

RESOLUTION NO.

**A RESOLUTION OF THE CITY COUNCIL OF THE CITY
OF ARROYO GRANDE UPDATING THE FUND BALANCE
AND RESERVE POLICY**

WHEREAS, the Governmental Accounting Standards Board (“GASB”) released Statement No. 54 - “Fund Balance Reporting and Governmental Fund Type Definitions” on March 11, 2009. The objective of the Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications and by clarifying governmental fund type definitions; and

WHEREAS, the City Council has expressed a desire to update the established Fund Balance and Reserve Policy for the General Fund that promotes responsible financial management by adhering to best budget practices and Generally Accepted Accounting Principles (GAAP); and

WHEREAS, by maintaining sufficient fund balances and reserves, the City will be well positioned to provide financial security and continued delivery of services, withstand economic downturns and other financial stressors such as a natural disaster or emergency, promote stable tax rates and fees, protect the city’s credit worthiness and bond rating, respond to opportunities, and consider long-term financial needs; and

WHEREAS, adopting a resolution updating the Fund Balance and Reserve Policy is not subject to the California Environmental Quality Act (“CEQA”) because it has no potential to result in either a direct, or reasonably foreseeable indirect, physical change in the environment. (State CEQA Guidelines, Cal. Code Regs., tit. 14, §§ 15060, subd. (c)(2)-(3), 15378.); and

WHEREAS, the policy will establish a target threshold for the unassigned General Fund balance, provide requirements to replenish the depleted reserves, and guidelines by which surpluses may be spent; and

WHEREAS, the City Council desires to update the Fund Balance and Reserve Policy at this time.

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Arroyo Grande, that:

1. The recitals set forth herein are true, correct and incorporated herein by this reference.
2. The Fund Balance and Reserve Policy attached to this Resolution and marked as Exhibit A, is hereby incorporated herein by this reference. The Fund Balance and Reserve Policy shall become effective concurrently with the adoption of this

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Resolution.

3. The City Council finds that the Fund Balance and Reserve Policy is reasonable and necessary to ensure the City is prepared in times of financial difficulties to continue to provide vital services to its residents.
4. The City Council further finds the types of reserve funds and the amounts to be funded within each fund described in the Fund Balance and Reserve Policy are reasonable and necessary to meet the City's financial planning needs.
5. The City Council may amend the Fund Balance and Reserve Policy from time to time as may be necessary.
6. This Resolution shall become effective immediately upon its adoption.

On motion of Council Member _____, seconded by Council Member _____, and by the following roll call vote, to wit:

AYES:

NOES:

ABSENT:

the foregoing Resolution was passed and adopted this 11th day of June, 2024.

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CAREN RAY RUSSOM, MAYOR

ATTEST:

JESSICA MATSON, CITY CLERK

APPROVED AS TO CONTENT:

MATTHEW DOWNING, CITY MANAGER

APPROVED AS TO FORM:

ISAAC ROSEN, CITY ATTORNEY

EXHIBIT A

Fund Balance and Reserve Policy

INTRODUCTION

The purpose of this document is to state the policy goals of the City of Arroyo Grandes' General Fund reserves, and the budgeting practices that maintain such reserves. Although there is no formula that defines a completely adequate Fund Balance, a conservative approach should enable the City to finance its operations and meet unplanned expenditures without having to incur short-term debt or raise new revenues.

These policies are intended to provide guidelines for budget decisions as to the appropriate use of General Fund resources and the maintenance of adequate reserves for contingencies, emergencies, capital improvements, and other such uses as determined by the City Council. After amounts projected to be available from the year-end fund balance of the General Fund are allocated to Assigned categories, the remaining amount, referred to as the Unassigned Fund Balance, will be reserved for contingencies as further set forth below.

PURPOSE

The purpose of the Fund Balance and Reserve Policy is to ensure strong fiscal management to guide the City of Arroyo Grande's financial planning, while continuing to provide services to the residents of the City. Additionally, the policy will: aide in reducing financial impacts of temporary revenue short falls and unpredicted one-time expenditures, such as disasters or catastrophic events; assist the City in responding to challenges of a changing economic environment; and preserve adequate reserve levels to improve or maintain the City's credit worthiness. The Fund Balance and Reserve Policy establishes the appropriate level of reserves in the Consolidated General Fund. The policy sets conditions warranting the use of reserves and outlines the plan to replenish them if the balances fall below the levels established in this policy.

BACKGROUND

Governmental Accounting Standards Board (GASB) Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, was implemented in FY 2010-11 with the intent of improving financial reporting by providing fund balance categories that will be more easily understood. The categories are more clearly defined to make the nature and extent of the constraints placed on a government's fund balance more transparent. This Fund Balance and Reserve Policy establishes the procedures for reporting unrestricted fund balance in the financial statements. The policy also authorizes and directs the Administrative Services Director to prepare financial reports which accurately categorize fund balance as per GASB Statement No. 54.

Fund Balance and Reserve Policy

POLICY

Fund balance is essentially the difference between the assets and liabilities reported in a governmental fund. There are five separate components of fund balance, each of which identifies the extent to which the City is bound to honor constraints on the specific purposes for which amounts can be spent.

- Non-spendable fund balance: Amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact.
- Restricted fund balance: To be used for specific purposes stipulated by external resource providers, constitution, or through enabling legislation.
- Committed fund balance: To be used for specific purposes as established by City Council.
- Assigned fund balance: Amounts intended for a specific purpose as authorized by the City Manager, but are neither restricted nor committed.
- Unassigned fund balance: The residual amount not contained in the other classifications. The first two components listed above, non-spendable and restricted fund balances, are not addressed in this policy due to the nature of the restrictions. Examples of non-spendable fund balance include prepaid expenses, loan receivables, and inventory. Restricted fund balance is either imposed by laws or constrained by grantors, contributors, or laws or regulations of other governments. This policy is focused on financial reporting of unrestricted fund balance, which is the last three components listed above. These three components are further defined below.

These funds may be pooled for investment earning purposes only and interest earned shall be credited to each individual fund based upon the proportionate share of the revenues invested.

Committed Fund Balance

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. Five types of committed reserves are set aside by the City including Operating Reserve, Pension and Other Post-Employment Benefits Reserve, Information Technology Reserve, Fleet Replacement Reserve, and Facility Repairs Reserve. The intended use of each reserve and the Fund(s) in which they are held is outlined below. To develop the appropriate amount of reserves, the City considered guidance from the Government Finance Officers Association (GFOA), as well as the current economic conditions and needs of the City. Reserve balances will be reviewed at the end of each fiscal year to ensure compliance with this Policy.

Fund Balance and Reserve Policy

- Operating Reserve – The GFOA recommends that general-purpose governments maintain reserves in the general fund of no less than two months (16.67%) of annual general fund operating revenues or annual general fund operating expenditures. The City has established an Operating Reserve in the Consolidated General Fund to mitigate financial and service delivery risk due to unexpected revenue shortfalls or unanticipated critical expenditures. The purpose of this reserve is to provide budgetary stabilization and not to serve as an alternative funding source for new programs and ongoing operating expenditures. It is for one-time needs and expenditures identified in the budget and not ongoing structural challenges. The City will aim to maintain a minimum balance in the Operating Reserves equal to approximately 15%, with a goal of 20% of the City’s annual operating expenditures.
- Pension and Other Post-Employment Benefits Reserve – Funds set aside under this reserve in the Consolidated General Fund to be used to further mitigate costs associated with pensions and other post-employment benefits. These funds will be used: as a funding source for potential additional discretionary payments to pay down unfunded liability; or held in the reserve account; or placed in a City Council approved trust instrument. Funds may be used for such purposes as a supplemental funding source for unanticipated increases to the annual pension and/or other post-employment benefit costs resulting from future actuarial assumptions and investment market volatility, or to make the City’s annual payments during times of economic uncertainty as brought on by such circumstances as a recession resulting in funding gaps.
- Information Technology Reserve – This fund, established in the Consolidated General Fund, provides for information system and technology projects including communications systems, hardware, and software, which are capital in nature. Technology can change rapidly within the information systems sphere and often comes at a large cost. This reserve helps the City keep pace with changes in information technology and take advantage of improvement/efficiency opportunities in this area. This reserve will not exceed 1.0% of annual Consolidated General Fund operating expenditures.
- Fleet Replacement Reserve – The City will maintain a Fleet Replacement Reserve in the Consolidated General Fund to provide for the timely replacement of existing vehicles should they come to the end of their useful life or become inoperable. This reserve will not exceed 1.0% of annual Consolidated General Fund operating expenditures.
- Facility Repairs Reserve – This reserve is set up in the Consolidated General Fund to address any unforeseen maintenance and repairs or planned replacements within City owned facilities. This reserve will not exceed 1.0% of annual Consolidated General Fund operating expenditures.

Fund Balance and Reserve Policy

Assigned Fund Balance

Amounts that are constrained by the City's intent to be used for specific purposes, but are neither restricted nor committed, should be reported as assigned fund balance. This policy hereby delegates the authority to assign amounts to be used for specific purposes to the City Manager or designee for the purpose of reporting these amounts in the annual financial statements. Examples of assigned fund balance include:

- Encumbered Fund balance levels must be sufficient to meet funding requirements for materials or services ordered, but not received, before the end of the fiscal year.
- Continuing Appropriations Fund balance levels must be sufficient to meet funding requirements for projects approved in prior years and which must be carried forward into the new fiscal year.
- Other Designations Assigned fund balance can also include amounts designated for certain programs, additional reduction of debt, special events, or other non-recurring expenditure needs of the City.

Unassigned Fund Balance

Unassigned fund balance is the residual positive net resources in excess of what can properly be classified in one of the other four categories. The Consolidated General Fund is the only fund that may report a positive (surplus) unassigned balance. Conversely, any governmental fund in a negative (deficit) position could report a negative amount of unassigned fund balance.

Fund Balance Classification

The accounting policies of the City consider restricted fund balance to have been spent first when the expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available. Similarly, when the expenditure is incurred for purposes for which amounts in any of the unrestricted classifications of fund balance could be used, the City considers committed amounts to be reduced first, followed by assigned amounts and the unassigned amounts.

Surplus

Since a surplus of unassigned fund balance does not represent a recurring source of revenue, it shall not be used to fund a recurring expense; however, the surplus may be appropriated for use to fund a one-time expenditure or use not already funded through an appropriation. If it is determined there is an operating surplus, the City Council may appropriate funds for the following nonrecurring purposes, listed in order of priority:

Fund Balance and Reserve Policy

- Surplus funds may be used to meet the minimum Operating Reserve requirement;
- Any surplus may be transferred to reduce the unfunded pension liability and/or any other unfunded postemployment benefit liabilities;
- If there is 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 advantageous for the City; and
- Surplus funds may be used for capital improvements and equipment purchases that are not financed with borrowings or other contributions.

Replenishment of Reserves

If the Operating Reserve balance established in this policy falls below the minimum required level, the City shall strive to restore it to the minimum required balance by any feasible means, including, but not limited to, adopting a budgetary surplus; applying any cost savings, over-realized revenues, and/or surpluses realized within the applicable fund.

If the Information Technology Reserve, Fleet Replacement Reserve, or Facility Repairs Reserve fall below the 1.0% of annual Consolidated General Fund operating expenditures, the levels will be replenished when surplus funds become available.

These guidelines may be suspended, in whole or part, if financial or economic circumstances prevent meeting any or all of the timelines. These policy guidelines may also be amended by action of the City Council from time to time.

This policy is instituted to provide a measure of protection for the City against unforeseen circumstances and to comply with GASB Statement No. 54. No other policy or procedure supersedes the authority and provisions of this policy.

Enterprise Fund Reserves

Reserves for Enterprise Funds – Water and Wastewater (Sewer): Revenues contained in these funds are restricted and may only be used for their described purposes below. In no event will these funds be used to fund general fund services.

- Operating Reserve – The purpose of the Enterprise Fund Operating Reserve is to provide working capital to meet cash flow needs during normal operations and support the operation, maintenance and administration of the utility. This reserve ensures that operations can continue

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should there be significant events that impact cash flows. The target balance to be maintained is 90 days (25 percent) of the current annual operating expense budget.

- Capital Reserve – The purpose of the Enterprise Fund Capital Reserve is to fund future replacement of assets and CIP projects. The Capital reserves are used to fund the construction of the projects as the projects progress and the funds are expended. The reserve target has been established at \$500,000 each for the water and wastewater systems through prior cost of service studies.
- Lopez Fund Reserve – The Enterprise Fund Lopez Fund accounts for the revenue and expenditures of the surface water purchases from the County. Revenues are collected through the water rates in sufficient amounts to provide for a transfer of revenue to meet the expenses in the Lopez Fund. A reserve is maintained in the fund at least equal to annual Lopez debt service.