CITY OF BATAVIA

DATE: November 10, 2014
TO: Mayor & City Council
FROM: Peggy Colby, Finance Director
SUBJECT: 2015 Draft Budget Q & A Round 3 Ques. 1-10

Following are the third set of questions received to date in regards to the 2015 budget. Answers have come from appropriate staff.:

1. In Fund #21 Electric Utility what is source of other revenues 95K?

Response:
Other revenues include $30,000 budgeted for miscellaneous receipts which are generally the sale of scrap metal and the sale of obsolete inventory. The balance of other revenues, $65,000 is the budget for investment income.

2. Is it legislated where a municipality is required to have 60 days reserves?

Response:
There is no legislative requirement that a city have a certain level of reserves. The 60-day minimum is a recommended practice from the Government Finance Officers Association. I have attached the recommended practice. The GFOA has also clarified that this practice is to be considered only as the minimum.

Each city should consider their own circumstances as to what is an appropriate level of fund balance. In addition, as mentioned in the attachment, rating agencies look at fund balance as a major factor in their rating. I would prefer that the City try to maintain 90 days of reserves or more. The current 5-year outlook has our reserves dipping to 92 days but it also does not provide for any new revenue. There will likely be recommendations for new revenues within the 5-year plan.

3. In Fund 11 Acct 11/06 Other Revenues - $1,436,643.00 this amount is greater than any year since 2012, where did this amount come from?

Response:
Please refer to page 70 and 71. The total includes some type of loan proceeds to fund the budgetary cash shortfall. It will be either an inter-fund loan or a bank loan.

4. Page 77 what project is budgeted under TIF #1?

   Response:
   Page 77 refers to a transfer from TIF #3 to TIF#1 for its contribution to TIF#1 projects. All projects have been budgeted under TIF #1 and TIF#3 has been contributing all tax revenues towards the projects. TIF #3 is contributing funds for the Walgreens grant and Houston Street Streetscape.

5. Pages 124A – 124C in the narrative there is no mention of separating our combination sewers. Is this not the city's goal to separate storm from sanitary sewer pipes to ease the pressure on our Waste Water facility? Is the city still pursuing this?

   Response:
   The first sewer separation project will be included with the Main Street reconstruction project. It is a long-range goal to separate the combined sewers but it has a hefty price tag associated with it and so it will be handled as part of a long-range plan. The cost would not be recovered through reduced processing costs as a result of separation, although it would provide some benefit. It is more likely that we will be required to invest in separating them by some future date in order to meet EPA standards. At this juncture, there are the more pressing EPA issues of phosphates and equipment upgrades needed at the plant.

6. What engineering firm is doing design engineering for Well #4 improvements?

   Response:
   The engineering firm has not been selected yet.

7. What is the status of the WWTP rate study?

   Response:
   The rate study just got underway one month ago. It is still in process. We will provide the results of the study as soon as they are available. It will most likely be completed by early 2015.

8. Electric high wire repair at Carlisle road/Batavia Ave., Colonial Village, Fabyan/Western Ave. and the Highlands is scheduled for overhead repairs, why is the city not attempting to place new wire underground for safety, maintenance and beautifying the neighborhoods?

   Response:
   The costs associated with placing electric lines underground are much higher than replacing the existing overhead lines. However, the current engineering study includes a financial analysis of overhead replacement versus underground replacement. We will look at both possibilities from a lifecycle cost perspective and present the results to city Council prior to moving forward with the final design.

9. In the Strategic Plan section under Environmental Identity, 5E is it possible to arrange for bus service from downtown Batavia to Geneva train station at certain hours in the morning and afternoon/early evening? This would enable residents w/o automobiles to possibly find work in downtown Chicago?

   Response:
   The Mayor has indicated that Pace is about to announce service based upon a Geneva train station- Fermilab connection but also to serve the industrial areas along Kirk. Bill's understanding is that between Routes the bus will be like a dial-a-ride service. We hope we will be able to work on that project to start looking at downtown.

10. Why is it our largest Enterprise Fund does not have a Superintendent? Gary Holm can only do so much.

    Response:
    The position has been vacant for some time due to the lack of applicants. There has possibly been some reluctance of applicants to apply as a result of some of the negative press the utility has received in the recent past. There are also significant challenges being faced by our utility that applicants may want to avoid. Although there are no urgent concerns for the operation of the utility, we need the position filled. Bill, Gary and I have met multiple times on this matter, most recently last week. The current plan is to try again to fill the position after the first of the year.

C: Department Heads
Website

GFOA Best Practice

Determining the Appropriate Level of Unrestricted Fund Balance in the General Fund

Background. Accountants employ the term *fund balance* to describe the net assets of governmental funds calculated in accordance with generally accepted accounting principles (GAAP). Budget professionals commonly use this same term to describe the net assets of governmental funds calculated on a government's budgetary basis.[1] In both cases, fund balance is intended to serve as a measure of the financial resources available in a governmental fund.

Accountants distinguish up to five separate categories of fund balance, based on the extent to which the government is bound to honor constraints on the specific purposes for which amounts can be spent: *nonspendable fund balance*, r*estricted fund balance*, *committed fund balance*, *assigned fund balance*, and *unassigned fund balance*.[2] The total of the last three categories, which include only resources without a constraint on spending or for which the constraint on spending is imposed by the government itself, is termed *unrestricted fund balance*.

It is essential that governments maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. Fund balance levels are a crucial consideration, too, in long-term financial planning.

In most cases, discussions of fund balance will properly focus on a government's general fund. Nonetheless, financial resources available in other funds should also be considered in assessing the adequacy of unrestricted fund balance (i.e., the total of the amounts reported as committed, assigned, and unassigned fund balance) in the general fund.

Credit rating agencies monitor levels of fund balance and unrestricted fund balance in a government's general fund to evaluate a government's continued creditworthiness. Likewise, laws and regulations often govern appropriate levels of fund balance and unrestricted fund balance for state and local governments.

Those interested primarily in a government's creditworthiness or economic condition (e.g., rating agencies) are likely to favor increased levels of fund balance. Opposing pressures often come from unions, taxpayers and citizens' groups, which may view high levels of fund balance as "excessive."

Recommendation. GFOA recommends that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund.[3] Such a guideline should be set by the appropriate policy body and should provide both a temporal framework and specific plans for increasing or decreasing the level of unrestricted fund balance, if it is inconsistent with that policy.[4]

The adequacy of unrestricted fund balance in the general fund should be assessed based upon a government's own specific circumstances. Nevertheless, GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.[5] The choice of revenues or expenditures as a basis of comparison may be dictated by what is more predictable in a government's particular circumstances.[6] Furthermore, a government's particular situation often may require a level of unrestricted fund balance in the general fund significantly in excess of this recommended minimum level. In any case, such measures should be applied within the context of long-term forecasting, thereby avoiding the risk of placing too much emphasis upon the level of unrestricted fund balance in the general fund at any one time.

In establishing a policy governing the level of unrestricted fund balance in the general fund, a government should consider a variety of factors, including:

- The predictability of its revenues and the volatility of its expenditures (i.e., higher levels of unrestricted fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile);
- Its perceived exposure to significant one-time outlays (e.g., disasters, immediate capital needs, state budget cuts);
- The potential drain upon general fund resources from other funds as well as the availability of resources in other funds (i.e., deficits in other funds may require that a higher level of unrestricted fund balance be maintained in the general fund, just as, the availability of resources in other funds may reduce the amount of unrestricted fund balance needed in the general fund);[7]
- Liquidity (i.e., a disparity between when financial resources actually become available to make payments and the average maturity of related liabilities may require that a higher level of resources be maintained); and
- Commitments and assignments (i.e., governments may wish to maintain higher levels of unrestricted fund balance to compensate for any portion of unrestricted fund balance already committed or assigned by the government for a specific purpose).

Furthermore, governments may deem it appropriate to exclude from consideration resources that have been committed or assigned to some other purpose and focus on unassigned fund balance rather than on unrestricted fund balance.

Naturally, any policy addressing desirable levels of unrestricted fund balance in the general fund should be in conformity with all applicable legal and regulatory constraints. In this case in particular, it is essential that differences between GAAP fund balance and budgetary fund balance be fully appreciated by all interested parties.

Notes:

1 For the sake of clarity, this recommended practice uses the terms GAAP fund balance and budgetary fund balance to distinguish these two different uses of the same term.

2 These categories are set forth in Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which must be implemented for financial statements for periods ended June 30, 2011 and later.

3 Sometimes restricted fund balance includes resources available to finance items that typically would require the use of unrestricted fund balance (e.g., a contingency reserve). In that case, such amounts should be included as part of unrestricted fund balance for purposes of analysis.

4 See Recommended Practice 4.1 of the National Advisory Council on State and Local Budgeting governments on the need to "maintain a prudent level of financial resources to protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures" (Recommended Practice 4.1).

5 In practice, a level of unrestricted fund balance significantly lower than the recommended minimum may be appropriate for states and America's largest governments (e.g., cities, counties, and school districts) because they often are in a better position to predict contingencies (for the same reason that an insurance company can more readily predict the number of accidents for a pool of 500,000 drivers than for a pool of fifty), and because their revenues and expenditures often are more diversified and thus potentially less subject to volatility.

6 In either case, unusual items that would distort trends (e.g., one-time revenues and expenditures) should be excluded, whereas recurring transfers should be included. Once the decision has been made to compare unrestricted fund balance to either revenues or expenditures, that decision should be followed consistently from period to period.

7 However, except as discussed in footnote 4, not to a level below the recommended minimum.

Approved by the GFOA's Executive Board, October, 2009.

GFOA Updates Best Practice on Fund Balance

By Stephen J. Gauthier

The changes that will result from the implementation of GASB Statement No. 54 led the GFOA to review and "fine tune" certain aspects of its best practice on the appropriate level of fund balance in the general fund.

In 2002, the Government Finance Officers Association (GFOA) issued a recommended practice (now a best practice) on *The Appropriate Level of Unreserved Fund Balance in the General Fund*. In 2009, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which replaces the traditional categories of *reserved* and *unreserved* fund balance with five new categories (i.e., *nonspendable*, *restricted*, *committed*, *assigned*, and *unassigned*) that represent a fundamentally different approach to classifying fund balance.

The changes that will result from the implementation of GASB Statement No. 54 made it necessary, at a minimum, that the GFOA revise its 2002 best practice to reflect the new categories of fund balance. At the same time, the very process of revision created an excellent opportunity for the GFOA to review and "fine tune" certain aspects of its 2002 guidance. Accordingly, the GFOA's Committee on Accounting, Auditing, and Financial Reporting (CAAFR) and the GFOA's Committee on Governmental Budgeting and Fiscal Policy jointly prepared a draft revised version of the 2002 best practice in June, which was subsequently approved by the GFOA's Executive Board at its October 2009 meeting.

FOCUS

The revised best practice, like its predecessor, deals exclusively with the appropriate level of fund balance in the general fund. The revised best practice also, like its predecessor, focuses on just one portion of fund balance. Prior to GASB Statement No. 54, of course, the focus had been on *unreserved fund balance*. Now that the distinction between *reserved* and *unreserved* fund balance has been eliminated, the focus henceforth will be on unrestricted fund balance, defined as the sum of *committed fund balance*, *assigned fund balance*, and *unassigned fund balance*. The revised best practice goes on to suggest that some governments may wish to focus even more narrowly on just the *unassigned* portion of unrestricted fund balance.

MINIMUM LEVEL

A primary objective of a fund balance policy is to maintain adequate resources to cope with contingencies. As a practical matter, very large governments often are in a much better position to predict contingencies than are smaller governments (for the same reason that an insurance company can more readily predict the number of accidents for a pool of 500,000 drivers than for a pool of fifty). In preparing the original 2002 best practice, the GFOA intended to set a minimum target of approximately two months of operating revenues or expenditures, while at the same time acknowledging that an amount as low as 5 percent could be appropriate for very large governments. Accordingly, the original best practice spoke of a *minimum* target of "no less than 5 to 15 percent" and explained in a footnote that

> In practice, levels of fund balance…typically are less for larger governments than for smaller governments because of the magnitude of the amounts involved and because the diversification of their revenues and expenditures often results in lower degrees of volatility.

Unfortunately, this guidance has sometimes been misinterpreted. Some, for instance, have misunderstood the reference to "no less than 5 to 15 percent" as setting both a *minimum* target (5 percent) and a *maximum* target (15 percent) for unreserved fund balance, whereas the GFOA very much intended that 15 percent be the *minimum* target for most governments. Likewise, the GFOA intended that the "larger government" exception apply to just a few very large governments, whereas it has sometimes been misunderstood to encompass anything "larger" than a small government.

The revised best practice attempts to eliminate the first misunderstanding by clearly stating that:

> GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.

A related footnote goes on to explain that a "significantly lower" level "may be appropriate for *states and America's largest governments* …" (emphasis added) without specifying how low that level might be.

FUTURE DEVELOPMENTS

The GFOA's Executive Board was not content with simply issuing a revised best practice on *The Appropriate Level of Unrestricted Fund Balance in the General Fund*. The board also directed the committees concerned to explore the possibility of developing additional guidance on: 1) appropriate levels of fund balance in governmental fund types other than the general fund, and 2) the appropriate level of working capital that should be maintained in proprietary funds. The committees will likely consider both topics at the upcoming winter committee meetings, which are scheduled for January 2010 in Washington, D.C.

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