

City of Sedona Fund Balance Policy

I. Purpose:

To ensure financial stability, the City of Sedona desires to manage its financial resources by establishing fund balance/net asset targets or ranges for selected funds. This will ensure the City maintains a prudent level of financial resources to provide sufficient cash flow for daily financial needs, secure and maintain investment grade bond ratings, offset significant economic downturns and revenue shortfalls, and provide funds for unforeseen expenditures related to emergencies.

II. Definitions:

A. **Fund Balance:** Fund balance means the difference between fund assets and fund liabilities as reported in a governmental fund. Furthermore, Government Accounting Standards Board (GASB) Statement No. 54 establishes the following fund balance classifications depicting the relative strength of the constraints that control how specific amounts can be spent:

1. **Non-spendable fund balance** includes amounts that are not in a spendable form (inventory, for example) or are required to be maintained intact (the principal of an endowment fund, for example).
2. **Restricted fund balance** includes amounts that can be spent only for the specific purposes stipulated by external resource providers (for example, grant providers), constitutionally, or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use). Effectively, restrictions may be changed or lifted only with the consent of resource providers.
3. **Committed fund balance** includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority. Commitments may be changed or lifted only by the government taking the same formal action that imposed the constraint originally.
4. **Assigned fund balance** comprises amounts *intended* to be used by the government for specific purposes. Intent can be expressed by the governing body or by an official or body to which the governing body delegates the authority. In governmental funds other than the General Fund, assigned fund balance represents the amount that is not restricted or committed. This indicates that resources in other governmental funds are, at a minimum, intended to be used for the purpose of that fund.
5. **Unassigned fund balance** is the residual classification for the General Fund and includes all amounts not contained in the other classifications. Unassigned

amounts are technically available for any valid government purpose. If another governmental fund has a fund balance deficit, then it will be reported as a negative amount in the unassigned classification in that fund. Positive unassigned amounts will be reported only in the General Fund.

- B. Net Assets: Net assets are the difference between assets and liabilities as reported in a financial reporting unit such as proprietary funds and fiduciary funds.
- C. Fund Balance Range: Fund balance range is the range of amounts this policy has set within which the City means to maintain the available fund balance.
- D. Surplus: Surplus is the amount by which the available fund balance exceeds the fund balance target or the upper limit of the fund balance range.
- E. Shortfall: Shortfall is the amount by which the fund balance target or the lower limit of the fund balance range exceeds the available fund balance.
- F. Available Fund Balance: Remaining fund balance after all balances designated as non-spendable, restricted, committed, and/or assigned (other than assigned balances in governmental funds representing residual balances) within the fund.
- G. Expenditures: Expenditures are all uses of financial resources and include operating and capital expenses, debt service, and transfers to other funds.
- H. Operating Expenditures: Operating expenditures are uses of financial resources for personnel, supplies, services and materials, and indirect cost allocations, and exclude capital expenses, debt service, and transfers to other funds.

III. Fund Balance Target or Range:

Fund balance targets or ranges are established for each governmental fund type that contains operating expenses, as well as the enterprise funds. The amounts set for each fund are based on the predictability of revenues, volatility of expenditures, and liquidity requirements of each fund and may need to be reviewed periodically.

The calculation of the various fund balances to proposed expenditures would be established as part of the budget preparation process taking the previous year's estimated actual expenditures and the established fund ratio to determine the ensuing budget year's fund balance requirements.

IV. Designations for Proprietary Funds:

Unrestricted net assets in proprietary funds do not necessarily represent resources available for appropriation. This is due to the fact that capital assets are included in proprietary funds and are offset in unrestricted net assets. Since it is not likely the

organization will sell the capital asset in order to fund operations, its value is not available for appropriation. In order to take this into account when calculating the ratio related to the fund balance range, staff will adjust the net assets to follow the same basis of accounting used for the General Fund.

V. Funds:

A. General Fund: The General Fund is considered to have a high level of risk to operations due to its dependence on revenue streams that are susceptible to economic downturns and revenue reduction impacts from outside agency actions. In addition, the General Fund is the main funding source when responding to unexpected events or emergencies. The fund balance for the General Fund consists of several balances for multiple purposes. These balances are identified below.

1. Operating Reserve: The operating reserve will be maintained to:
 - a. Insulate General Fund programs and current service levels from large and unanticipated one-time expenditure requirements, a revenue reduction due to a change in state or federal legislation, adverse litigation or any similar unforeseen action, and/or
 - b. Temporarily insulate General Fund programs and current service levels from slower revenue growth that typically occurs during an economic recession.

The Council may use this reserve during the first 18 to 24 months of a recession to either maintain current General Fund services and programs or transition expenditure growth to match lower revenues. For purposes of this policy, lower revenues trigger the Council's assessment of use of this reserve when ongoing revenues fall 3% or more for two consecutive quarters compared to the same quarters of the prior year or the financial forecast estimates that ongoing revenues will fall 3% or more for the next fiscal year. Ongoing revenue is defined as revenue typically received every year. One-time revenue is defined as revenue not received annually or significant revenue in excess of routine levels (i.e., significant construction-related revenues, fluctuating grants and donations, "windfall" revenues, etc.).

The operating reserve target for the General Fund shall be 30% of the total adopted budgeted operating expenditures of the General Fund budget.

2. Budget Carryover Reserve: A reserve will be set aside for any budget carryovers and will not be considered part of any surplus.
3. Equipment Replacement Reserve: An equipment replacement reserve will be established and based on an annual allocation of equipment costs over the useful life of the asset. This reserve will be used to fund the replacement of such equipment.

4. The City may establish additional committed, assigned, or unassigned fund balances in any amount as deemed necessary.

B. Streets Fund: The fund balance for the Streets Fund consists of several balances for multiple purposes. These balances are identified below.

1. Operating Reserve: The operating reserve will be maintained to:

- a. Insulate Streets Fund programs and current service levels from large and unanticipated one-time expenditure requirements, a revenue reduction due to a change in state or federal legislation, adverse litigation or any similar unforeseen action, and/or
- b. Temporarily insulate Streets Fund programs and current service levels from slower revenue growth that typically occurs during an economic recession.

The Council may use this reserve during the first 18 to 24 months of a recession to either maintain current Streets Fund services and programs or transition expenditure growth to match lower revenues. For purposes of this policy, lower revenues trigger the Council's assessment of use of this reserve when ongoing revenues fall 3% or more for two consecutive quarters compared to the same quarters of the prior year or the financial forecast estimates that ongoing revenues will fall 3% or more for the next fiscal year. Ongoing revenue is defined as revenue typically received every year. One-time revenue is defined as revenue not received annually or significant revenue in excess of routine levels (i.e., significant construction-related revenues, fluctuating grants and donations, "windfall" revenues, etc.).

The operating reserve target for the Streets Fund shall be 30% of the total adopted budgeted operating expenditures of the Streets Fund budget.

2. Streets Rehabilitation/Pavement Preservation Reserve: The fund balance target for the Streets Fund (excluding any other committed or assigned fund balances for specific purposes) shall be the difference between the highest expected annual pavement preservation/street rehabilitation cost and the average annual pavement preservation/street rehabilitation cost. The transfers from the General Fund to bridge the gap between revenues and expenditures will be budgeted based on maintaining the target balance. If actual Streets Fund results exceed the target balance, the difference will be considered a surplus up to the total amount of the General Fund transfer. The portion of Streets Fund monies from the City's share of Highway User Revenue Fund (HURF) monies are restricted and cannot be transferred.
3. Equipment Replacement Reserve: An equipment replacement reserve will be established and based on an annual allocation of equipment costs over the useful life of the asset. This reserve will be used to fund the replacement of such equipment.

- C. Grants & Donations Funds: The fund balance in this fund is restricted to the purposes for which the monies were received. Balances will automatically carryover to the following fiscal year.
- D. Wastewater Enterprise Fund: The City's current plan is to gradually eliminate the sales tax subsidy to the Wastewater Enterprise Fund. Once the subsidy is eliminated, the reserve levels will be reevaluated.

The fund balance for the Wastewater Enterprise Fund consists of several balances for multiple purposes. These balances are identified below.

- 1. **Operating Reserve**: The operating reserve will be maintained to guard against service disruption in the event of unexpected temporary revenue shortfalls or unpredicted one-time expenses.

The operating reserve range for the Wastewater Enterprise Fund, including maintenance, operations, and administration shall be not less than 25% (90 days) and not more than 33.3% (120 days) of the total budgeted operating expenses of the Fund.

- 2. **Legal Debt Service Reserve**: Debt service reserves required by any bond covenants shall be established to meet those legal requirements.
- 3. **Policy Debt Service Reserve**: In addition to any legally required debt service reserves, additional debt service reserves shall be established equal to the average of one year of the remaining enterprise fund debt service repayment requirements for any debt issuances that do not have specified reserve requirements and are not covered by bond insurance.
- 4. **Budget Carryover Reserve**: A reserve will be set aside for any budget carryovers and will not be considered part of any surplus.
- 5. **Equipment Replacement Reserve**: An equipment replacement reserve will be established and based on an annual allocation of equipment costs over the useful life of the asset. This reserve will be used to fund the replacement of such equipment.
- 6. **Major Maintenance Reserve**: A major maintenance reserve will be established and based on an annual allocation of major maintenance costs over the life of the anticipated maintenance need. This reserve will be used to fund the maintenance costs as needed.
- 7. **Capital Improvements Reserve**: A capital improvements reserve will be established and maintained based on the higher of the estimated ensuing fiscal year's "pay-as-you-go" projects or an average of the "pay-as-you-go" projects over the next five years in accordance with the City's Capital Improvement Plan.

8. The City may establish additional committed, assigned, or unassigned fund balances in any amount as deemed necessary.
- E. Public Transit Enterprise Fund: The fund balance for the Public Transit Enterprise Fund consists of several balances for multiple purposes. These balances are identified below.
1. Budget Carryover Reserve: A reserve will be set aside for any budget carryovers and will not be considered part of any surplus.
 2. Equipment Replacement Reserve: An equipment replacement reserve will be established and based on an annual allocation of equipment costs over the useful life of the asset. This reserve will be used to fund the replacement of such equipment.
 3. The City may establish additional committed, assigned, or unassigned fund balances in any amount as deemed necessary.
- F. Capital Improvements Fund: The Capital Improvements Fund was created to account for resources designated to construct or acquire capital assets and major improvements. Occasionally, these projects may extend beyond a single fiscal year. Therefore, although no specific reserve requirement is established for the Capital Improvements Fund, at a minimum, the fiscal year-end fund balance, coupled with estimated revenues for the ensuing fiscal year, must be sufficient to fund the “pay-as-you-go” capital fund obligations for the next fiscal year. This will follow the City’s Capital Improvement Plan.
- G. Development Impact Fee Funds: The fund balance in this fund is restricted to the purposes for which the monies were received. Balances will automatically carryover to the following fiscal year.
- H. Art in Public Places Funds: The fund balance in this fund is restricted to the purposes for which the monies were received. Balances will automatically carryover to the following fiscal year.
- I. Internal Service Funds: Currently, the City’s only Internal Service Fund is the Information Technology Fund. The fund balance for the Internal Service Funds consists of several balances for multiple purposes. These balances are identified below.
1. Budget Carryover Reserve: A reserve will be set aside for any budget carryovers and will not be considered part of any surplus.
 2. Equipment Replacement Reserve: An equipment replacement reserve will be established and based on an annual allocation of equipment costs over the useful life of the asset. This reserve will be used to fund the replacement of such equipment.

3. The City may establish additional committed, assigned, or unassigned fund balances in any amount as deemed necessary.

VI. Assignment of Fund Balances

The City Manager is authorized to assign fund balances for specific purposes in accordance with the intent of the City Council and assigned fund balances can only be spent as authorized in the City's Purchasing Policy.

VII. Use of Reserves

It is the intent of the City to limit use of the Operating Reserves to address unanticipated, non-recurring needs. Reserves shall not normally be applied to recurring annual operating expenditures. Reserves, however, may be used to allow time for the City to restructure its operations in a deliberate manner (as might be required in an economic downturn), but such use will only take place in the context of an adopted long-term plan.

VIII. Surplus:

If it is determined there is a surplus (an amount in excess of the fund balance target or the upper limit of the fund balance range for any fund), the funds may be designated or appropriated at the next budget cycle for the following purposes in order of priority:

- A. Eliminate shortfalls in related funds. Any General Fund surplus shall be transferred to cover shortfalls within Streets, Capital Improvement or any other fund initiated by the City to provide City services. Any Utilities Operating Fund (Enterprise) surplus shall be transferred to the respective Utilities Capital Improvements Fund.
- B. Reduction or avoidance of debt. If there is short- or long-term debt within the fund, the surplus may be applied to reduce or eliminate the debt if financial analysis proves this 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 financial analysis proves this to be advantageous for the City.
- C. One-time capital needs. Since a surplus does not represent a recurring source of revenue it should not be used to fund a recurring expense; however, if a one-time capital expenditure has been identified, but not already funded through an appropriation, the surplus may be appropriated for this use.
- D. Tax, fee, or rate stabilization. Surplus funds may be designated for stabilization in order to avoid raising taxes, fees, or rates related to the fund in subsequent years. For instance, a surplus in the Enterprise Fund may trigger reevaluation and possible reduction of the sales tax subsidy provided to the Enterprise Fund in the future.

IX. Shortfall:

If it is determined there is a shortfall (an amount below the fund balance target or the lower limit of the fund balance range for any fund), the fund balance is to be replenished as quickly as possible through the following mechanisms in order of priority:

- A. With exception of funds with legal restrictions as to the use of funding sources, a distribution of surplus from other related funds as delineated under “Surplus” category.
- B. An appropriation during the next annual budget process of at least 20% of the shortfall until the target or lower limit has been reached.
- C. If A. or B. is financially infeasible, a written plan shall be forwarded by the Director of Financial Services to the City Manager for Council approval in order to restore the fund balance to an amount equal to the target or within the range within a practical time frame. This plan may require reduction of services, increases in taxes, fees, or rates, or some combination thereof.