations are impaired by over-allocation.

## **OVERVIEW**

There are three categories of funds per generally accepted accounting principles:

- Governmental funds (e.g., the General Fund, Special Revenue Funds, and Capital Projects Funds)
- Proprietary funds (e.g., water and sewer enterprise funds, vehicle maintenance/replacement, insurance, and related internal service funds)
- Fiduciary funds (e.g., former Community Development Commission funds)

The GASB 54 classifications only apply to Governmental Funds. Therefore, this section will focus exclusively on the General Fund. The following section deals with the City's Internal Service Funds and the various reserve levels in each.

The fund balance is only an approximate measure of liquidity or working capital. Therefore, it is necessary for the City to recognize how fund balance is constituted and isolate funds that are needed for longer-term obligations, discern what funds are restricted for specified purposes, and classify those funds that are not available at all. To accomplish this goal, the City's financial statements for governmental funds are comprised of five fund balance classifications, as spelled out in GASB Statement No. 54:

- Nonspendable Funds
- Restricted Funds
- Committed Funds
- Assigned Funds
- Unassigned Funds

## **NONSPENDABLE AND RESTRICTED FUND BALANCE**

The first two classifications are subject to requirements outside the local governing body's control for financial decision-making and planning purposes. "Nonspendable" resources are essentially irrelevant because, by their nature, they are not liquid (i.e., land or similar non-cash assets). "Restricted" resources are of no discretionary value given the restrictions placed upon them by a third-party outside of the City's control (i.e., reserve funds required to be set aside for bond payments). Accordingly, this policy will just briefly describe these two classifications. In addition the City of La Palma only utilizes the "nonspendable" classification since there are no "restricted" funds.

## **Nonspendable Funds**

Some of the assets that are included in determining the City's fund balance are inherently nonspendable:

- Assets that will never convert to cash, such as prepaid items and inventories.
- Assets that will not convert to cash within sixty (60) days from the start of the fiscal year, such as long-term loans receivable, and non-financial assets held for resale.
- Assets that must be maintained intact pursuant to legal or contractual requirements, such as an endowment.

## **Restricted Funds**

Restricted funds describe the portion of the fund balance that is subject to externally enforceable legal restrictions, these restrictions fall into three (3) categories:

- (i) Restrictions are imposed by parties altogether outside the scope of the City's governance:
  - Creditors (typically through a debt covenant)
  - Grantors (typically state, federal and other governmental agencies)
  - Contributors
  - Other governments.
- (ii) Restrictions that arise when the authorization to raise revenues is conditioned upon the revenue being used for a particular purpose, such as:
  - Gas taxes must be used for street repair
  - Prop C must be used for fixed transit routes
  - Prop A must be used for transit programs
  - Measure R must be used for local street repair

Long-term loans receivable and non-financial assets that are collected can also be considered Restricted if the collected funds are subject to an externally enforceable restriction on how they can be spent.

## **PROCEDURES**

This Section provides a comprehensive protocol on what is legally deemed the unrestricted (or spendable) portion of the General Fund fund balance, and the order in which the classifications are spent.

The unrestricted portion of the fund balance is comprised of the General Fund's resources classified as "Committed," "Assigned," or "Unassigned."

## **UNRESTRICTED (SPENDABLE) FUND BALANCE**

### **Committed Funds – Economic Uncertainty Reserve**

Committed funds describe the portion of the fund balance that is constrained by limitations imposed by the La Palma City Council. The City Council imposed limitation must occur no later than the close of the reporting period (i.e., end of the fiscal year) and remains binding unless removed under the same manner. A commitment is made by City Council adoption of a resolution that states the amount and purpose of the commitment. This policy requires the commitment to be made as part of the annual budget adoption process.

This reserve policy establishes a commitment for an Economic Uncertainties Reserve equal to an amount calculated as 60% of the General Fund's annual operating expenditures. Appropriations from the Economic Uncertainties Reserve commitment can only be made by formal City Council action.

Generally, appropriations and access to these funds will be reserved for emergency situations. Examples of such emergencies include, but are not limited to:

- Reduction in revenue equal to or greater than 20% of adopted General Fund appropriations
- An unplanned, major, catastrophic event such as a natural disaster requiring expenditures over 10% of General Fund adopted appropriations
- Unfunded and/or unpredictable State or Federal legislative or judicial mandates
- Any other unforeseen event that causes the City to expend funds in excess of 10% of General Fund adopted appropriations

### **Assigned Funds**

Assigned funds describe the portion of General Fund reserves that reflect the use of resources by the La Palma City Council intended for unprogrammed and/or unfunded capital and infrastructure projects.

This reserve policy establishes an assignment for unprogrammed/unfunded capital and infrastructure projects equal to an amount calculated as 40% of the General Fund's annual operating expenditures. These Assigned funds are set aside for major emergency or unexpected repairs of the City's streets, hardscape, facilities, communication and technology systems, or other City-owned property. In addition, this reserve amount can be utilized by the

City Council for funding infrastructure or capital projects which are not part of the approved Capital Improvement Program (CIP) (i.e., unfunded projects).

### **Unassigned Funds**

The General Fund may have net resources in excess of what is classified in one of the four previous categories. This amount is presented as the unassigned fund balance. Only the general Fund can report a positive unassigned fund balance; however, all governmental funds can report a negative unassigned fund balance.

This policy logically dictates that any amount of fund balance classified as “unassigned” is in excess of 100% of General Fund expenditures since the “committed” and “assigned” amounts equal 100% of General Fund expenditures. This policy allows for “unassigned” funds in excess of 100% of General Fund expenditures and places no specific restrictions on their use. In general, the City Council could choose to utilize “unassigned” fund balance for one-time projects in a given fiscal year, such as technology upgrades, infrastructure improvements, economic development efforts, or other such one-time uses.

### **Use of Resources**

In circumstances when an expenditure is made for a purpose for which amounts are available in multiple fund balance classifications, the order of allocation of these available funds is first restricted, second committed, third assigned, and lastly unassigned amounts.

### **REPLENISHMENT OF COMMITTED AND/OR ASSIGNED RESERVES**

In keeping with the principles discussed in this policy, when either Committed or Assigned funds are utilized for their specific, intended purposes, and the levels fall below the policy levels (60% for Committed and 40% for Assigned), the City Council, will develop a reserve replenishment plan to return the reserves to their policy levels. This plan will seek to return the Committed and/or Assigned reserves to their policy levels within one (1) to three (3) years, per City Council direction.

## **INTERNAL SERVICE FUND RESERVES**

Internal service funds are used to centrally manage and account for specific program activity in a centralized fund. The revenue (resources) for these funds generally comes from internal charges to Departmental operating budgets, based on different allocation methods depending on the internal service provided. Each of these internal service funds are classified as Proprietary funds in the City's annual financial statements (Certified Annual Financial Report, CAFR). These funds have several functions:

- Normalizing departmental budgeting for programs and uses that have life cycles greater than one fiscal year, helping to facilitate level budgeting for expenditures that could be erratic from year to year (such as vehicles or technology replacement)
- Serve as a repository of a reasonable amount of savings to utilize for long-term asset replacement and/or funding liabilities
- Enable appropriate distribution of citywide costs to individual Departments and programs, which more readily establishes the true costs of various operations

The City of La Palma has five (5) Internal Service Funds:

- Employee Benefits
- Insurance
- Vehicle Maintenance and Replacement
- Facilities Maintenance and Replacement
- Technology Maintenance and Replacement

The guiding purpose of each fund is to gather enough resources to meet annual expenses as well as maintain a reasonable fund balance for contingency purposes. Therefore, this policy will enumerate minimum fund balance levels for each internal service fund based on specific fund-type metrics. The intent of this policy is twofold:

- 1. To ensure sufficient resources exist in each internal service fund to pay for annual, ongoing expenses while maintaining a reasonable reserve to fund replacement purchases (i.e., annual vehicle replacement); and,**
- 2. Establish a fund balance level for each fund that is reasonable and prevents the over-accumulation of resources beyond what is needed for normal operating needs plus any amount required for emergency or contingency needs.**

## **PROCEDURES**

The following procedures will be utilized to establish reserve levels for each of the five Internal Service Funds:

## **Employee Benefits**

This fund allocates all of the costs related to maintaining a highly functioning full-time and part-time work force. Some of the major expenses allocated to each Department and Program through this fund are: CalPERS retirement, health insurance, dental insurance, workers compensation, tuition reimbursement, and other Human Resources management expenses (e.g., training).

This policy states that the fund balance level for the Employee Benefits fund will be calculated using the total amount of compensated absences, as noted in the CAFR "Statement of Net Assets." This amount represents the total outstanding liability of all accrued employee vacation and sick time. Furthermore, while the CAFR "Statement of Net Assets" lists this liability as that "due within one year" versus "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.

Using "compensated absences" as a measurement for appropriate fund balance allows for one type of liability to be covered. Being able to show how the "compensated absences" liability could be fully covered, if in the highly unlikely scenario the entire amount needed to be converted to an expense, is a useful metric upon which to base a reserve level policy.

## **Insurance**

This internal service fund is responsible for allocation costs related to the City's insurance coverage. The City of La Palma is a member of the California Joint Powers Insurance Authority (CJPIA). This pooled insurance joint powers authority (JPA) allows La Palma, as a small city, to receive insurance coverage at a reasonable amount.

Therefore, this policy establishes a reserve amount equal to three times the annual insurance expenses of the immediately preceding fiscal year. This reserve level provides sufficient funding to cover annual insurance expenses while providing additional funds for any unseen, emergency needs (i.e., contingency reserve) such as an adverse legal judgment, a large one-time deductible payment, or other similar one-time expense. It should be noted that the City's General Fund Economic Uncertainties Commitment (as established in this policy) could also be utilized as a further source of funds in the event of a large insurance related claim.

## **Vehicle Maintenance and Replacement**

The City has a fleet of rolling stock and other equipment that is maintained and replaced through the Vehicle internal service fund. The City's Police, Public Works, and Recreation and Community Services Departments comprise the largest users of and contributors to the Vehicle internal service fund. 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 (primarily rolling stock) at their economic obsolescence.

This policy establishes a reserve level equal to one-third (33%) of the replacement value of all rolling stock. The definition of rolling stock includes such equipment as Police patrol vehicles,

Public Works utility trucks, and Recreation and Community Services utility vehicles. The replacement value shall be that updated and used annually as part of the budget development process. This metric was chosen since the average, annual total replacement value of vehicles for the past seven years has been approximately \$200,000. The one-third of the replacement value reserve level would actually be three times higher than this seven year historical actual expenditure amount. Setting the reserve level at one-third of the replacement value of all rolling stock will provide sufficient funds should there be a need for a one-time, larger than normal expenditure related to fleet services.

### **Facilities Maintenance and Replacement**

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 Hall, Police Building and Central Park offices and community center. The City maintains a long-term, facilities master plan that is utilized to guide long-range budgeting for major building expenses.

This reserve policy establishes a fund balance level for the Facilities internal service fund equal to a rolling six-year average of actual Maintenance and Operations expenses, updated annually. This metric is chosen in order to provide a long-enough historical expenditure level that includes routine as well as some non-capital, one-time emergency expenditures. Using a six-year rolling average levels out annual operating and maintenance expenditures.

In addition, there is established a contingency amount equal to half of the rolling six-year average of actual Maintenance and Operations expenses. This contingency amount could be utilized to fund non-routine rehabilitation projects. It should be noted that normal practice is to also utilize the Capital Outlay Reserve (COR) fund to pay for non-routine facilities capital projects. The purpose of the contingency reserve is to set aside additional capital funding that can be used in addition to COR funds.

### **Technology Maintenance and Replacement**

The City's computer network, communications system (i.e., telephone), desktop and peripheral hardware, and technology software expenses are accounted for in the Technology internal service fund. This fund is utilized for periodic replacement of desktop computers, the annual expense related to enterprise-wide software licenses (i.e., Microsoft Office), upgrades to servers and networks, and maintenance and upkeep of the communications (i.e., telephones) system.

The reserve level established for this internal service fund shall be the full replacement value of the City's entire technology network, as determined annually through the budget development process. Choosing this reserve level metric does not suggest the funds would be use to completely replace the technology in use. Instead, it is a useful measure to allow for periodic upgrades and enhancements to the City's collection of information and communications technology, while also providing sufficient funds to meet annual operating costs.

## **REPLENISHMENT OF INTERNAL SERVICE FUND RESERVE LEVELS**

In keeping with the principles discussed in this policy, when the reserve level of any Internal Service Fund falls below the policy levels as outlined here, the Finance Director will adjust allocations to those Internal Service Fund which have insufficient reserve levels beginning with the immediately succeeding fiscal year from when the reserve deficiency occurs. Allocation levels will be adjusted through the budget process in a manner that seeks to return the Internal Service Fund reserves to their policy levels within one (1) to three (3) years.

DRAFT

## **SUMMARY**

### **Components of the Fund Balance**

#### **Nonspendable Fund Balance**

- Inherently nonspendable
- Portion of net resources that cannot be spent because of their form
- Portion of net resources that cannot be spent because they must be maintained intact

#### **Restricted Fund Balance**

- Externally enforceable limits on use
- Limitations imposed by creditors, grantors, contributors, or laws and regulations of other governments
- Limitations imposed by law through constitutional provisions or enabling legislation

#### **Committed Fund Balance**

- Council/Agency Self-imposed Limitations set in place prior to the end of the fiscal year
- Limitation imposed at highest level of decision making that requires formal action at the same level to remove

#### **Assigned Fund Balance**

- Limitation resulting from intended use
- Intended use established by the Finance Director

#### **Unassigned Fund Balance**

- Total fund balance in the General Fund in excess of nonspendable, restricted, committed and assigned fund balance (surplus)
- Excess of nonspendable, restricted, and committed fund balance over total fund balance (deficit)

#### **Use of Fund Balance**

- Restricted
- Committed
- Assigned

## **GLOSSARY**

State and local governments use three broad categories of funds: *governmental* funds, *proprietary* funds, and *fiduciary* funds.

**Governmental** funds include the following.

- *General* fund. This fund is used to account for general operations and activities not requiring the use of other funds.
- *Special revenue* funds are required to account for the use of revenue earmarked by law for a particular purpose. State and federal fuel tax revenues require special revenue funds, because federal and state laws restrict these taxes to transportation uses.
- *Capital projects* funds are used to account for the construction or acquisition of fixed assets such as buildings, equipment and roads. Depending on its use, a fixed asset may instead be financed by a special revenue fund or a proprietary fund. A capital project fund exists only until completion of the project. Fixed assets acquired and long-term debts incurred by a capital project are assigned to the government's *General Fixed Assets* and *Long-Term Debts*.
- *Debt service* funds are used to account for money that will be used to pay the interest and principal of long-term debts. Bonds used by a government to finance major construction projects, to be paid by tax levies over a period of years, require a debt service fund to account for their repayment.

The debts of special assessment and proprietary funds are serviced within those funds, rather than by a separate debt service fund.

- *Special assessment* funds account for public infrastructure improvements financed by special levies against property holders. Sidewalk and alley repairs often rely on special assessments.

**Proprietary** funds include the following.

- *Internal service* funds are used for operations serving other funds or departments within a government on a cost-reimbursement basis. A printing shop, which takes orders for booklets and forms from other offices and is reimbursed for the cost of each order, would be a suitable application for an internal service fund.
- *Enterprise* funds are used for services provided to the public on a user charge basis, similar to the operation of a commercial enterprise. Water and sewage utilities are common examples of government enterprises.

**Fiduciary** funds are used to account for assets held in trust by the government for the benefit of individuals or other entities. The employee pension fund, created by the State of Maryland to provide retirement benefits for its employees, is an example of a fiduciary fund. Financial statements may further distinguish fiduciary funds as either *trust* or *agency* funds; a trust fund generally exists for a longer period of time than an agency fund.

# Attachment 3

## GENERAL FUND RESERVES: CURRENT POLICY vs. RECOMMENDED POLICY SHOWING PROJECTED ENDING RESERVES USING POLICY CLASSIFICATIONS

### GENERAL FUND RESERVES at 06/30/2013: CURRENT CLASSIFICATION AND RESERVE POLICY

Nonspendable	915,758	
Restricted		
Committed		
Assigned	4,541,983	<1>
Unassigned	9,289,212	
	<u>14,746,953</u>	
<b>Spendable (Net Nonspendable)</b>	<b><u>13,831,195</u></b>	
GF FY 2012-13 Projected Revenue	9,648,405	
GF FY 2012-13 Projected Expenditures*	(9,099,400)	
Transfer to COR	(1,700,000)	
Add To / (Use Of) Reserves	(1,150,995)	
	<u>0</u>	
<b>Projected GF Fund Balance 06/30/2013</b>	<b><u>12,680,200</u></b>	
"Surplus" FB over 100%	<b><u>3,580,800</u></b>	

<1> This amount is "backed into" after subtracting the nonspendable and unassigned amounts. The CAFR indicates "assigned for capital project." Following past practice, this amount is not designated for any specific projects. It is only a classification utilized to indicate one potential use of these reserves. The assigned amount can be used how City Council indicates.

### GENERAL FUND RESERVES at 06/30/2013: RECOMMENDED RESERVE POLICY

Nonspendable	643,508	<2>
Restricted	-	
Committed (Economic Uncertainty Reserve, 60%)	5,459,640	
Assigned (Infrastructure/Capital Projects, 40%)	3,639,760	
Unassigned (Excess of 100% / Available)	3,580,800	
	<u>9,099,400</u>	
<b>Restricted + Committed + Assigned</b>	<b><u>9,099,400</u></b>	
<b>Total</b>	<b><u>12,680,200</u></b>	

<2> \$586,654 of this amount is related to a 2002 City Loan to the former CDC; per AB1484, this loan must be re-calculated using LAIF rates. The 06/30/2012 CAFR had this balance as \$858,904.

**PROPOSED INTERNAL SERVICE FUND (ISF) FUND BALANCES  
RECOMMENDED RESERVE POLICY FUND BALANCE AMOUNTS  
USING JUNE 30, 2013 PROJECTED FUND BALANCE LEVELS**

**FUND 060, INSURANCE**

**Reserve Policy Level: 3 TIMES ANNUAL INSURANCE EXPENSES**

FY 13-14 INSURANCE PREMIUM ESTIMATE	308,300		
3X ANNUAL INSURANCE EXPENSES	924,900	<b>06/30/2013</b>	
<b>TOTAL SUGGESTED FB</b>	<b>1,000,000</b>	1,001,583	<= 06/30/2013 Projected Fund Balance
		1,583	<= EXCESS / (DEFICIT) from 06/30/2013 Projected Fund Balance

**FUND 061 EMPLOYEE BENEFITS**

**Reserve Policy Level: 100% of 06/30/20XX COMPENSATED ABSENCES <1>**

DUE WITHIN ONE YEAR	144,738		
DUE BEYOND ONE YEAR	434,213	<b>06/30/2013</b>	
<b>TOTAL SUGGESTED FB</b>	<b>580,000</b>	864,315	<= 06/30/2013 Projected Fund Balance
		284,315	<= EXCESS / (DEFICIT) from 06/30/2013 Projected Fund Balance

<1> From the 06/30/2012 CAFR, "Statement of Net Assets," p 16

**FUND 062, FACILITIES MAINTENANCE**

**Reserve Policy Level: 6-YR AVG OF ACTUAL OPERATING (MAINTENANCE) EXPENDITURES**

FY 2006-07	316,134		
FY 2007-08	287,002		
FY 2008-09	368,775		
FY 2009-10	338,840		
FY 2010-11	280,495		
FY 2011-12	338,720		
6 YR AVERAGE EXPENDITURES (ACTUALS)	321,661		
CONTINGENCY AMOUNT	178,339	<b>06/30/2013</b>	
<b>TOTAL SUGGESTED FB</b>	<b>500,000</b>	953,292	<= 06/30/2013 Projected Fund Balance
		453,292	<= EXCESS / (DEFICIT) from 06/30/2013 Projected Fund Balance

**FUND 063, VEHICLE REPLACEMENT**  
**Reserve Policy Level: 1/3 OF REPLACEMENT VALUE OF ALL VEHICLES**

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ESTIMATED REPLACEMENT VALUE OF ALL VEHICLES	2,065,500	<b>&lt;2&gt;</b>			
1/3 OF REPLACEMENT VALUE	688,500			<b>06/30/2013</b>	
<b>TOTAL SUGGESTED FB</b>			<b>689,000</b>	697,761	<= 06/30/2013 Projected Fund Balance
				8,761	<= EXCESS / (DEFICIT) from 06/30/2013 Projected Fund Balance

*<2> Based on FY 2013-14 updated vehicle replacement listing, amount represents value of rolling stock (Public Works, Police and Recreation)*

**FUND 064, COMPUTER MAINTENANCE**  
**Reserve Policy Level: ESTIMATED CITYWIDE NETWORK REPLACEMENT VALUE**

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FY 13-14 EST CITYWIDE NETWORK REPLACE VALUE	394,300	<b>&lt;3&gt;</b>			
<b>TOTAL SUGGESTED FB</b>			<b>390,000</b>	<b>06/30/2013</b>	
				451,200	<= 06/30/2013 Projected Fund Balance
				61,200	<= EXCESS / (DEFICIT) from 06/30/2013 Projected Fund Balance
				<b>809,151</b>	<b>&lt;= EXCESS / (DEFICIT) TOTAL, ALL 5 ISF</b>

*<3> Based on value in FY 2013-14 Technology Maint/Replace fund; does not include value of desktop computers or peripherals (i.e., printers)*

# Attachment 4

## **GASB 54 Fund Balance Classification Overview/Definitions Components of the Fund Balance**

### Nonspendable Fund Balance

- Inherently nonspendable
- Portion of net resources that cannot be spent because of their form
- Portion of net resources that cannot be spent because they must be maintained intact

### Restricted Fund Balance

- Externally enforceable limits on use
- Limitations imposed by creditors, grantors, contributors, or laws and regulations of other governments
- Limitations imposed by law through constitutional provisions or enabling legislation

### Committed Fund Balance

- Council/Agency Self-imposed Limitations set in place prior to the end of the fiscal year
- Limitation imposed at highest level of decision making that requires formal action at the same level to remove

### Assigned Fund Balance

- Limitation resulting from intended use
- Intended use established by the Finance Director

### Unassigned Fund Balance

- Total fund balance in the General Fund in excess of nonspendable, restricted, committed and assigned fund balance (surplus)
- Excess of nonspendable, restricted, and committed fund balance over total fund balance (deficit)

### Use of Fund Balance

- Restricted
- Committed
- Assigned



# AGENDA ITEM

Item Number:

7

Submitted By:

Keith D Neves *Keith*  
Finance Director

TO: CITY COUNCIL  
FROM: CITY MANAGER *D*

**Meeting Date:**  
June 7, 2011

**Subject:** Implementation of Governmental Accounting Standards Board Statement No. 54

**RECOMMENDATION:**

It is recommended that the City Council adopt a Resolution approving the Policy implementing Governmental Accounting Standards Board Statement No. 54.

**SUMMARY:**

In March 2009, the Governmental Accounting Standards Board (GASB) issued Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, to address issues related to how fund balance was being reported in governmental financial statements. The intent of the Statement is to bring greater transparency and consistency to fund balance reporting in the governmental sector. The City is required to implement GASB Statement No. 54 for the Fiscal Year ending June 30, 2011.

This new standard does not change the total amount of a given fund balance, but it substantially alters the categories and terminology used to describe the components of a fund balance. The new categories and terminology reflect an approach that focuses, not on financial resources available for appropriation within a fund, but on the extent to which the City is bound to honor constraints on the use of the funds. In the past, fund balances have been classified into three separate components: Reserved, Designated, and Undesignated. There are almost always important limitations on the purpose for which all or a portion of the resources can be used. The force of these limitations can vary significantly depending on their source. The various components of the new fund balance reporting standard are designed to indicate the extent to which the City is bound by these limitations placed upon the resources.

GASB Statement No. 54 defines five new components of fund balance that will replace the current existing three components. The five new components are:

Nonspendable Fund Balance. The portion of a fund balance that cannot be spent because they are either: (a) not in a spendable form, such as prepaid items, inventories of supplies, or loans receivable; or (b) legally or contractually required to be maintained intact, such as the principal portion of an endowment. This category was traditionally reported as a “reserved” fund balance under the old statement.

Restricted Fund Balance. The portion of a fund balance that has constraints placed on the use of resources that are either: (a) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or (b) imposed by law through constitutional provisions or enabling legislation. This category was traditionally reported as a “reserved” fund balance under the old standard.

Committed Fund Balance. The portion of a fund balance that includes amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the City Council and remain binding unless removed in the same manner. This category was traditionally reported as a “designated” fund balance under the old statement.

Assigned Fund Balance. The portion of a fund balance that includes amounts that are constrained by the government’s intent to be used for specific purposes, but that are neither Restricted nor Committed. Such intent needs to be established either by the City Council or by an official designated for that purpose. This category was traditionally reported as a “designated” fund balance under the old standard.

Unassigned Fund balance. The portion of a fund balance that includes amounts that do not fall into one of the above four categories. The General Fund is the only fund that should report this category of fund balance. This category was traditionally reported as an “undesignated” fund balance under the old standard.

Part of the City’s implementation of this statement for Fiscal Year 2010-11 is the formal adoption of a fund balance policy. The policy explains the five components of fund balance and formally delegates to the Finance Director, as required by GASB Statement No. 54, the authority to assign fund balances for specific purposes for inclusion in the annual financial reports. Prior to GASB Statement No. 54, these amounts were reported by the Finance Director as Reserved, Designated, and Undesignated and did not require City Council delegation.

The City’s independent auditor, Kevin Pulliam of Vavrinek, Trine, Day & Co., LLP, has reviewed the draft Policy and concurs with its recommendations. Upon adoption, this policy will be incorporated into the City Council Policy Manual as a new policy.



RESOLUTION NO. 2011-

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF  
LA PALMA APPROVING THE COMMITMENT OF FUND  
BALANCES IN ACCORDANCE WITH GOVERNMENTAL  
ACCOUNTING STANDARDS BOARD STATEMENT NO. 54

**WHEREAS**, the Governmental Accounting Standards Board (GASB) has issued Statement No. 54 – Fund Balance Reporting and Governmental Fund Type Definitions, which changes the terminology used for fund balance reporting on balance sheets of Governmental Funds, and

**WHEREAS**, for financial statement reporting purposes, the GASB Statement defines Restricted amounts as those that are constrained to specific purposes by their providers through constitutional provisions or enabling legislation; and

**WHEREAS**, for financial statement reporting purposes, the GASB Statement defines assigned amounts as those the government intends to use for a specific purpose; and

**WHEREAS**, when expenditures are incurred for purposes for which both restricted and unrestricted (committed, assigned, or unassigned) fund balances are available, the City's policy is to first apply restricted fund balance. When expenditures are incurred for purposes for which committed, assigned, or unassigned fund balances are available, the City's policy is to first apply committed fund balance, then assigned fund balance, and finally unassigned fund balance.

**WHEREAS**, this policy delegates to the Finance Director the authority to assign unrestricted fund balance amounts where the City's intent is for those amounts to be used for specific purposes. This delegation of authority is for the sole purpose of reporting these amounts in the annual financial statements.

**WHEREAS**, the City has established a General Fund minimum fund balance policy. At the end of each fiscal year, the General Fund should have a minimum fund balance of 100% of the next fiscal year's General Fund annual budgeted operating expenditures, as calculated by the Finance Director. This target amount has been established in order to provide a reasonable level of assurance that the City's day-to-day operations will be able to continue even if circumstances occur where revenues are insufficient to cover expenditures. The minimum fund balance is shown in the annual financial statements as unassigned fund balance.

**NOW, THEREFORE, BE IT RESOLVED** that the City Council of La Palma hereby approves the attached Fund Balance Policy for compliance with Governmental Accounting Standards Board Statement No. 54, Fund Balance Reporting and Governmental Fund Type definitions.

**APPROVED AND ADOPTED** by the City Council of the City of La Palma at a regular meeting held on the 7th day of June 2011.

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Ralph D. Rodriguez  
Mayor

ATTEST:

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Laurie A. Murray, CMC  
City Clerk

STATE OF CALIFORNIA )  
COUNTY OF ORANGE ) SS  
CITY OF LA PALMA )

I, LAURIE A. MURRAY, City Clerk of the City of La Palma, California, DO HEREBY CERTIFY that the foregoing resolution was adopted by the City Council of said City at a regular meeting of said City Council held on the 7th day of June 2011, and that it was so adopted by called vote as follows:

AYES:

NOES:

---

Laurie A. Murray, CMC  
City Clerk

## City of La Palma Fund Balance Policy

This policy establishes the procedures for reporting, within the annual financial statements, unrestricted fund balance (comprised of Committed, Assigned, and Unassigned categories) within the City's governmental funds: General Fund, Special Revenue Funds, Debt Service Fund, and Capital Projects Funds.

### **Definitions**

Fund balance is the difference between the assets and liabilities reported in the City's governmental funds. There are generally limitations on the purpose for which all or a portion of the resources of a governmental fund may be used. The force behind these limitations can vary significantly, depending upon their source. Consequently, the fund balance reported in the annual financial statements is categorized into five components whereby each component identifies the extent to which the City is bound to honor constraints on the specific purposes for which amounts in the fund can be spent. The five components of fund balance are as follows:

- **Nonspendable:** Resources that are 1) not in spendable form, such as inventories, prepaids, long-term receivables, or non-financial assets held for resale, or 2) required to be maintained intact such as an endowment.
- **Restricted:** Resources that are subject to externally enforceable legal restrictions; these restrictions would be either 1) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or 2) imposed by law through constitutional provisions or enabling legislation.
- **Committed:** Resources that are constrained to specific purposes by a formal action of the City Council such as an ordinance or resolution. The constraint remains binding unless removed in the same formal manner by the City Council. Council action to commit fund balance must occur within the fiscal reporting period while the amount committed may be determined subsequently.
- **Assigned:** Resources that are constrained by the City's intent to be used for specific purposes, but that are neither restricted nor committed.
- **Unassigned:** Within the General Fund, the residual resources, either positive or negative, in excess of what can be properly classified in one of the other four fund balance categories. Within all other governmental funds, the negative residual resources in excess of what can be properly classified as nonspendable, restricted, or committed.

## **Policy**

1. When expenditures are incurred for purposes for which both restricted and unrestricted (committed, assigned, or unassigned) fund balances are available, the City's policy is to first apply restricted fund balance. When expenditures are incurred for purposes for which committed, assigned, or unassigned fund balances are available, the City's policy is to first apply committed fund balance, then assigned fund balance, and finally unassigned fund balance.
2. This policy delegates to the Finance Director the authority to assign unrestricted fund balance amounts where the City's intent is for those amounts to be used for specific purposes. This delegation of authority is for the sole purpose of reporting these amounts in the annual financial statements.
3. The City has established a General Fund minimum fund balance policy. At the end of each fiscal year, the General Fund should have a minimum fund balance of 100% of the next year's General Fund annual budgeted operating expenditures, as calculated by the Finance Director. This target amount has been established in order to provide a reasonable level of assurance that the City's day-to-day operations will be able to continue even if circumstances occur where revenues are insufficient to cover expenditures. The General Fund's minimum fund balance policy is reported in the notes to the annual financial statements. The minimum fund balance is shown in the annual financial statements as unassigned fund balance.

This policy has been prepared in accordance with Governmental Accounting Standards Board (GASB) Statement No. 54. No other policy or procedure supersedes the authority and provisions of this policy.