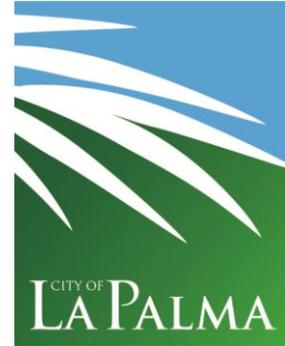


City of La Palma

Agenda Item No. 9



MEETING DATE: May 7, 2013

TO: CITY COUNCIL

FROM: CITY MANAGER

SUBMITTED BY: Ellen Volmert, City Manager

AGENDA TITLE: Presentation of Proposed Fiscal Year 2013-14 Budget

PURPOSE:

To provide an overview of the proposed Fiscal Year 2013-14 budget and allow for City Council and resident review and discussion of the budget.

BACKGROUND:

This past fiscal year has presented many challenges. The budget for Fiscal Year 2013-14 has been developed within the context of losing a significant sales tax provider, the dissolution of redevelopment, and other fiscal and organizational issues. Through a series of budget study sessions – two already held and one scheduled for after this City Council meeting – the City Council and residents have had the opportunity to review, discuss, and provide direction on the budget plan for next year.

All of this feedback, as well as considerable Staff analysis and research, have been incorporated into the proposed budget document provided as Attachment 1 to this staff report. Staff believes the proposed budget provides a clear, sustainable, and fiscally prudent plan to provide all of the services which La Palma residents have come to expect. The following pages will provide an overview of the proposed budget, with additional discussion occurring at the study session next week.

SUMMARY:

The proposed FY 2013-14 budget is essentially the same plan presented to the City Council on April 16. Total appropriations across all funds are proposed to be \$19,994,670, against \$17,722,595 in revenue. The draw on total reserves is primarily due to the use of funds in the Capital Outlay Reserve (COR), Water and Sewer and Facilities funds for various infrastructure and capital projects. The table “Summary of Resources and Requirements by Fund” included in the proposed budget provides detail on projected revenue, expenditures, and ending fund balances for FY 2013-14 and FY 2014-15.

The General Fund proposes a one-time use of reserves of approximately \$263,545. General Fund appropriations are \$8,591,645 across all six departments, against \$8,328,100 in revenue. The proposed budget provides additional detail for each department as well as the various programs/divisions.

The budget message provides a detailed and comprehensive treatment of the proposed budget, the challenges facing the City, and the many positive changes made to the budget document itself in an effort to present financial data in a more transparent and accessible manner. The presentation by each Department as well as next week's study session will provide additional opportunity for review and discussion of the proposed budget plan. Questions or requests for additional information on May 7, 2013, will become part of the May 15, 2013, informational materials.

ALTERNATIVES:

At this point, since this item represents the first presentation of the full proposed FY 2013-14 budget, there are no alternatives to receiving the document and presentation and providing an opportunity for public and Councilmember comment.

FISCAL IMPACT:

The General Fund FY 2013-14 proposed budget, as attached, includes a one-time use of reserves in the amount of \$263,545. This one-time bridge amount would allow for essential services to continue to be provided while some of the current revenue uncertainty is resolved. The estimated FY 2014-15 budget shows a surplus of \$134,695.

Overall, the non-General Fund portion of the City's budget will provide various infrastructure, public safety, rehabilitation, internal services and utility services. Sufficient fund balance exists in all of the funds. Attachment 1 provides detail for the City's enterprise, internal service, and special revenue funds operations.

RECOMMENDED ACTION:

It is recommended that the City Council receive the Staff presentation on the proposed FY 2013-14 budget and provide direction for additional materials needed for the study session scheduled for next week.

APPROVED:



Finance Director



City Manager

- Attachments: 1. Proposed Fiscal Year 2013-14 Budget
2. City Council Approved Reserve Policies, March, 2013

ATTACHMENT 1

FY 2013-14 Proposed Budget
provided separately for your convenience

CITY OF LA PALMA General Fund and Internal Services Funds Reserve Policy

Fund balance refers to the difference between assets and liabilities in the city's governmental funds balance sheet. This information is one of the most widely used elements of state and local government financial statements. Financial statement users examine fund balance information to identify the available liquid resources that can be used to pay down unfunded liabilities, finance capital improvements, or enhance the overall financial position of the city.

PURPOSE

The purpose of this policy is to provide guidance on maintaining reasonable levels of reserves in both governmental and proprietary funds, focusing exclusively on the General Fund and the City's five Internal Service Funds. In addition, this policy will help improve financial reporting by establishing fund balance classifications that create a hierarchy based on the extent to which the City is bound to observe spending constraints that govern how the City can use amounts reported in the governmental fund balance sheet. In addition, the policy will help guide current and future allocation levels to the five Internal Service Funds in a manner that maintains reasonable fund balance levels in each, without the funds being "over-allocated" in any given fiscal year. As referencing governmental funds, this policy satisfies the requirements of Governmental Accounting Standards Board (GASB) Statement No. 54 and incorporates all previous City Council policies regarding GASB Statement No. 54.

POLICY

It is the policy of the City of La Palma to identify the various classifications of the City's governmental and proprietary fund balances in its Comprehensive Annual Financial Report (CAFR). These classifications take into consideration the City's long-term infrastructure needs, non-current liabilities, funds necessary to mitigate economic uncertainties, funding that has spending constraints such as grants, and fixed assets that will not easily convert to cash.

The fund balance is a tool the City uses to have an effective long-term financial plan, as well as to ensure sufficient liquidity to meet its financial obligations in the short-term.

OBJECTIVES

The City of La Palma's Reserve Policy has two primary objectives:

- 1. To determine the available liquid resources; and**
- 2. To provide the information necessary to make informed financial decisions.**

The fund balance classifications of the City's General Fund are designed to clarify the extent to which the City is bound to honor constraints on the specific purposes for which amounts in the fund can be spent, rather than to simply represent the financial resources available for appropriation. The reserve policy, as applied to the five Internal Service Funds, is designed to provide guidance on maintaining a reasonable fund balance level in each fund. The goal of internal service funds is to provide enough liquidity in each to meet current as well as longer-

term funding needs, while ensuring they are not overly funded to the extent ongoing operations are impaired by over-allocation.

OVERVIEW

There are three categories of funds per generally accepted accounting principles:

- Governmental funds (e.g., the General Fund, Special Revenue Funds, and Capital Projects Funds)
- Proprietary funds (e.g., water and sewer enterprise funds, vehicle maintenance/replacement, insurance, and related internal service funds)
- Fiduciary funds (e.g., former Community Development Commission funds)

The GASB 54 classifications only apply to Governmental Funds. Therefore, this section will focus exclusively on the General Fund. The following section deals with the City's Internal Service Funds and the various reserve levels in each.

The fund balance is only an approximate measure of liquidity or working capital. Therefore, it is necessary for the City to recognize how fund balance is constituted and isolate funds that are needed for longer-term obligations, discern what funds are restricted for specified purposes, and classify those funds that are not available at all. To accomplish this goal, the City's financial statements for governmental funds are comprised of five fund balance classifications, as spelled out in GASB Statement No. 54:

- Nonspendable Funds
- Restricted Funds
- Committed Funds
- Assigned Funds
- Unassigned Funds

NONSPENDABLE AND RESTRICTED FUND BALANCE

The first two classifications are subject to requirements outside the local governing body's control for financial decision-making and planning purposes. "Nonspendable" resources are essentially irrelevant because, by their nature, they are not liquid (i.e., land or similar non-cash assets). "Restricted" resources are of no discretionary value given the restrictions placed upon them by a third-party outside of the City's control (i.e., reserve funds required to be set aside for bond payments). Accordingly, this policy will just briefly describe these two classifications. In addition the City of La Palma only utilizes the "nonspendable" classification since there are no "restricted" funds.

Nonspendable Funds

Some of the assets that are included in determining the City's fund balance are inherently nonspendable:

- Assets that will never convert to cash, such as prepaid items and inventories.
- Assets that will not convert to cash within sixty (60) days from the start of the fiscal year, such as long-term loans receivable, and non-financial assets held for resale.
- Assets that must be maintained intact pursuant to legal or contractual requirements, such as an endowment.

Restricted Funds

Restricted funds describe the portion of the fund balance that is subject to externally enforceable legal restrictions, these restrictions fall into three categories:

- (i) Restrictions are imposed by parties altogether outside the scope of the City's governance:
 - Creditors (typically through a debt covenant)
 - Grantors (typically State, Federal and other governmental agencies)
 - Contributors
 - Other governments.
- (ii) Restrictions that arise when the authorization to raise revenues is conditioned upon the revenue being used for a particular purpose, such as:
 - Gas taxes must be used for street repair
 - Measure M2 must be used for local street repair
- (iii) Long-term loans receivable and non-financial assets that are collected can also be considered Restricted if the collected funds are subject to an externally enforceable restriction on how they can be spent.

PROCEDURES

This Section provides a comprehensive protocol on what is legally deemed the unrestricted (or spendable) portion of the General Fund fund balance, and the order in which the classifications are spent.

The unrestricted portion of the fund balance is comprised of the General Fund's resources classified as "Committed," "Assigned," or "Unassigned."

UNRESTRICTED (SPENDABLE) FUND BALANCE

Committed Funds – Economic Uncertainty Reserve

Committed funds describe the portion of the fund balance that is constrained by limitations imposed by the La Palma City Council. The City Council imposed limitation must occur no later than the close of the reporting period (i.e., end of the fiscal year) and remains binding unless removed under the same manner. A commitment is made by City Council adoption of a

resolution that states the amount and purpose of the commitment. This policy requires the commitment to be made as part of the annual budget adoption process.

This reserve policy establishes a commitment for an Economic Uncertainties Reserve equal to an amount calculated as 60% of the General Fund's annual operating expenditures. Appropriations from the Economic Uncertainties Reserve commitment can only be made by formal City Council action.

Generally, appropriations and access to these funds will be reserved for emergency situations. Examples of such emergencies include, but are not limited to:

- Reduction in revenue equal to or greater than 20% of adopted General Fund appropriations
- An unplanned, major, catastrophic event such as a natural disaster requiring expenditures over 10% of General Fund adopted appropriations
- Unfunded and/or unpredictable State or Federal legislative or judicial mandates
- Any other unforeseen event that causes the City to expend funds in excess of 10% of General Fund adopted appropriations

Assigned Funds

Assigned funds describe the portion of General Fund reserves that reflect the use of resources by the La Palma City Council intended for un-programmed and/or unfunded capital and infrastructure projects.

This reserve policy establishes an assignment for un-programmed/unfunded capital and infrastructure projects equal to an amount calculated as 40% of the General Fund's annual operating expenditures. These Assigned funds are set aside for major emergency or unexpected repairs of the City's streets, hardscape, facilities, communication and technology systems, or other City-owned property. In addition, this reserve amount can be utilized by the City Council for funding infrastructure or capital projects which are not part of the approved Capital Improvement Program (CIP) (i.e., unfunded projects).

Unassigned Funds

The General Fund may have net resources in excess of what is classified in one of the four previous categories. This amount is presented as the unassigned fund balance. Only the general Fund can report a positive unassigned fund balance; however, all governmental funds can report a negative unassigned fund balance.

This policy logically dictates that any amount of fund balance classified as "unassigned" is in excess of 100% of General Fund expenditures since the "committed" and "assigned" amounts equal 100% of General Fund expenditures. This policy allows for "unassigned" funds in excess of 100% of General Fund expenditures and places no specific restrictions on their use. In general, the City Council could choose to utilize "unassigned" fund balance for one-time projects in a given fiscal year, such as technology upgrades, infrastructure improvements, economic development efforts, or other such one-time uses.

Use of Resources

In circumstances when an expenditure is made for a purpose for which amounts are available in multiple fund balance classifications, the order of allocation of these available funds is first restricted, second committed, third assigned, and lastly unassigned amounts.

REPLENISHMENT OF COMMITTED AND/OR ASSIGNED RESERVES

In keeping with the principles discussed in this policy, when either Committed or Assigned funds are utilized for their specific, intended purposes, and the levels fall below the policy levels (60% for Committed and 40% for Assigned), the City Council, will develop a reserve replenishment plan to return the reserves to their policy levels. This plan will seek to return the Committed and/or Assigned reserves to their policy levels within one (1) to three (3) years, per City Council direction.

INTERNAL SERVICE FUND RESERVES

Internal service funds are used to centrally manage and account for specific program activity in a centralized fund. The revenue (resources) for these funds generally comes from internal charges to Departmental operating budgets, based on different allocation methods depending on the internal service provided. Each of these internal service funds are classified as Proprietary funds in the City's annual financial statements (Certified Annual Financial Report, CAFR). These funds have several functions:

- Normalizing departmental budgeting for programs and uses that have life cycles greater than one fiscal year, helping to facilitate level budgeting for expenditures that could be erratic from year to year (such as vehicles or technology replacement)
- Serve as a repository of a reasonable amount of savings to utilize for long-term asset replacement and/or funding liabilities
- Enable appropriate distribution of citywide costs to individual Departments and programs, which more readily establishes the true costs of various operations

The City of La Palma has five (5) Internal Service Funds:

- Employee Benefits
- Insurance
- Vehicle Maintenance and Replacement
- Facilities Maintenance and Replacement
- Technology Maintenance and Replacement

The guiding purpose of each fund is to gather enough resources to meet annual expenses as well as maintain a reasonable fund balance for contingency purposes. Therefore, this policy will enumerate minimum fund balance levels for each internal service fund based on specific fund-type metrics. The intent of this policy is twofold:

- 1. To ensure sufficient resources exist in each internal service fund to pay for annual, ongoing expenses while maintaining a reasonable reserve to fund replacement purchases (i.e., annual vehicle replacement); and,**
- 2. Establish a fund balance level for each fund that is reasonable and prevents the over-accumulation of resources beyond what is needed for normal operating needs plus any amount required for emergency or contingency needs.**

PROCEDURES

The following procedures will be utilized to establish reserve levels for each of the five Internal Service Funds:

Employee Benefits

This fund allocates all of the costs related to maintaining a highly functioning full-time and part-time work force. Some of the major expenses allocated to each Department and Program

through this fund are: CalPERS retirement, health insurance, dental insurance, workers compensation, tuition reimbursement, and other Human Resources management expenses (e.g., training).

This policy states that the fund balance level for the Employee Benefits fund will be calculated using the total amount of compensated absences, as noted in the CAFR "Statement of Net Assets." This amount represents the total outstanding liability of all accrued employee vacation and sick time. Furthermore, while the CAFR "Statement of Net Assets" lists this liability as that "due within one year" vs. "due beyond one year," it is prudent to establish a fund balance level based on the total amount of compensated absences, regardless of when the liability can reasonably be expected to be converted to an expense.

Using "compensated absences" as a measurement for appropriate fund balance allows for one type of liability to be covered. Being able to show how the "compensated absences" liability could be fully covered, if in the highly unlikely scenario the entire amount needed to be converted to an expense, is a useful metric upon which to base a reserve level policy.

Insurance

This internal service fund is responsible for allocation costs related to the City's insurance coverage. The City of La Palma is a member of the California Joint Powers Insurance Authority (CJPIA). This pooled insurance joint powers authority (JPA) allows La Palma, as a small city, to receive insurance coverage at a reasonable amount.

Therefore, this policy establishes a reserve amount equal to three times the annual insurance expenses of the immediately preceding fiscal year. This reserve level provides sufficient funding to cover annual insurance expenses while providing additional funds for any unseen, emergency needs (i.e., contingency reserve) such as an adverse legal judgment, a large one-time deductible payment, or other similar one-time expense. It should be noted that the City's General Fund Economic Uncertainties Commitment (as established in this policy) could also be utilized as a further source of funds in the event of a large insurance related claim.

Vehicle Maintenance and Replacement

The City has a fleet of rolling stock and other equipment that is maintained and replaced through the Vehicle internal service fund. The City's Police, Public Works and Recreation and Community Services Departments comprise the largest users of and contributors to the Vehicle internal service fund. This fund receives operating resources from Departments in order to provide for equipment maintenance (annual ongoing costs) and to fund the regular replacement of major pieces of equipment (primarily rolling stock) at their economic obsolescence.

This policy establishes a reserve level equal to one-third (33%) of the replacement value of all rolling stock. The definition of rolling stock includes such equipment as Police patrol vehicles, Public Works utility trucks, and Recreation and Community Services utility vehicles. The replacement value shall be that updated and used annually as part of the budget development process. This metric was chosen since the average, annual total replacement value of

vehicles for the past seven years has been approximately \$200,000. The one-third of the replacement value reserve level would actually be three times higher than this seven year historical actual expenditure amount. Setting the reserve level at one-third of the replacement value of all rolling stock will provide sufficient funds should there be a need for a one-time, larger than normal expenditure related to fleet services.

Facilities Maintenance and Replacement

The Facilities internal service fund is responsible for costs related to routine maintenance (i.e., custodial services) and major rehabilitation (i.e., roof replacement) of City Hall, Police Building and Central Park offices and community center. The City maintains a long-term, facilities master plan that is utilized to guide long-range budgeting for major building expenses.

This reserve policy establishes a fund balance level for the Facilities internal service fund equal to a rolling six-year average of actual Maintenance and Operations expenses, updated annually. This metric is chosen in order to provide a long-enough historical expenditure level that includes routine as well as some non-capital, one-time emergency expenditures. Using a six-year rolling average levels out annual operating and maintenance expenditures.

In addition, there is established a contingency amount equal to half of the rolling six-year average of actual Maintenance and Operations expenses. This contingency amount could be utilized to fund non-routine rehabilitation projects. It should be noted that normal practice is to also utilize the Capital Outlay Reserve (COR) fund to pay for non-routine facilities capital projects. The purpose of the contingency reserve is to set aside additional capital funding that can be used in addition to COR funds.

Technology Maintenance and Replacement

The City's computer network, communications system (i.e., telephone), desktop and peripheral hardware, and technology software expenses are accounted for in the Technology internal service fund. This fund is utilized for periodic replacement of desktop computers, the annual expense related to enterprise-wide software licenses (i.e., Microsoft Office), upgrades to servers and networks, and maintenance and upkeep of the communications (i.e., telephones) system.

The reserve level established for this internal service fund shall be the full replacement value of the City's entire technology network, as determined annually through the budget development process. Choosing this reserve level metric does not suggest the funds would be used to completely replace the technology in use. Instead, it is a useful measure to allow for periodic upgrades and enhancements to the City's collection of information and communications technology, while also providing sufficient funds to meet annual operating costs.

REPLENISHMENT OF INTERNAL SERVICE FUND RESERVE LEVELS

In keeping with the principles discussed in this policy, when the reserve level of any Internal Service Fund falls below the policy levels as outlined here, the Finance Director will adjust allocations to those Internal Service Funds which have insufficient reserve levels beginning with

the immediately succeeding fiscal year from when the reserve deficiency occurs. Allocation levels will be adjusted through the budget process in a manner that seeks to return the Internal Service Fund reserves to their policy levels within one (1) to three (3) years.

SUMMARY

Components of the Fund Balance

Nonspendable Fund Balance

- Inherently nonspendable
- Portion of net resources that cannot be spent because of their form
- Portion of net resources that cannot be spent because they must be maintained intact

Restricted Fund Balance

- Externally enforceable limits on use
- Limitations imposed by creditors, grantors, contributors, or laws and regulations of other governments
- Limitations imposed by law through constitutional provisions or enabling legislation

Committed Fund Balance

- Council/Agency Self-imposed Limitations set in place prior to the end of the fiscal year
- Limitation imposed at highest level of decision making that requires formal action at the same level to remove

Assigned Fund Balance

- Limitation resulting from intended use
- Intended use established by the Finance Director

Unassigned Fund Balance

- Total fund balance in the General Fund in excess of nonspendable, restricted, committed and assigned fund balance (surplus)
- Excess of nonspendable, restricted, and committed fund balance over total fund balance (deficit)

Use of Fund Balance

- Restricted
- Committed
- Assigned

GLOSSARY

State and local governments use three broad categories of funds: *governmental* funds, *proprietary* funds and *fiduciary* funds.

Governmental funds include the following.

- *General* fund. This fund is used to account for general operations and activities not requiring the use of other funds.
- *Special revenue* funds are required to account for the use of revenue earmarked by law for a particular purpose. State and federal fuel tax revenues require special revenue funds, because federal and state laws restrict these taxes to transportation uses.
- *Capital projects* funds are used to account for the construction or acquisition of fixed assets such as buildings, equipment and roads. Depending on its use, a fixed asset may instead be financed by a special revenue fund or a proprietary fund. A capital project fund exists only until completion of the project. Fixed assets acquired and long-term debts incurred by a capital project are assigned to the government's *General Fixed Assets* and *Long-Term Debts*.
- *Debt service* funds are used to account for money that will be used to pay the interest and principal of long-term debts. Bonds used by a government to finance major construction projects, to be paid by tax levies over a period of years, require a debt service fund to account for their repayment.

The debts of special assessment and proprietary funds are serviced within those funds, rather than by a separate debt service fund.

- *Special assessment* funds account for public infrastructure improvements financed by special levies against property holders. Sidewalk and alley repairs often rely on special assessments.

Proprietary funds include the following.

- *Internal service* funds are used for operations serving other funds or departments within a government on a cost-reimbursement basis. A printing shop, which takes orders for booklets and forms from other offices and is reimbursed for the cost of each order, would be a suitable application for an internal service fund.
- *Enterprise* funds are used for services provided to the public on a user charge basis, similar to the operation of a commercial enterprise. Water and sewage utilities are common examples of government enterprises.

Fiduciary funds are used to account for assets held in trust by the government for the benefit of individuals or other entities. The employee pension fund, created by the State of Maryland to provide retirement benefits for its employees, is an example of a fiduciary fund. Financial

statements may further distinguish fiduciary funds as either *trust* or *agency* funds; a trust fund generally exists for a longer period of time than an agency fund.