



CITY OF SAN LUIS OBISPO

FUND BALANCE & RESERVE POLICY

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Fund Balance & Reserve Policy

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Table of Contents

Introduction

Purpose	1
GASB Statement No. 54	1
Accounting Guidance	1
Primary Objective	2
Applicability	2

Fund Balance and Working Capital Determination

Committed Fund Balance.....	3
Assigned Fund Balance	3
Unassigned Fund Balance	3
Annual Reporting and Periodic Review	3

Reserve Levels – All Funds

Governmental Funds	4
Enterprise Funds	5
Uses of Reserves	5
Replenishment of Reserves.....	5

Designated Funds	6
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Review of appropriateness of Reserve Levels

Adopting Resolution

PURPOSE

This policy establishes guidelines and procedures for allocating and reporting the City's fund balances in the financial statements in accordance with Governmental Accounting Standards Board (GASB) Statement No. 54 and as committed by the City Council effective beginning fiscal year ending June 30, 2021.

Additionally, the policy establishes the City's reserve levels to address protection from risk and unexpected situation that require financial resources. The City of San Luis Obispo faces risks like revenue shortfalls during recessions and losses from extreme events, like earthquakes, wildland fires, flooding, and other natural disasters. Prudent reserve levels help make sure that the City of San Luis Obispo can respond quickly and decisively to those events. Reserves also support vital public services during revenue declines. A reserve policy describes how much the City will try to retain in the reserves. It also describes acceptable uses of reserves.

Since reserve levels need to be considered when establishing fund balances, both are addressed within this policy.

GASB STATEMENT NO. 54 – FUND BALANCE REPORTING AND GOVERNMENTAL FUND TYPE DEFINITION

The objective of GASB Statement No. 54 is to enhance the usefulness of fund balance information by providing clear fund balance classifications that can be consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

ACCOUNTING GUIDANCE

Fund balance is the difference between the assets and liabilities reported in a governmental fund. GASB Statement No. 54 defines five separate components of fund balance, each of which identifies the extent to which amounts can be spent.

The following components are defined by GASB Statement 54 and shall be reflected in the City's Fund Balance designations:

- **Non-spendable Fund Balance.** Assets that cannot be converted to cash (i.e., prepaid items and inventories of supplies) and assets that will not be converted to cash soon enough to affect the current accounting period.
- **Restricted Fund Balance.** Limitations imposed by creditors, grantors, contributors, or laws and regulations of other governments and limitations imposed by law through constitutional provisions or enabling legislation.
- **Committed Fund Balance.** Limitations imposed at the highest level of decision making that requires formal action at the same level to remove (City Council).

- **Assigned Fund Balance.** Intended use established by highest level of decision making by a body designated for that purpose or by an official designated for that purpose (delegated by the City Council to the City Manager).
- **Unassigned Fund Balance.** Excess of non-spendable, restricted, committed, and assigned total fund balance.

PRIMARY OBJECTIVE

This policy is focused on the allocation and financial reporting of the last three components – committed, assigned, and unassigned – as the first two components (non-spendable and restricted) are defined by the nature of their restrictions.

This policy also addresses the City's defined reserve levels for inclusion in the City's budget and fiscal policies and application throughout the various fund forecasts.

APPLICABILITY

This policy pertains to all funds that have adopted reserve levels. It further defines the Governmental Funds' ending fund balance and their components.

FUND BALANCE & WORKING CAPITAL DETERMINATION

COMMITTED FUND BALANCE

The following fund balances shall be committed fund balance for the purpose of the City's annual financial statements. Since this level of fund balance and its limitations are imposed at the highest level of decision making, they require formal action at the same level to be removed.

1. Minimum fund balances or working capital as outlined in the Reserves section of the policy.
2. Any revenue over expenditures at fiscal year end in the Local Revenue Measure sub-fund. The City's Local Revenue Oversight Committee, an advisory body to the City Council, shall make recommendations as to the use of the fund balance.
3. Remaining fund balance in the Insurance Fund

ASSIGNED FUND BALANCE

The following assignments are considered assigned fund balance for the purpose of the City's annual financial statements:

- Encumbrances
- Development Services Designation
- Others as applicable at fiscal year-end
- Public Safety Equipment-project funds
- Approved Year-End Carryover

UNASSIGNED FUND BALANCE

These are residual positive net resources in excess of what can properly be classified in one of the other four components of fund balance (surplus). Since a surplus does not represent a recurring source of revenue, it shall not be used to fund a recurring expenditure; however, it may be appropriated to fund one-time expenditures or uses not already funded through an annual budget appropriation.

The City Council may appropriate funds for the following non-recurring purposes:

- Elimination of unfunded liabilities related to the CalPERS retirement system or Other Post-Employment Benefit (OPEB) obligations.
- Capital improvements or purchases.
- Reduction or avoidance of debt. If there is a short-term debt within the General Fund, the surplus may be applied to reduce or eliminate the debt, if determined to be advantageous for the City. If a borrowing is scheduled, the surplus may be used to reduce the principal amount the City needs to obtain, if determined to be in the best long-term interest of the City.
- Any other purpose the City Council deems in the best interest of the community and the City organization.

ANNUAL REPORTING AND PERIODIC REVIEW

Before completion of the City's Annual Financial Report, the Finance Director shall prepare a fund balance status report as part of the City's financial reporting process. At least every two years, together with the City's Financial Plan adoption, the City Council shall affirm or revise the Policy including the percentage range established by the components described herein.

RESERVES

GOVERNMENTAL FUNDS

- A. **Minimum Fund Balances.** The City will maintain a minimum fund balance of at least 20% of operating expenditures in the General Fund. This is considered the minimum level necessary to maintain the City's credit worthiness and to adequately provide for:
- a. Economic uncertainties, local disasters, and other financial hardships or downturns in the local or national economy.
 - b. Contingencies for unseen operating or capital needs.
 - c. Cash flow requirements.
- B. **Fleet Replacement.** For the General Fund fleet, the City will establish and maintain a Fleet Replacement Fund to provide for the timely replacement of vehicles and related equipment with an individual replacement cost of \$15,000 or more. The minimum committed fund balance in the Fleet Replacement Fund is set at \$500,000 for the emergency replacement of vehicles that are damaged beyond repair and are either not covered under the City's property insurance program or the vehicle has a high replacement cost and insurance proceeds will be inadequate to provide for the vehicle's replacement (fire engine). Above this contingency level, the amount retained in this fund, coupled with the annual contributions received by it from any source, shall be adequate to fully fund the equipment replacements approved in the Financial Plan. If in any given year, the minimum fund balance is depleted for above mentioned uses and as approved by the City Council, it shall be replenished over the next two-year Financial Plan period.

Interest earnings and the proceeds from the sales of surplus equipment as well as any related damage and insurance recoveries will be credited to the Fleet Replacement Fund.

- C. **Information Technology (IT) Replacement Fund.** The City will establish an IT Replacement Fund for the General Fund to provide for the timely replacement of information technology, both hardware and software, with an individual replacement cost of \$25,000 or more. The minimum committed fund balance in this fund is set at \$400,000 for the emergency replacement of equipment that is damaged beyond repair and not covered under the City's property insurance program. If in any given year, the minimum fund balance is depleted for above mentioned uses and as approved by the City Council, it shall be replenished over the next two-year Financial Plan period.

Interest earnings and the proceeds from the sale of surplus equipment as well as any related damage and insurance recoveries will be credited to the fund.

- D. **Capital Projects Reserve Fund.** The City will maintain a committed reserve of 20% of capital improvement plan budget from the Local Revenue Measure for the purposes of offsetting unanticipated cost increases, unforeseen conditions, and urgent unanticipated projects to provide continued investment in infrastructure maintenance and enhancement. Use and

allocations of funds from the Capital Projects Reserve Fund will be made to Capital Projects including Major Facility Replacement upon Council approval as necessary during any fiscal year.

ENTERPRISE FUNDS

- A. **Minimum Fund and Working Capital Balances.** The City will maintain a minimum fund balance of at least 20% of operating expenditures in the water, sewer and parking enterprise funds. This is considered the minimum level necessary to maintain the City's credit worthiness and to adequately provide for:
1. Economic uncertainties, local disasters, and other financial hardships or downturns in the local or national economy.
 2. Contingencies for unseen operating or capital needs.
 3. Cash flow requirements.
- B. **Water and Sewer Rate Stabilization Reserves.** The City will maintain a reserve for the purposes of offsetting unanticipated fluctuations in Water Fund or Sewer Fund revenues to provide financial stability, including the stability of revenues and the rates and charges related to each Enterprise. The funding target for the Rate Stabilization Reserve will be 10% of sales revenue in the Water Fund and 5% of sales revenue in the Sewer Fund.

Conditions for utilization and plan for replenishment of the reserve will be brought to Council for its consideration during the preparation and approval of the Financial Plan or as may become necessary during any fiscal year.

USES OF RESERVES

The City limits the use of reserves and working capital balances to address unanticipated, one-time needs or opportunities. Under no circumstances can they 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 if circumstances do not allow for the activation of the City's Fiscal Health Contingency Plan implementing hiring, purchasing, and travel chills/freezes.

REPLENISHMENT OF RESERVES

Reserves shall be replenished to the extent annual revenues exceed expenditures as reported in the City's annual audited financial statements. Revenues in excess of expenditures at the end of the fiscal year shall be used to first satisfy committed reserve requirements before appropriating for other uses.

DESIGNATED FUNDS

- A. **Major Facility Replacement Fund.** The City will maintain a designated fund for the purpose of providing for improvements having a cost of \$25,000 or more to City-owned, general government building and structures. The amount retained in this fund, coupled with annual contributions received by it from any source, shall be adequate to fund maintenance and replacement of City facilities.
- B. **Infrastructure Investment Fund.** The City will maintain a designated fund for the purpose of funding infrastructure projects that contribute to improved economic development and enhanced quality of life in the City of San Luis Obispo. The following evaluation criteria shall be applied to project eligibility:
- a. The use of City funds shall not offset any cost that would be expected to be paid to meet the fair share obligation of any developer.
 - b. The use of City funds shall not offset a project specific cost identified through the environmental review process or under existing regulations or policies.
 - c. The use of funds shall support a project that would not otherwise be feasible due to economic, timing or other issues outside control of the project proponents or the City.
 - d. The project shall provide public benefit by contributing to economic development and quality of life within the City.
- C. **Insurance Fund.** The City shall maintain an Insurance Fund to manage payments for liability, workers' compensation, crime, pollution, special events, property, and volunteer insurance. Within the Insurance Fund, a self-insured retention (SIR) will be set aside to cover expenses associated with claims from the Excess Liability Insurance Program. The SIR will be funded based on 150% (75% confidence level) of the previous five-year average claims experience (claims paid, reserves for known claims, and administrative expenses). The Insurance Fund will maintain a reserve sufficient to guard against substantial claims which will be determined based on annual actuarial report information.
- If required due to depletion of fund balance, sufficient annual appropriations will be transferred to the Insurance Fund from the General Fund in the amount needed to ensure the 150% funding status.
- D. **Future Capital Project Designations.** The Council may designate specific fund balance levels for future development of capital projects that it has determined to be in the best long-term interests of the City.
- E. **Other Designations and Reserves.** In addition to the designations noted above, fund balance levels will be sufficient to meet funding requirements for projects approved in prior years which are carried forward into the new year; debt service reserve requirements; reserves for encumbrances; and other reserves or designations required by contractual obligations, state law, or generally accepted accounting principles.
- F. **Essential Safety Equipment Funding.** The City will carry forward year-end project balance designated for essential safety equipment indefinitely.