

**CITY OF VERNON  
COMMISSIONER MEETING**

**MEETING DATE:** 1.24.2023

**DEPARTMENT:** Finance

**AUTHOR:** Dee Boatenhamer

**AGENDA ITEM:** Adoption of Financial Policy – FY22-23

**BACKGROUND:** City desires an annually adopted Financial Policy to include minimum cash reserves and a mechanism to alert the public when those reserves fall below a set limit. In this proposed Financial Policy, if total Cash on Hand balance in Pooled Cash falls below 90 days or 25%, the City's Finance Committee shall issue directives to eliminate spending other than mandatory operational expenses, payroll, debt and contractual obligations. The proposed Financial Policy delineates between Fund Balance and Cash on Hand required for Operating Funds. It provides a strategy for Minimum Cash on Hand Balance - General Fund and Enterprise Fund.

One of the City's long-term financial strategies has been to develop adequate reserves, or "fund balance" in its operating funds to mitigate financial risk from unforeseen revenue fluctuations, unanticipated expenditures, and response to natural disasters or major emergencies.

Cash Balance vs. Fund Balance:

An entity's "fund balance" represents its equity within a fund at any given time, represented by the difference between the fund's assets and liabilities. Some types of assets, such as property taxes receivable and accounts receivables (water and sewer, sales tax, franchise tax and ambulance) are not immediately available to pay bills. For that reason, the "fund balance" may be less useful than the "cash balance" in describing assets on hand to meet current obligations. At the same time, the "fund balance" offers a broader picture of the entity's financial condition, as it takes all assets and liabilities into account. As concerns about available cash flows to meet expenditure requirements are paramount, an entity's "cash balance" is used for cash flows purposes.

**ATTACHMENT(S):** Proposed Financial Policy

**FINANCIAL IMPACT:** \$0 in Current Year. Goal is to increase Cash on Hand and subsequent Unassigned Fund Balance in future years

**RECOMMENDATION:** Adoption of Financial Policy

**ACTION REQUESTED:** Adoption of Financial Policy

## **Proposed Financial Policy – 2022-2023 City of Vernon**

### Purpose

The purpose of this Financial Policy is to establish a key element of the financial stability of the City of Vernon by setting Fund Balance and Cash on Hand guidelines for operating funds. City desires an annually adopted Financial Policy to include minimum cash reserves and a mechanism to alert the public when those reserves fall below a set limit. If total Cash on Hand balance in Pooled Cash falls below 90 days or 25%, the City's Finance Committee shall issue directives to eliminate spending other than mandatory operational expenses, payroll and debt. The proposed Financial Policy delineates between Fund Balance and Cash on Hand required for Operating Funds. It provides a strategy for Minimum Cash on Hand Balance - General Fund and Enterprise Fund.

It is essential that the City maintain adequate levels of Cash on Hand to mitigate financial risk that can occur from unforeseen revenue fluctuations, unanticipated expenditures, and similar circumstances. This strategy will ensure that the City maintains adequate Cash on Hand in the City's two operating funds with the capacity to:

1. Provide sufficient cash flow for daily financial needs,
2. Secure and maintain strong bond credit ratings,
3. Offset significant economic downturns or revenue shortfalls, and
4. Provide funds for unforeseen expenditures related to emergencies.

### Cash Balance vs. Fund Balance:

An entity's "fund balance" represents its equity within a fund at any given time, represented by the difference between the fund's assets and liabilities. Some types of assets, such as property taxes receivable and accounts receivables (water and sewer, sales tax, franchise tax and ambulance) are not immediately available to pay bills. For that reason, the "fund balance" may be less useful than the "cash balance" in describing assets on hand to meet current obligations. At the same time, the "fund balance" offers a broader picture of the entity's financial condition, as it takes all assets and liabilities into account. As concerns about available cash flows to meet expenditure requirements are paramount, an entity's "cash balance" is used for cash flows purposes.

Fund Equity – A fund's equity is generally the difference between its assets and its liabilities.

Governmental Fund Balance – An accounting distinction is made between the portions of fund equity that are spendable and nonspendable. Fund balance in governmental funds is classified into five categories:

1. Nonspendable fund balance – includes the portion of net resources that are not in a spendable form or are required to be maintained intact. Examples are inventory, long term loans, prepayments, or permanent funds.
2. Restricted fund balance – includes the portion of net resources that can be spent only for the specific purposes stipulated by external resource providers either

constitutionally or through enabling legislation. Examples include bond proceeds, grant awards, specific contributions.

3. Committed fund balance – includes the portion of net resources that can be used only for the specific purposes determined by a formal action of the City Commission. Commitments may be changed or lifted only by the government taking the same formal action that imposed the constraint originally. The formal action must be approved before the end of the fiscal year in which the commitment will be reflected on the financial statements.
4. Assigned fund balance – comprises the portion of net resources for which an intended use has been established by the City Commission or the City Official authorized to do so by the City Commission. Assignments of fund balance are much less formal than commitments and do not require formal action for their imposition or removal. In governmental funds other than the general fund, assigned fund balance represents the amounts that are not restricted or committed, but are, at a minimum, intended to be used for the purpose of that fund.
5. Unassigned fund balance – includes the amount in an operating fund in excess of what can properly be classified in one of the other four categories of fund balance. Unassigned amounts are technically available for any purpose.
6. Cash on Hand - for City of Vernon's expenditures, is the City's Joint Fund, also known as Pooled Cash.

Enterprise Fund Balance – Fund balance in enterprise funds is considered as net assets.

Unassigned fund balance – unrestricted net assets in enterprise funds is roughly equivalent to unassigned fund balance in the governmental funds; however, in the case of enterprise funds, unrestricted net assets include capital assets such as buildings and equipment and does not necessarily represent funds available for appropriation. In order to take this into account, unassigned fund balance in the enterprise funds is considered in this policy to be the total unrestricted cash and cash equivalents in the fund less any assignments for subsequent year expenditures (encumbrances).

Committed Fund Balance

The City Commission is the City's highest level of decision-making authority and the formal action that is required to be taken to establish, modify, or rescind a fund balance commitment is a resolution approved by the Commission at the City's Commission meeting. The resolution must either be approved or rescinded, as applicable, prior to the last day of the fiscal year for which the commitment is made. The amount subject to the constraint may be determined in the subsequent period.

Assigned Fund Balance

The City Commission has authorized the City's City Manager as the official authorized to assign fund balance to a specific purpose as approved by this fund balance policy.

**Strategy: Minimum cash reserves and a mechanism to alert the public when those reserves fall below a set limit**

Minimum Cash on Hand Balance - General Fund and Enterprise Fund

It is the strategy of the City to achieve and maintain a minimum Cash on Hand Balance equal to 90 days or 25% of the combined expenditures in the General Fund and Enterprise Fund. For financial calculation purposes, a year is deemed to be 360 days, thus 90 days is 25% of a year. The long-term strategy will be to keep Fund Balance above 90 days of the combined expenditures of the General and Enterprise Fund while making capital expenditures for improvement of the city infrastructure. As Assets increase without corresponding increases in liabilities, Fund Balance also increases. The Finance Director will report monthly Cash on Hand balances to City Commission in a Pooled Cash Report. If total Cash on Hand balance in Pooled Cash falls below 90 days or 25%, the City's Finance Committee shall issue directives to eliminate spending other than mandatory operational expenses, payroll and debt. The City should plan to adjust budget resources in subsequent fiscal years to restore the balance.

Example: Calculation of minimum 90 days or 25% Cash on Hand:

| <b>Adopted 2022.23 Budget</b>                     |                 |              |
|---|-----------------|--------------|
| General Fund Expenditures                         | \$8,622,216     |              |
| Subtotal  |                 | \$8,622,216  |
| Enterprise Fund Expenditures                      | \$8,392,153     |              |
| Less: Transfers to General Fund and Funds 25 - 50 | (\$2,487,000)   |              |
| Less: Transfers to General Fund in Lieu Of's      | (\$862,702)     |              |
| Subtotal  |                 | \$5,042,401  |
| Total General Fund and Enterprise Fund            |                 | \$13,664,617 |
| Cash requirement calculation                      | 90 days or 25%  | \$3,416,154  |
| Cash requirement calculation                      | 120 days or 33% | \$4,509,324  |

**Expenditures Available to Spend with Fund Balance**

As City grows Fund Balance, there will be funds available for appropriation from unassigned fund balance. The City Commission may appropriate unassigned fund balances for emergency purposes, as deemed necessary.

**Order of Expenditure of Funds**

As City grows Fund Balance, there will be an order of expenditure of funds available for appropriation from unassigned fund balance. When multiple categories of fund balance are available for expenditure (for example, a construction project is being funded partly by a grant, funds set aside by the City Commission, and unassigned fund balance), the City will start with the most restricted category and spend those funds first before moving down to the next category with available funds.