



STAFF REPORT

DATE: November 21, 2017

REGULAR

ITEM: #17

MOTION

TO: Honorable Mayor and Members of the City Council
FROM: Brian A. Swanson – Finance Director
AGENDA ITEM: Fund Balance/Net Position Policy Discussion
REVIEWED BY: Kristina Handt, City Administrator

BACKGROUND:

Per several Finance Committee meetings, staff presented information regarding the original Fund Balance/Net Assets Policy and a revised Fund Balance/Net Position Policy for review and discussion. Based on these discussions, the Finance Committee provided clarity to the revised policy, subsequently approved it, and recommended it be considered by the City Council for approval. Therefore, staff wanted provide the City Council with the opportunity discuss the policy, and consider adoption of the revised Fund Balance/Net Position Policy this evening.

ITEMS OR QUESTIONS BEFORE THE FINANCE COMMITTEE:

- 1) Should the Council approve the attached Fund Balance/Net Position Policy recommended by the Finance Committee on November 9, 2017?

DISCUSSION:

Staff thought it would be useful to provide the City Council with some context regarding the original Fund Balance/Net Assets Policy as well as the revised Fund Balance/Net Position Policy for review, comment and consideration. The main differences between the original policy, which was adopted on April 2, 2013, and the revised policy for consideration are as follows:

- 1) Updated language to reflect Governmental Accounting Standards Board Statement Number 54 (GASB 54) for classifications of Fund Balance within Governmental Funds.
- 2) Updated Unassigned Fund Balance Percentage in the General Fund moving it from 35-50% to a target floor of 50-60% of the subsequent budgeted fiscal year expenditures.
- 3) Additional language regarding the General Fund in terms of appropriations and commitment of fund balance.
- 4) Removal of language that is not directly under the City's control regarding maintaining its bond rating.
- 5) Addition of a brief Debt Service section to capture all of the City's Governmental Funds.
- 6) Additional language regarding Proprietary Funds, such as Water, Sewer and Storm Water, including suggestions on unrestricted net position percentage targets.

By regularly analyzing, discussing and updating the policy as needed helps to ensure sound financial management concerning fund balance/net position. In addition, working to achieve adequate cash flow allows the City to be nimble and proactive if an opportunity arises that makes sound business sense. Finally, review of governing and oversight bodies helps to ensure the policies and procedures are in congruence with the goals of those entities.

FISCAL IMPACT:

The fiscal impact would be contingent upon the 2018 Proposed Budget that is adopted and the results of each fiscal year in terms of revenues and expenditures. As such, as of 12/31/16, the unassigned fund balance in the General Fund is \$3,279,815. Based on the 2017 Adopted Budget, expenditures are budgeted at \$3,915,386, which would result in an unassigned fund balance percentage in the General Fund of approximately 83% at 12/31/17. As of the most recent 2018 Proposed General Fund Budget the City Council received on November 14, 2017, expenditures are budgeted to be \$4,701,452, resulting in an unassigned fund balance percentage of 67% in the General Fund at 12/31/18.

RECOMMENDATION:

- 1) Motion to approve the attached City of Lake Elmo Fund Balance/Net Position Policy – Revised - November 21, 2017.

ATTACHMENT:

- 1) City of Lake Elmo Fund Balance/Net Position Policy – Revised – November 21, 2017



CITY OF LAKE ELMO FUND BALANCE/NET POSITION POLICY

PURPOSE

It is important for the financial stability of the City of Lake Elmo to maintain fund balance/net position for unanticipated expenditures or unforeseen emergencies, as well as to provide adequate working capital for current operating needs so as to avoid short-term borrowing. The purpose of this policy is to establish appropriate fund balance/net position levels for each fund that is primarily supported by property tax revenues or user fees. This policy will help ensure that adequate resources are available to meet cash flow needs for carrying out the regular operations of the City, as well as to meet the fund balance/net position requirements that may be externally or internally imposed.

POLICY STATEMENT

The City Council authorizes the City Administrator and/or the Finance Director to assign fund balance that reflects the City's intended use of those funds. When both restricted and unrestricted resources are available for use, it is the City's policy to first use restricted resources, and then use unrestricted resources as they are needed. When unrestricted resources are available for use, it is the City's policy to use resources in the following order; 1) committed 2) assigned 3) unassigned.

The fund balance classifications below apply only to Governmental Funds, not Proprietary Funds.

Classification of Fund Balance/Procedures

1. Nonspendable

Amounts that cannot be spent because they are not in a spendable form or are legally or contractually required to be maintained intact. Examples are inventory or prepaid items.

2. Restricted

Amounts subject to externally enforceable legal restrictions. Examples include bond proceeds and grants.

3. Unrestricted

The total of committed fund balance, assigned fund balance, and unassigned fund balance:

- **Committed fund balance** – amounts that can be used only for the specific

purposes determined by a formal action of the government's highest level of decision-making authority. Commitments may be changed or lifted only by the government taking the same formal action that imposed the constraint originally.

- **Assigned fund balance** – amounts intended to be used for a specific purpose; intent can be expressed by the government body or by an official or body to which the governing body delegates the authority.
- **Unassigned fund balance** – residual amounts that are available for any purpose in the general fund. The General Fund should be the only fund that reports a positive unassigned fund balance amount. This classification is also used to account for deficit fund balances in other governmental funds.

Governmental Funds

A. General Fund

- The city will maintain unassigned fund balance in the General Fund with a target floor of 50-60% of the subsequent budgeted fiscal year expenditures, with any additional percentage point(s) be able to be set aside for approved capital purchases, or for reduction in debt service via defeasance or refunding; however, this need could fluctuate with each year's budget objectives.
- Annual proposed General Fund budgets shall include this benchmark policy. The City Council and Finance Committee shall review the amounts in fund balance in conjunction with the annual budget approval, and make adjustments as necessary to meet expected cash-flow needs.
- In the event the unassigned fund balance in the General Fund is determined to be less than the minimum requirement at the completion of any fiscal year, the city shall plan to adjust budget resources in the subsequent fiscal years to bring the fund balance into compliance with this policy, which could include increasing the property tax levy.
- The City Council may consider appropriating (for authorized purposes) year-end fund balance in excess of the policy level or increasing the minimum fund balance. An example of preferred use of excess fund balance would be for expenditures, such as:
 1. to fund capital items
 2. to fund a one-time (non-recurring) expenditure or grant match opportunity
 3. to provide for funding of obligations not previously recognized
 4. to fund a one-time unplanned revenue shortfall
 5. to fund an unplanned expenditure due to an emergency or disaster
 6. to retire existing debt
 7. to fund policy shifts by other governmental entities having a negative impact on the city
- Appropriation from the minimum fund balance shall require the approval of the City Council and shall be used only for non-recurring expenditures, unforeseen emergencies or immediate capital needs that cannot be

accommodated through current year savings. Replenishment recommendations will accompany the decision to utilize fund balance.

- At the discretion of the City Council, fund balance may be committed for specific purposes by resolution designating the specific use of fund balance and the amount. The resolution would need to be approved no later than the close of the reporting period and will remain binding unless removed in the same manner.

B. Special Revenue Funds

The city will maintain reserves in the Special Revenue funds at levels sufficient to provide working capital for current expenditure needs plus an amount that is estimated to be needed to meet legal restrictions, requirements by external funding sources and/or pay for future capital projects. Future capital projects must be identified and quantified in a written plan for the fund, which shall be included in the city's annual Capital Improvement Plan.

C. Debt Service Funds

The city will maintain reserves in the Debt Service funds at levels sufficient to provide working capital for current debt service expenditure needs plus an amount that is estimated to be needed to meet legal restrictions and requirements by external funding sources.

D. Capital Project Funds

The city will maintain reserves in the Capital Project funds at levels sufficient to provide working capital for current expenditure needs plus an amount that is estimated to be needed to meet legal restrictions, requirements by external funding sources and/or pay for future capital projects. Future capital projects must be identified and quantified in a written finance plan for the fund, which shall be included in the city's annual Capital Improvement Plan.

Proprietary Funds

A. Enterprise Funds

These funds were established to account for the operation of Water, Sewer, and Storm Water operations which are designed to be self-supporting from user charges.

1) Water Utility

This fund is used to account for the provision of water services to the customers of the City related to administration, operations, maintenance, billing and collection. This fund is financed predominantly through user charges.

Unrestricted net position - The City will strive to maintain an unrestricted net position in the Water Utility Fund of at least 50% of the subsequent budgeted fiscal year operating expenses. Since a significant source of revenue in the Water Utility Fund comes from user charges, maintaining an unrestricted net position that is equal to at least 50% of the budgeted fiscal year operating expenses ensures that sufficient resources are available to fund basic City functions between receipts of user charges.

Restricted net position – The City will restrict Water Availability Charges (WAC) for the purpose of infrastructure and capital expenses, and/or debt service.

2) Sewer Utility

This fund is used to account for the provisions of sewer services to the customers of the City. All activities necessary to provide this utility to the customers are administration, operations, maintenance, billing and collection. This fund is financed predominantly through user charges.

Unrestricted net position - The City will strive to maintain an unrestricted net position in the Sewer Utility Fund of at least 50% of the subsequent budgeted fiscal year operating expenses. Since a significant source of revenue in the Sewer Utility Fund comes from user charges, maintaining an unrestricted net position that is equal to at least 50% of the budgeted fiscal year operating expenses ensures that sufficient resources are available to fund basic City functions between receipts of user charges.

Restricted net position – The City will restrict Sewer Availability Charges (SAC) for the purpose of infrastructure and capital expenses, and/or debt service.

3) Storm Water Utility

This fund is used to account for the provision of storm water to the customers of the City related to administration, operations, maintenance, billing and collection. This fund is financed predominantly through user charges.

The City will strive to maintain an unrestricted net position in the Storm Water Utility Fund in the range of at least 50–65% of the subsequent budgeted fiscal year expenses. This will ensure that sufficient resources are available to fund basic Storm Water activities since user charges are billed annually.

ROLE OF THE CITY COUNCIL, FINANCE COMMITTEE AND STAFF

Relevant information will be brought to the City Council and Finance Committee when applicable to aid in policy, procedure and other key decision or direction regarding City business. As such, staff will provide applicable fund balance or net position information and where appropriate, suggest revisions to the policy for consideration. In addition, as the business needs and vision of the City Council and Finance Committee change, this policy can be reviewed and updated as necessary.