



City of Murrieta City Council Policy

POLICY: FUND BALANCE AND RESERVE POLICY

POLICY NO.: 100-11

DATE: February 1, 2022

I. PURPOSE

The purpose of the Fund Balance and Reserve Policy is to ensure strong fiscal management to guide the City of Murrieta'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 General Fund, Measure T Fund, Community Service District Fund, Fire Fund, and Library 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.

II. BACKGROUND

Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, was implemented in fiscal year 2010/11 with the intent of improving financial reporting by providing fund balance categories that will me 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 Finance Director to prepare financial reports which accurately categorize fund balance as per GASB Statement No. 54.

III. 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.

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.

Six types of committed reserves are set aside by the City including Operating Reserves, Economic Contingency Reserves, Pension and Other Post-Employment Benefits Reserves, Information Technology Reserves, Fleet Replacement Reserves, and Facility Repairs Reserves. 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 GFOA, as well as the current economic conditions and needs of the City. Reserve balances will be reviewed at mid-year and at the end of each fiscal year to ensure compliance with this 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 General Fund, Measure T Fund, Community Services District Fund, Fire District Fund, and Library 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 25% of the City's annual operating expenditures in each of aforementioned funds with established Operating Reserves.
- **Economic Contingency Reserve** – The Economic Contingency Reserve shall be maintained in the General Fund and Measure T Fund to address financial impacts resulting from changes in the economic environment. If revenues are insufficient to meet the normal operating requirements of essential services in times of economic downturn, funds contained in the Economic Contingency Reserve may be used if approved by City Council action. This reserve will maintain a balance of 5% of annual General Fund operating expenditures.
- **Pension and Other Post-Employment Benefits Reserve** – Funds set aside under this reserve in the General Fund and Measure T Fund shall 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 Information Services 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.
- Fleet Replacement Reserve - The City will maintain a Fleet Replacement Reserve in the General Fund, Measure T Fund, and Fire District Fund to provide for the timely replacement of existing vehicles should they come to the end of their useful life or become inoperable. The annual contribution to this reserve will generally be based on the annual use allowance, which is determined based on the estimated life of the vehicle, or equipment, and its original purchase cost.
- Facility Repairs Reserve – This reserve is set up in the General Fund, Measure T Fund, Community Services District Fund, and Fire District Fund to address any unforeseen maintenance and repairs or planned replacements within City owned facilities.

There is no set required balances for the last four reserves but it is recommended that these reserves be funded at levels adequate to fund the City's schedules for equipment replacement, facility repairs, and future pension obligations.

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:

- Encumbrances
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 General Fund and Measure T Fund are the only funds 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:

- 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 any 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; or transferring a portion of the General Fund Economic Contingency Reserve.

Unless otherwise noted, the following guidelines will be used to restore a reserve fund:

- If a reserve is drawn down to 75-99% of its minimum required balance or its original balance prior to draw down if the reserve does not have an established required balance, it shall be restored to 100% over a 1 to 3 year period.
- If a reserve is drawn down to 50-74% of its minimum required balance or its original balance prior to draw down if the reserve does not have an established required balance, it shall be restored to 100% over a 3 to 5 year period.
- If a reserve is drawn down below 50% of its minimum required balance or its original balance prior to draw down if the reserve does not have an established required balance, it shall be restored to 100% over a 5 to 7 year period.

These guidelines may be suspended, in whole or part, if financial or economic circumstances prevent meeting any or all of the timelines.

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.

HISTORY

Adopted: June 21, 2011

Amended: February 1, 2022