



Agenda Report

Fullerton City Council

MEETING DATE: JUNE 18, 2019

TO: CITY COUNCIL / SUCCESSOR AGENCY

FROM: KENNETH A. DOMER, CITY MANAGER

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ADMINISTRATIVE SERVICES

SUBJECT: GENERAL FUND – FUND BALANCE POLICY
DISCUSSION

SUMMARY

At the May 21, 2019 City Council meeting, Staff was directed to bring an item to discuss the current policy for the use and designation of monies contained within the fund balance of the General Fund. This item provides a framework for City Council discussion of additional policies such as a Fund Balance Assignment Policy for the General Fund, Recurring Revenue Policy, and a One-time Revenue Policy. Direction received at this meeting will be formatted into a resolution for City Council consideration in advance of fund allocation.

RECOMMENDATION

Provide Staff direction regarding creation of a Fund Balance Assignment Policy for the General Fund, Recurring Revenue Policy, and a One-time Revenue Policy. Direct Staff to prepare a resolution to adopt the policies for City Council review and approval.

BUDGET POLICY PRIORITY STATEMENT

This item matches the following Budget Policy Priority Statements:

- Fiscal and Organizational Stability.
- Public Safety
- Infrastructure and City Assets

FISCAL IMPACT

No fiscal impact at this time.

BACKGROUND

Definition of “Fund Balance”

The term “fund balance” is generally used to describe the amount of money that exists within a governmental fund. It is measured at the end of the Fiscal Year after all expenditures, revenues and transfers have been properly accrued and accounted for. While the City’s Fiscal Year closes on June 30th, it is not until at least 30 days after that time that the books are closed on the prior year due to paying outstanding invoices for services or supplies ordered and received in the prior month. In common terms, “fund balance” may be viewed as similar to the balance of a bank account after taking into account all of the payments and deposits of the account. It is important for the City to maintain adequate levels of fund balance to provide a cushion for unexpected revenue decreases and or expenditure increases. It is especially important for the City’s General Fund because a large portion of revenues are derived from property, sales, and other taxes that are susceptible to rapid changes in economic conditions.

Generally Accepted Accounting Principles allow for five classifications of fund balance, shown in order from most constraining to least constraining: 1) nonspendable, 2) restricted, 3) committed, 4) assigned and 5) unassigned. The first two classifications, nonspendable and restricted, include any monies that are constrained for reasons outside of the control of the City and may include federal grant monies and inventories or supplies. The last three classifications are collectively referred to as “unrestricted fund balance” because they are not constrained by any entity outside of the City Council.

Current Policy

On March 19, 2019, the City Council adopted a Statement of Financial Policies (Attachment A) which set forth a basic level of financial policies in conformance with best practices set forth by the Government Finance Officers Association. The adopted Statement of Financial Policies (Policies) are general policies on many financial issues and contain a specific section, Section 4.1, regarding the General Fund which states:

“The City shall maintain a minimum General Fund balance of 10% of annual General Fund expenditures and shall strive to increase the level to 17% (approximately two months of expenditures). The 10% fund balance will be designated as ‘assigned’ and will be designated to be used in the event of a significant financial emergency.”

Within the policies, it also states:

“Any year end operating surpluses will revert to unassigned fund balances for use in maintaining fund balance levels set by policy and will be available for capital projects and / or ‘one-time only’ General Fund expenditures.”

Current General Fund – Fund Balance

The fund balance of the General Fund was \$14.3 million at the start of FY 2018-19 and was originally projected to be \$11.4 million at the end of FY 2018-19 after all revenues, expenditures, transfers and use of one-time revenues received from the sale of City-owned assets. As the end of FY 2018-19 draws near, more recent projections show the

fund balance of the General Fund may be as much as \$14.1 million, approximately \$2-3 million higher than originally expected.

The exact amount is subject to accrual of expenditures and revenues that occur after the fiscal year end but meet the accounting requirements for inclusion in FY 2018-19. The reason for the projected increase in fund balance of the General Fund has been discussed at several previous City Council meetings as part of the quarterly budget report, strategic planning session, and budget workshop and is primarily the result of vacant positions that have not been filled throughout the fiscal year. It is not expected that this increase in fund balance will occur in the upcoming FY 2019-20 because an increased vacancy rate of 4% was utilized within the General Fund budget for FY 2019-20 so budgetary savings from vacant positions is already assumed.

Therefore, at this time, any year end operating surpluses, resulting from any combination of increased revenues, salary and benefit savings from vacancies, or reduced expenditures not carried over, are designated as unassigned fund balance.

The projected ending fund balance of \$14.1 million for the General Fund is equal to 15.1% of the projected FY 2018-19 General Fund expenditures and 14.5% of projected FY 2019-20 General Fund expenditures. Based on the current Policies, any remaining fund balance beyond the 10% amount will be designated as “unassigned” until further action is taken by the City Council. Accordingly, because the City has not closed out Fiscal Year 2018-19, it is projected that approximately \$9.3 million of fund balance available will be “assigned” to cover the 10% Policies requirement and up to \$3-4 million of fund balance will be designated as “unassigned” as also required by the Policies.

DISCUSSION

Additional Fiscal Policies

As previously discussed with City Council during the adoption of the Fiscal Policies on March 19th, it is recommended that the City Council consider and adopt further financial policies to include a specific policy on Fund Balance Assignments for the General Fund, including end of the year fund balances due primarily to vacancies and one-time only sources of funding.

Additionally, it is prudent to have a financial policy regarding newer recurring sources of revenue. As previously directed by the City Council, City Staff continues to look for methods of increasing revenue and new revenue sources would be initially guided by a policy until the City Council provided alternative direction. Having a financial policy regarding new, recurring revenues allows a pre-determination for such a revenue to be used for a critical priority from the beginning versus having to re-establish after other expenditures begin to rely on the source.

Fund Balance Assignment Policy for the General Fund

The Fund Balance Policy for the General Fund, as established in the Policies, states that the City “shall maintain a minimum General Fund balance of 10% of annual General Fund expenditures and shall strive to increase the level to 17%.” As discussed in the Strategic Planning study session as well as the adoption of the Fiscal Year 2019-20 Budget, the City will be fiscally challenged, even going forward with status quo budgets, and will dip below our 10% assigned fund balance level and not exceed that

amount until the year 2030 under a nominal scenario. The City will not exceed the 17% fund balance level until after the year 2032, again, under a fiscal scenario with no major issues or expenditures. Under the scenario described above, the additional fund balance from the current fiscal year, projected to be approximately \$2 to \$3 million, was assumed to be fully assigned to the General Fund– Fund Balance.

It is recommended that until the City is more financially sustainable the majority (65%) of one-time only fund balances should be assigned to the General Fund – Contingency Reserve in order to strive to achieve a 17% General Fund – Contingency Reserve or, at a minimum as shown in our five year projections, maintain a level as close to 10% as possible without going lower than 5%.

Recommended Fund Balance Assignment Policy for the General Fund Direction: No less than 65% of any one-time unassigned fund balance at the close of a fiscal year shall be assigned to the General Fund – Contingency Reserve until such time that the General Fund – Contingency Reserve is 17%; assign 25% to infrastructure and equipment; and 10% to strategic priorities.

Recurring Revenue Policy

According to the Government Finance Officers Association (GFOA), recurring revenues are the portion of a government's revenues that can reasonably be expected to continue year to year, with some degree of predictability. Recurring revenues can be restricted for certain uses or general purpose in character. An example of a restricted use is SB 1 gas tax for road improvements and SB 2 documentary tax for affordable housing and homeless services. Those funds are restricted in how they are used and cannot become part of a City's normal operating funds. General purpose revenues can include new franchise fees, new taxes such as a cannabis tax, increased transit occupancy tax, or sales tax.

New recurring revenues will range in size but generally recurring revenues below \$500,000 should be reviewed as to their source, volatility in receipt, and any legal requirements prior to determining how they are categorized. As such, all new recurring revenues less than \$500,000 that are general purpose are recommended to be made part of the General Fund.

New recurring revenues above \$500,000 that are general purpose are recommended to be utilized to achieve a fiscally sustainable organization through assigned fund balances, improved infrastructure, reduced debt or pension obligations, employee retention and recruitment, and strategic priorities (such as initiatives to increase public safety, economic development, advanced planning, etc.).

Recommended Recurring Revenues Policy Direction: New recurring revenues above \$500,000 a year are recommended to be assigned as follows:

If the Assigned Fund Balance Contingency Reserve is less than 17%:

- 50% - Infrastructure improvements (e.g., roads, alleys, buildings, sidewalks)
- 10% - Pension/Liability obligations
- 20% - General Fund Contingency Reserve
- 10% - Employee retention and recruitment
- 10% - Strategic priorities

If the Assigned Fund Balance Contingency Reserve is at or above 17%:

- 60% - Infrastructure improvements (e.g., roads, alleys, buildings, sidewalks)
- 15% - Pension/Liability obligations
- 15% - Employee retention and recruitment
- 10% - Strategic priorities

One-time Revenue Policy

One-time revenues are revenues that the City cannot reasonably expect to receive on an ongoing basis. The current Policies describes one-time revenue windfalls to include: sales of city-owned real estate, lump sum (net present value) savings from debt restructuring, litigation settlement, unexpected revenues and other similar sources of revenue as designated by the City Council.

The GFOA recommends a policy for use of one-time revenues because, by definition, the revenues cannot be depended upon in a future budget period. The GFOA lists examples of potential uses to include startup costs (such as for technology projects), stabilization (e.g., to cover expenditures that temporarily exceed revenues), early debt retirement, capital purchases, vehicle purchases (assuming ongoing maintenance is already planned for), and increased street maintenance efforts. Generally, one-time revenues not added to the General Fund Assigned Fund Balance should only be expended for items that will not have recurring direct or indirect costs.

Recommended One-time Revenue Policy Direction: One-time revenues should not be used to fund on-going expenditures. One-time revenues should generally be utilized and/or obligated by the City Council for the purpose of achieving appropriate progress towards identified priority policies, goals, and objectives.

Next Steps

Given that the unaudited preliminary fund balance of the General Fund is not reported to City Council until October 2019 and the final audited fund balance will not be reported until December 2019 now is the time for the City Council to establish a policy based on the percentages recommended in this report which will then be brought forth in the form of a resolution for City Council consideration and approval.

Attachments:

- Attachment 1 – Statement of Financial Policies (adopted March 19, 2019)