

<b>CITY OF MENIFEE</b> City Council Policy	Policy Number: <b>CC-07</b>  Approving Authority: <b>City Council</b>
<b>Subject</b>  <b>Fund Balance Policy for the General Fund</b>	Effective Date: 6/21/2011 Last Modified: 9/15/2021
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**1. PURPOSE**

The purpose of this Policy is to establish the City's minimum levels of unrestricted fund balance to address protection from risk and unexpected situations that require financial resources. The identified fund balance levels will be maintained in various accounts to identify certain requirements for classifying fund balance in accordance with the Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Definitions*.

**2. SCOPE/BACKGROUND**

These policies/procedures apply to the General Fund of the City of Menifee as described below. The City of Menifee's primary financial objective is to maintain the fiscal stability of the organization. Fund balance is the difference between the assets and liabilities reported in a governmental fund. Unrestricted fund balance is an important measure of economic stability. It is essential that the City maintain adequate levels of unrestricted fund balance to mitigate financial risk that can occur from unforeseen revenue fluctuations, unanticipated expenditures, and similar circumstances. Having adequate financial resources will enable the City to achieve this objective and its mission of serving the citizens of Menifee.

**3. POLICY**

**A. Governmental Fund Reserves (Fund Balance)**

For Governmental Funds, the Governmental Accounting Standards Board ("GASB") Statement No. 54 defines five specific classifications of fund balance. The five classifications are intended to identify whether the specific components of fund balance are available for appropriation and are therefore "Spendable." The classifications also are intended to identify the extent to which fund balance is constrained by special restrictions, if any. Applicable only to governmental funds, the five classifications of fund balance are as follows:

**CLASSIFICATION**

Non-spendable  
Restricted

**NATURE OF RESTRICTION**

Cannot be readily converted to cash  
Externally imposed restrictions

Committed  
Assigned  
Unassigned

City Council imposed commitment City  
Manager assigned purpose/intent  
Residual balance not otherwise restricted

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

**i. Non-Spendable Fund Balance**

That portion of fund balance that includes amounts that are either (a) not in a spendable form, or (b) legally or contractually required to be maintained intact.

**ii. Restricted Fund Balance**

The portion of fund balance that reflects constraints placed on the use of resources (other than non-spendable items) that are either (a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments; or (b) imposed by law through constitutional provisions or enabling legislation.

**iii. Committed Fund Balance**

Limitations imposed at the highest level of decision making that requires formal action at the same level to remove (City Council).

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 specified 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.

**iv. Assigned Fund Balance**

Assigned fund balance comprises amounts intended to be used by the government for specific purposes.

The City Council has authorized the City Manager or designee as the official authorized to assign fund balance to a specific purpose as approved by the fund balance policy. Such assignments cannot exceed the available (spendable, unrestricted, uncommitted) fund balance in any particular fund.

**v. Unassigned Fund Balance**

That portion of a fund balance that includes amounts that do not fall into one of the above four categories. The General Fund is the only fund that will report this category of fund balance.

**vi. Reporting Encumbrances**

Encumbering amounts in governmental funds for specific purposes for which resources have already been restricted, committed, or assigned should not result in a separate display of encumbered amounts. Encumbered amounts for specific purposes for which amounts have not been previously restricted, committed or assigned, will be classified as committed or assigned, as appropriate, based on the definitions and criteria set forth in GASB Statement No. 54.

**vii. Hierarchy of Fund Balance Use**

When multiple categories of fund balance are available for expenditure, the City will spend the most restricted funds first before moving down to the next category with available funds in the following order:

- a. Restricted
- b. Committed
- c. Assigned
- d. Unassigned

**viii. Establishing An Operating Reserve Stabilization Fund Balance (Committed)**

Maintaining an Operating Reserve Stabilization Fund Balance is a necessity for sound financial management and fiscal accountability. The City Council has the authority to establish an Operating Reserve Stabilization Fund Balance that will be a Committed Fund Balance.

An Operating Reserve Stabilization Fund Balance in the General Fund is established for the purpose of providing funds for an urgent effect that affects the safety of residents, employees, or property (e.g., earthquake, wildfires, terrorist attack etc.). The minimum level for the Financial Stabilization Account is ~~12.5~~15% of General Fund operating expenditures. The recognition of an urgent event must be established by the City Council by adoption of a resolution explaining the nature of the fiscal crisis and requires approval by a majority vote of the City Council in order for staff to utilize the funds set aside in the Operating Reserve Stabilization Fund Balance.

**ix. Use of Operating Reserve Stabilization Fund Balance**

General Fund Operating Reserve Stabilization Fund Balance shall be used only to fund unanticipated needs and/or emergencies as described below:

Catastrophic Events and Major Disasters-The Financial Stabilization fund balance is to fund the extraordinary operating costs, legal costs and cash flow problems associated with delays in State and Federal reimbursements for any catastrophic event and major disaster (natural or man-made) declared by the City Council of their designee, or by the State of California, or by the federal government that are nonrecurring expenditures.

A budget revision must be approved by the City Council. A maximum of fifty percent of the prior year ending balance in the Operating Reserve Stabilization Fund may be used. At no time may the balance be less than 5 percent of the \_

adopted annual appropriations, or half of the prior year ending balance, whichever is greater.

x. **—Changes and Replenishment of Operating Reserve Stabilization Fund Balance**

The City Council may, by a majority vote of its members, change the amount of this commitment and/or the specific uses of these monies. In the event that the balance drops below the established minimum level, the City Council will develop a plan to replenish the Operating Reserve Stabilization Fund Balance to the established minimum level within three years. The progress of replenishment should be reported in the annual budget. The City will use non-recurring revenues, budget surplus, proceeds from the sale of City-owned surplus property, and any other funds identified in the budget to increase the Operating Reserve Stabilization Fund Balance.

**B. MINIMUM LEVEL OF FUND BALANCE**

It is the goal of the City to achieve and maintain a minimum unrestricted (committed, assigned and unassigned) fund balance in its General Fund equal to **3540% of the current year's budgeted operating expenditures**. This percentage represents a balance roughly equal to four (4) months of operating expenditures. The Government Finance Officers Association (GFOA) recommends that "general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months (roughly 16.7%) of regular general fund operating revenues or regular general fund operating expenditures."<sup>1</sup> The City considers a balance of less than 20% to be a cause for concern, barring unusual or deliberate circumstances.

i. **Committed Fund Balance for Operating Reserve Stabilization Fund**

The City's General fund balance committed for Operating Reserve Stabilization is established at a minimum of **twelve and a half fifteen percent (12.515%)** of the General Fund's current operating expenditures, to be used in a catastrophic event or major emergency.

ii. **Assigned Fund Balance for Economic Uncertainty Reserve Fund**

The City's Assigned for Economic Uncertainty Reserve Fund Balance is established at a minimum of **twelve and a half fifteen percent (12.515%)** of the General Fund's current operating expenditures, to be used during times of severe economic distress such as protracted

recessionary periods, State raids on local resources, or other impactful unforeseen events which greatly diminish the financial ability of the City to deliver core services. The Assigned for Economic Uncertainty Reserve Fund Balance will be used during periods of economic distress as measured by one of the following triggers:

- Consumer Price Index exceeds the index for the previous year by more than five percent for two consecutive years.
- Local unemployment rate exceeds ten percent for three consecutive quarters.
- The rate of inflation exceeds the growth in property tax revenue by five percent for two consecutive fiscal years.

<sup>1</sup> GFOA Best Practice: Appropriate Level of Unrestricted Fund Balance in the General Fund (2002 and 2009)

- Significant State take-away of revenue totaling more than five percent of total revenue in a given fiscal year.
- Sales Tax revenue falls by ten percent of the previous quarter for at least three consecutive quarters.
- Revenue forecasts for the next fiscal year estimates revenue loss of more than seven percent.

### iii. **Unassigned Fund Balance**

The City will achieve and maintain a minimum Unassigned Fund Balance in its General Fund of **ten percent (10%)** of the current year's operating expenditures. This minimum fund balance is to protect against cash flow shortfalls related to timing of projected revenue receipts and to maintain budgeted levels of service.

The Unassigned Fund Balance reserves may be used to provide temporary financing for unanticipated extraordinary needs, such as major storm drain repairs, or an unexpected liability created by Federal or State legislative action. If funds are appropriated (spent) from the operating reserves due to unanticipated needs, the funds should be replenished in the budget process during the subsequent fiscal year to maintain the minimum reserve balance.

Authorized use of the Unassigned Fund Balance Reserves will require approval by the City Council.

### iv. **Replenishing Minimum Fund Balance Deficiencies**

When minimum fund balance falls below the required threshold, the City Council must approve and adopt a plan to restore this balance to the target level within three years using the budget strategies described below:

- The City will use budget surplus
- The City will reduce recurring expenditures to eliminate any structural deficit or,
- The City will increase revenues or pursue other funding sources, or
- A combination of the three options above

The progress of replenishment shall be reported in the annual budget.

### v. **Deficit Fund Balance**

If the fund balance is not positive at any year-end, the City shall develop a funding plan and a timeframe to bring it into a positive state.

The unassigned fund balance deficit in General Fund shall be restored through the following mechanisms, in order of priority:

- Reduction of (1) assigned fund balance levels, (2) committed fund balance levels;
- Transfer of unassigned fund balances from other related funds, if allowed.

**vi. Surplus Fund Balance**

Unrestricted fund balance in the General Fund will be considered a surplus if over 40% of the budgeted operating expenditures. If unrestricted fund balance of the General Fund exceeds 40%, the City may consider such fund balance surpluses to be used for (a) capital projects and equipment (b) dedicated/specific restricted, assigned and/or committed fund balances defined below (bc) pay down long-term obligations, and/or (ed) one-time expenditures that are non-recurring in nature, and which do not require additional future operating expenditure outlay for maintenance, additional staffing or other recurring expenditure. Appropriation from the General Fund's unrestricted fund balance shall require the approval of the City Council.

Surplus funds are determined upon the close of the fiscal year if revenues exceed actual expenditures within the General Fund. Special consideration shall be made by the Chief Financial Officer each year when determining potential Surplus Funds so as not to leave any General Fund supported fund balances without adequate funding and accommodate future year operating expenditure growth.

Allocation and Prioritization of Surplus Fund Balance use shall be as follows:

- 1. Assigned Fund Balance: Self Insured Retention (SIR)**
- 2. Assigned Fund Balance: Fleet Replacement**
- 4.3. Assigned Fund Balance: Pension Liability**
- 4. Assigned Fund Balance: Public Facilities**
- 5. Committed Fund Balance: Public Facilities**
- 6. All other eligible uses as described in the previous paragraphs.**

**vii. Surplus Fund Balance- Self Insured Retention & Insurance Premium (Assigned)**

In any year where total revenues exceed total expenditures (including capital expenditures), and upon meeting the full funding of the 40% General Fund Operating Reserve Fund Requirement, available and identified surplus funds will be transferred by direction of the City Manager into an established Self-Insured Retention (SIR) Assigned Fund Balance account, funded with a minimum balance of \$500,000. Any unused budget for insurance premiums and/or claims expenses at the end of the year will be directed towards this Assigned Fund Balance. Additionally, other expenditure savings may also be considered for deposit into this fund.

**viii. Surplus Fund Balance- Fleet Replacement (Assigned)**

In any year where total revenues exceed total expenditures (including capital expenditures), and upon meeting the full funding of the 40% General Fund Operating Reserve Fund Requirement and Self-Insured Retention Assigned Fund Balance account is fully funded, any available and identified surplus funds will be transferred by direction of the City Manager into an established Fleet Replacement Assigned Fund Balance account, funded at with a minimum amount of \$1,000,000.

**ix. Surplus Fund Balance- Pension Liability (Assigned)**

In any year where total revenues exceed total expenditures (including capital

expenditures), and upon meeting the full funding of the 40% General Fund Operating Reserve Fund Requirement, Self-Insured Retention Assigned Fund Balance, and Fleet Replacement Assigned Fund Balance, any unused budget for pension liability expenses at the end of the year and at direction of the City Manager will be directed towards this Fund Balance Account and set aside for Pension Liability related expenses. Additionally, other expenditure savings may also be considered for deposit into this fund. The purpose of this assigned fund balance is to help offset future pension increases.

**x. Surplus Fund Balance- Public Facilities (Assigned)**

In any year where total revenues exceed total expenditures (including capital expenditures), and upon meeting the full funding of the 40% General Fund Operating Reserve Fund Requirement, Self-Insured Retention Assigned Fund Balance, Fleet Replacement Assigned Fund Balance, and Pension Liability Committed Fund Balance, identified surplus funds will be transferred by direction of the available and identified surplus funds will be transferred by direction of the City Manager to this account set aside for construction of public facilities projects.

**i. Surplus Fund Balance-City Hall Commitment**

In any year where total revenues exceed total expenditures (including capital expenditures), and the unrestricted fund balance of the General Fund exceeds 40%, the surplus may be transferred by direction of the City Council to the Committed Fund account set aside for construction of the future City Hall.

**i. Surplus Fund Balance /Public Facilities (Committed)**

In any year where available balance exists within the Assigned Public Facilities account, and by direction of the City Council, periodic contributions will be transferred set aside for construction of public facilities projects.

**4. PROCEDURES**

**A. ~~A.~~ Implementation and Review**

Upon adoption of this policy the City Council authorizes the Finance Department to establish standards and procedures which may be necessary for its implementation. The City Council shall review and approve this policy via resolution at a minimum of every three (3) years to ensure it continues to meet the needs of the City given the economic factors and the current financial status at that time interval.

**B. Calculation of Reserves**

The reserves will be calculated using the following year's Adopted General Fund budgeted operating expenditures.

**5. RESPONSIBILITIES**

**A. City Council**

- i. Adopt fund balance policy.

## **B. City Manager**

- i. Determine appropriate levels of fund balance in accordance with adopted policy.

## **C. City of Menifee, Finance**

- i. ~~Finance Director~~Chief Financial Officer to assign specific amounts for financial reporting purposes.
- ii. Responsible for recording amounts according to adopted policy.
- iii. Responsible for ensuring that fund balance is properly reported in the City's Comprehensive Annual Financial Report (CAFR).

## **6. DEFINITIONS**

### **Governmental Funds:**

The following definitions will be used in reporting activity in governmental funds across the City. The City may or may not report all funds types in any given reporting period, based on actual circumstances and activity.

- The general fund is used to account for all financial resources not accounted for and reported in another fund.
- Special revenue funds are used to account and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specific purposes other than debt services or capital projects.
- Debt service funds are used to account for all financial resource restricted, committed or assigned to expenditure for principal and interest.
- Capital project funds are used to account for all financial resources restricted, committed, or assigned to expenditures for the acquisition or construction of capital assets.
- Permanent funds are used to account for resources restricted to the extent that only earnings, and not principal, may be used for purposes that support the City's purposes.

### **Fund balance classification in governmental funds:**

Fund balance is defined as the excess of total assets as compared to total liabilities in a governmental fund. ~~GASS-GASB~~ Statement No. 54 outlines the requirement to report the fund balance for governmental funds in specific classifications which create a hierarchy primarily based on the extent to which the City is bound to the constraints on the specific purposes for which funds can be spent. The Fund Balance consists of the following categories:

- Non-spendable Fund Balance: That portion of a fund balance that includes amounts that cannot be spent because they are either (a) not in a spendable form, such as prepaid items, inventories of supplies, or loans receivable; or (b)

legally or contractually required to be maintained intact, such as the principal portion of an endowment.

- Restricted Fund Balance: That portion of a fund balance that reflects constraints placed on the use of resources (other than non-spendable items) that are either (a) externally imposed by creditors (such as through debt covenants), granters, contributors, or laws or regulations of other governments; or (b) imposed by law through constitutional provisions or enabling legislation.
- Committed Fund Balance: That portion of a fund balance that includes amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the government's highest level of decision-making authority and remain binding unless removed in the same manner.
- Assigned Fund Balance: That portion of a fund balance that includes amounts that are constrained by the government's intent to be used for specific purposes, but that are neither restricted nor committed. Such intent needs to be established at either the highest level of decision-making, or by an official designated for that purpose.
- Unassigned Fund Balance: That portion of a fund balance that includes amounts that do not fall into one of the above four categories. The General Fund is the only fund that will report this category of fund balance.

**Stabilization Arrangement:**

Per ~~GASS-GASB~~ Statement No. 54, governments have the option to formally set aside unrestricted fund balance amounts to use for budget or revenue stabilization, working capital needs, and contingencies or emergencies. The authority to set aside such amounts can be established by statute, ordinance, resolution, or charter. These amounts are subject to controls that dictate the circumstances under which they can be spent. The formal action that imposes the parameters for spending should identify and describe the specific circumstances under which a need for stabilization arises. These circumstances should be such that they would not be expected to occur routinely. Stabilization amounts should be reported in the general fund as restricted or committed if they meet the criteria of restricted or committed fund balance. A stabilization agreement would satisfy the criteria to be reported as a separate special revenue fund only if the resources are derived from a specific restricted or committed revenue source. The notes to the annual financial report disclose the authority for establishing the arrangement, the requirement for additions to the amount, the conditions under which amounts may be spent, and the balance.

**Revision History**

Revision No.	Date Approved	Approved By:	Comments
0	6/21/11	City Council	Original Policy
1	6/19/12	City Council	Revision# 1
2	8/21/13	City Council	FN01-2
3	9/15/2021	City Council	Revision 3/CC-07
<u>4</u>	<u>TBD</u>	<u>City Council</u>	

Bill Zimmerman, Mayor