

FUND BALANCE FOR THE GENERAL FUND

City Council Procedure #CC-14-003

Effective 10/7/2014



Purpose

A fund balance policy helps ensure that the City can:

- Quickly respond to unexpected situations such as natural disasters
- Weather economic recessions and other cyclical revenue downturns while avoiding large variations in taxes and fees or variations in the type and quality of municipal services provided
- Avoid the need for short-term borrowing to cover delays in revenue receipt
- Pursue strategic and opportunistic projects or activities

This policy establishes the amounts the City of Menlo Park will strive to maintain in its fund balance, how the fund balance will be funded, and the conditions under which fund balance may be spent.

Background

The City of Menlo Park has always maintained a high level of general fund reserves, which has contributed to good standings with credit rating agencies; provided financial flexibility in economic downturns; contributed a source of investment income for general fund operations; and assured financial coverage in the event of future emergencies.

Policies and procedures

This fund balance policy establishes the procedures for reporting unrestricted fund balance in the general fund financial statements. Certain commitments and assignments of fund balance will help ensure that there will be adequate financial resources to protect the City against unforeseen circumstances and events such as revenue shortfalls and unanticipated expenditures. The policy also authorizes and directs the finance director to prepare financial reports which accurately categorize fund balance as per Governmental Accounting Standards Board (GASB) Statement no. 54, Fund balance reporting and governmental fund type definitions. The policy will be reviewed annual by the City Council for revisions as appropriate.

Fund balance is essentially the difference between the assets and liabilities reported in a governmental fund. There are five separate components of fund balance, each of which identifies the extent to which the City is bound to honor constraints on the specific purposes for which amounts can be spent.

- Non-spendable fund balance (inherently non-spendable)
- Restricted fund balance (externally enforceable limitation on use)
- Committed fund balance (self-imposed limitations on use)
- Assigned fund balance (limitation resulting from intended use)
- Unassigned fund balance (residual net resources)

The first two components listed above are not addressed in this policy due to the nature of their restrictions. An example of non-spendable fund balance is inventory. Restricted fund balance is either imposed by law or constrained by grantors, contributors, or laws or regulations of other governments. This policy is focused on financial reporting of unrestricted fund balance, or the last three components listed above. These three components are further defined below.

Committed fund balance

The City Council, as the City's highest level of decision-making authority, may commit fund balance for specific purposes pursuant to constraints imposed by formal actions taken, such as an ordinance or resolution. These committed amounts cannot be used for any other purpose unless the City Council removes or changes the specific use through the same type of formal action taken to establish the commitment. City Council action to commit fund balance needs to occur within the fiscal reporting period; however, the amount can be determined subsequently.

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General fund emergency contingency

The City of Menlo Park's general fund balance committed for emergency contingencies is established at \$6,000,000. The City Council may wish to increase or decrease this amount, with the goal of providing an amount equivalent to 15-20 percent of the City's annual operating budget for the general fund. This range should be sufficient to allow for a quick and decisive municipal response to events such as natural disasters, catastrophic accidents, or other declared emergency incidents. As defined in the resolution establishing this commitment, the specific uses are listed as the declaration of a state or federal state of emergency or a local emergency as defined in the Menlo Park Municipal Code Section 2.44.010. The City Council may, by the affirming vote of three members, change the amount of this commitment and/or the specific uses of these monies.

Economic stabilization

The City of Menlo Park's general fund balance committed for the purpose of stabilizing the delivery of City services during periods of severe operational budget deficits and to mitigate the effects of major economic uncertainties resulting from unforeseen change in revenues and/or expenditures is established at \$8,000,000.

The City Council may wish to increase or decrease this amount, with the goal of providing an amount equivalent to 20-25 percent of the City's annual operating budget for the general fund. This range serves as a sufficient cushion, safeguarding the City's fiscal health against fluctuations in revenues and costs due to economic volatility. City Council approval shall be required before expending any portion of this committed fund balance. Access to these funds will be reserved for economic emergency situations. Examples of such emergencies include, but are not limited to:

- An unplanned, major event such as a catastrophic disaster requiring expenditures which exceed
- the general fund emergency contingency reserve
- Budgeted revenue taken over by another entity
- Drop in projected/actual revenue of more than five percent of the general fund's adopted revenue budget

Strategic pension funding reserve

The City of Menlo Park participates in the California Public Employees Retirement System (CalPERS), which provides members with a defined-benefit pension based on years of service. CalPERS is funded by a combination of investment earnings on the CalPERS portfolio, contributions by employees, and contributions by employers (the City.) Contribution rates for employers are variable and change annually based on a number of factors, including investment returns, benefits changes, and changes to actuarial assumptions. To mitigate the operational impact of employer contribution rate volatility, as well as to set aside funding for strategic opportunities to reduce the City's pension liability, \$1 million of the general fund's previously unassigned reserve was committed by City Council action on January 14, 2014, to establishing the strategic pension funding reserve. Subsequent to January 14, 2014, 25 percent of the general fund's final operating surplus, should there be one, will be added annually to the strategic pension fund reserve upon completion of the City's comprehensive annual financial report. City Council approval shall be required before expending any portion of this committed fund balance. Examples of the types of situations in which funds would be expended from the strategic pension fund reserve include, but are not limited to:

- Mitigate the impact of a significant year-over-year increase in employer contribution rates due
- to actions outside of the City's control, such as poor investment returns in the CalPERS
- portfolio and/or changes to actuarial assumptions
- Take advantage of opportunities to make non-recurring payments to CalPERS that will reduce the City's pension liabilities, such as paying down or paying off a side fund or other unfunded liability

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Assigned fund balance

Amounts that are constrained by the City’s intent to be used for specific purposes, but are neither restricted nor committed, should be reported as assigned fund balance. This policy hereby delegates the authority to assign amounts to be used for specific purposes to the city manager for the purpose of reporting these amounts in the annual financial statements. A few examples of assigned fund balance follow:

- Encumbrances – materials and services on purchase order and contracts which are unperformed
- Re-appropriations – appropriated by the City Council for specific projects or programs that were not completed and not encumbered by year end
- GASB 31 adjustment – unrealized investment gains that have been recorded in the financial statements in accordance with GASB 31
- Infrastructure maintenance projects – amounts to be transferred to the general capital improvement project fund for such projects in the subsequent fiscal year adopted budget
- Comprehensive planning projects – amounts needed to fully fund such projects as outlined in the 5-year capital improvement plan for the subsequent fiscal year

Unassigned fund balance

These are residual positive net resources of the general fund in excess of what can properly be classified in one of the other four categories.

Amounts held in reserve:

The total goal range for the City’s unrestricted fund balance (includes commitments and assignments of fund balance) is 43 percent to 55 percent of general fund expenditures.

From time-to-time, the City Council may find it prudent to set aside funds for an existing need, priority or investment in the community. Amounts in excess of the established target levels may be shown as additional commitments or assignments of the general fund balance. Such assignments will be reviewed with each fiscal year operating budget to determine if the funding is still necessary or can be released to the general fund reserves.

Funding of general fund balance targets:

Funding of general fund balance targets will come generally from one-time revenues, one-time expenditure savings, excess fund balance (e.g., unused or reversed assignment or commitments), and revenues in excess of projected expenditures.

Conditions for use and replenishment of reserves:

Use of reserves

It is the intent of the City to limit use of general fund balances to address unanticipated, one-time needs or opportunities. Fund balances shall not be applied to recurring annual operating expenditures. Reserves will be used to the extent annual expenditures exceed revenues as reported in the City’s annual audited financial statements (an operating deficit.) Reserves may also be used to allow for an investment in the City’s long-term assets as approved by the City Council.

Authority to use reserves

The city manager may authorize use of reserves consistent with the purposes described above, including amounts authorized in the fiscal period’s budget.

Replenishment of reserves

Reserves will be replenished to the extent annual revenues exceed expenditures as reported in the City’s annual audited financial statements (an operating surplus.) Revenues in excess of expenditures at the end

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of a fiscal year shall be used to first satisfy committed contingency requirements before appropriating for other uses.

Flow of funds:

Restricted fund balances will be expended before unrestricted fund balances when expenditures are incurred for purposes for which both are available. Unrestricted fund balances will be exhausted in the order of assigned, unassigned, and committed when expenditures are incurred for which any of these fund balances are available.

Procedure history

Action	Date	Notes
Proposed and approved by City Council	October 7, 2014	