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FINANCE & RECORDS**MEMO**

To: Gregg Mandsager, City Administrator
From: Nancy A. Lueck, Finance Director
Date: November 1, 2013
Re: Request to Adopt Updated General Fund Balance Policy

Introduction and Background:

One of City Council's Top Priorities in their goals for 2013/2014 was to update the City's Financial Policies to reflect a new target General Fund balance in excess of the current policy's minimum of 10% threshold. This policy update was also to address conditions for use of reserves, authority over reserves, and replenishment of reserves. In recent budgets, City Council has been incrementally increasing the fund balance and at the end of fiscal year 2012/2013 the ending balance was 17.93% of General Fund expenditures.

At the October 10th In Depth meeting a draft of the proposed new policy was reviewed with City Council as part of the review of the Fiscal Year 2012/2013 Budget-Basis financial statements.

The proposed policy has sections describing (1) the purpose of the policy, (2) definitions of various classifications of fund balance, (3) the proposed new policy's updated target level, (4) other policy provisions, and (5) administrative responsibilities. The minimum unassigned General Fund balance in the proposed policy is two months of expenditures, as recommended by the Government Finance Officers Association of the United States and Canada (GFOA). The two months expenditure level is equivalent to a minimum fund balance of 16.7% of expenditures (2/12 of the fiscal year). The proposed policy also addresses maintaining this minimum fund balance level, conditions for use of fund balance, and replenishment of reserves in the event the fund balance would be less than provided for in the policy.

Recommendations:

Please include the request to adopt the attached General Fund Balance Policy on the agenda for the November 7, 2013 meeting. Please contact me if you have any questions.

City of Muscatine, Iowa
General Fund Balance Policy
(Draft 10/7/13)

Purpose of Policy

The purpose of this policy is to establish a key element of the financial stability of the City by setting guidelines for the General Fund balance. The Unreserved/Unassigned General Fund balance is an important measure of the City's financial stability. It is essential that the City maintain adequate levels of General Fund balance to (1) mitigate financial risk that can occur from unforeseen revenue fluctuations, (2) fund unanticipated expenditures including those which may result from natural or other disasters, (3) provide cash flow liquidity to fund expenditures throughout the fiscal year, and (4) demonstrate financial strength to credit rating agencies who assign bond ratings at the time general obligation bonds are sold. Credit rating agencies determine the adequacy of the unassigned fund balance using a complex series of financial evaluations. The size of the fund balance is an important, but not the only consideration in the City's rating. Other important factors are the reliability of a government's revenue sources, economic conditions, community wealth factors, cash position, debt ratios, management performance, and fiscal decisions made by the legislative body.

Definitions

Fund Balance. The difference between assets and liabilities in governmental funds of the City, including the General Fund, is Fund Balance.

The Governmental Accounting Standards Board (GASB), who establishes financial reporting rules for governments, separates fund balance into five classifications that comprise a hierarchy based primarily on the restrictions placed on the funds.

- 1. Nonspendable.** This classification represents funds that are inherently nonspendable. Resources that must be maintained intact pursuant to legal or contractual requirements are nonspendable, as well as assets that will never convert to cash such as inventory or prepaid items
- 2. Restricted.** These funds are limited by externally enforceable limitations on use. This includes limitations from the entity providing the money, such as grantors. Also, this classification includes funds with limitations placed by law or enabling legislation.
- 3. Committed.** Funds in this classification are those with limitations the government places on itself. The purpose of these funds is decided by Council action and also requires Council action to change the purpose.
- 4. Assigned.** Assigned fund balance has limitations based on the intended use of the funds. The assigned use can be established by the City Council, the City Administrator, or Finance Director. This classification includes outstanding purchase orders, funds assigned for future equipment purchases, funds assigned for future grant commitments, and similar items.
- 5. Unassigned.** Residual net resources, or the balance after restricted, committed and assigned, are classified as unassigned fund balance. This is the amount of fund balance that is available to address emergencies and provide fiscal stability. This is the classification governed by this Fund Balance Policy.

Minimum Fund Balance Policy

The Government Finance Officers Association of the United States and Canada (GFOA) recommends that cities of any size maintain an unrestricted/unassigned General Fund balance of no less than two months of regular general fund operating revenues or expenditures, whichever is more predictable. For the City of Muscatine expenditures have historically been used to make this computation since expenditures vary less throughout each fiscal year. **Two months of expenditures** is equivalent to a fund balance of 16.7% of General Fund expenditures and this is the level targeted to be the new **minimum General Fund balance at the end of each fiscal year.**

The City Council during each budget review process may consider setting a ***budgeted*** ending balance less than the minimum percent noted above. It is suggested this be no less than 15% of budgeted General Fund expenditures but can be evaluated on a year-to-year basis by City Council. This can be considered since historically in all recent years the actual ending General Fund balances have exceeded the estimates developed during the budget process.

General Fund balances in excess of the minimum level, up to 20-25%, would further add to the financial stability of the City and allow more latitude in addressing revenue or expenditure fluctuations, disaster situations, and demonstrate credit worthiness to bond rating agencies. City Council, as a part of the budget process, can also choose to use fund balances above the minimum level for one-time capital purchases to reduce the amount of debt and resulting interest costs to be incurred by the City.

Other Policy Provisions

Maintaining Fund Balance. In the event that the unassigned general fund balance is calculated to be less than the policy states, the City shall plan to adjust budget resources or expenditures in the subsequent fiscal year(s) to restore the balance.

Utilization of Fund Balance. Except in extraordinary circumstances, unassigned fund balance should not be used to fund any portion of the ongoing and routine operating expenditures of the City. It should be used primarily to respond to unforeseen emergencies, to provide cash flow, and to provide overall financial stability.

Extraordinary circumstances can include significant revenue fluctuations (i.e. State legislative changes limiting property taxes, limiting automatic traffic enforcement (ATE) use, etc.). In the event that use of unassigned fund balance is necessary to provide a short-term solution to maintaining essential services, the City will evaluate current and future economic conditions to evaluate the extent of expenditure reductions or revenue increases that would be needed to achieve day-to-day financial stability and restore the fund balance.

Administrative Responsibilities. The Finance Director shall be responsible for monitoring and reporting the City's various fund balance assignments. The City Administrator is responsible for making recommendations to the City Council on the use of any unassigned fund balance above the minimum level as an element of the annual operating budget process and from time to time throughout the year if the need arises.

Annual Report. The Finance Director shall annually submit a report to the City Council outlining the status of the City's various components of the fund balance. This is to be included with the fiscal year-end financial report to City Council.

Draft Policy Dated: October 7, 2013

DRAFT