

MEMORANDUM

Department of Financial Services



To: Honorable Mayor and City Council
Through: Tom Williams, City Manager
From: Emma C. Karlen, Director of Financial Services *EW*
Subject: Revised Budget Guidelines and Fiscal Policies
Date: May 1, 2009

Background: The current Budget Guidelines and Fiscal Policies were last approved by the City Council in FY 06-07. There are sections in the Budget Guidelines and Fiscal Policies that need to be updated to reflect the current practices. The revised Budget Guidelines and Fiscal Policies are attached for the Council's review and comments. Staff's recommendation is for the City Council to approve these two documents simultaneously with the FY 09-10 budget adoption on June 2, 2009.

Discussion:

The Budget Guidelines is a set of specific guidelines established by the City Manager, for the preparation and administration of the budget. The Budget Guidelines identifies the roles and responsibilities of the City Council, City Manager, Finance Director and department heads in preparing and administering the annual operating budget. This document also identifies the form and content of the proposed budget and the budget authority of the City Manager. The changes in the revised Budget Guidelines are as follows:

- 1) Currently, the Budget Guidelines stated that there is a review of service level priorities by the City Council at an annual Planning Workshop. The change is to provide more flexibility by adding that either the City Council or the Finance Subcommittee can review the service level priorities for planning purposes and also change the word Workshop to Session.
- 2) Add a sentence to Section 4, Adoption of the Budget, to clarify that unless otherwise directed, all the funds that are presented in the operating budget document are subject to appropriation. This change is recommended by Government Finance Officer Association that the Operating Budget should state the funds that are subject to appropriation.

The City of Milpitas Fiscal Policies is a set of policy statements that were either previously adopted by the City Council or evolved overtime to reflect professional standards recommended by organizations such as Government Finance Officers Association of the United States and Canada (GFOA) and the California Society of Municipal Finance Offices (CSMFO). These policy statements contribute to the fiscal soundness of a governmental

agency's operation. The changes in the Revised City of Milpitas Fiscal Policies are as follows:

- 1) Clarify that the Public Employees Retirement Rate Stabilization Reserve may be drawn on if the required employer contribution rates exceed previous year's contribution rates by more than 3% of payroll and only upon City Council's approval. Previously, the Policy stated 3% without further explaining that it is 3% of payroll.
- 2) Add the word endeavor to the Policy to state that the City will endeavor to set-aside \$500,000 (instead of \$1 million) annually from the General Fund reserve for the repair and replacement of storm drain pump stations. Given the current economic environment, the General Fund is unable to fund \$1 million annually. This change will provide more flexibility in the reserve policy.
- 3) Delete the reference of anticipation of funding the normal cost for retiree medical benefits and change the wording to state that the City will fund the required contribution annually. The City set up an irrevocable trust for the purpose of funding retiree medical benefits and has been funding the required contribution annually since FY 07-08.
- 4) Add the word endeavor to the Policy to state that the City will endeavor to set-aside \$250,000 annually for technological equipment replacement. Given the current economic environment, the City may not be able to fund \$250,000 annually. This change will provide more flexibility in the reserve policy.

Recommendation: Approve the revised Budget Guidelines and Fiscal Policies.

BUDGET GUIDELINES

The annual operating budget is the primary short-term financial plan for the City. The operating budget shall serve as the policy document of the City Council for implementing Council goals and objectives. It is used to set forth the City's estimates of resources available to fund services that are consistent with the Council's goals. Since no plan will prove to be an absolutely accurate reflection of future events, management must have sufficient flexibility to make adjustments during the year, provided these adjustments do not materially alter the general intent of the City Council when adopting the budget. These guidelines are intended to provide that flexibility and to establish adequate controls, through budget monitoring and periodic reporting, to ensure that the overall distribution of resources achieves the results contemplated by the City Council.

Annually, the City Council establishes priorities regarding service levels to provide guidance to management in preparing the recommended budget. Through its legislative authority, the Council approves and adopts the budget by resolution.

The City Manager is responsible for proposing to the City Council a balanced budget which is consistent with the Council's service level priorities and sound business practices. Balanced budget is defined as a budget where the anticipated operating revenues and other financing resources including carryover of outstanding encumbrances from prior year are equal to or exceed operating expenditures. The City Manager is also responsible for establishing a system for the preparation, execution, and control of the budget which provides reasonable assurances that the intent of Council policies is met.

The Director of Financial Services is responsible for providing periodic budget status reports to the City Manager and the City Council and monthly budget reports to the Department Heads to facilitate control and compliance with the budget.

The Department Heads are responsible for monitoring their respective budgets for compliance with the intent of Council priorities and for insuring that appropriations of the aggregate total of the department are not exceeded.

SUMMARY OF BUDGET GUIDELINES

1. Basis of Budgeting

City budgets are adopted on a basis consistent with generally accepted accounting principles (GAAP) except that encumbrances are considered budgetary expenditures in the year of the commitment to purchase, and capital project expenditures are budgeted on a project length basis rather than a fiscal year. For all governmental funds, revenues and expenditures are budgeted on a modified accrual basis. For all proprietary funds, revenues and expenditures are budgeted on an accrual basis.

2. **Budget Calendar**

A budget preparation calendar will be provided to the Department Heads and to the City Council at the beginning of the budget process each year. The calendar will set forth, at a minimum, dates for the following:

- a. Review of service level priorities by the City Council or Finance Subcommittee at an annual Planning Session.
- b. Presentation of the City Manager's proposed budget to the City Council, which shall be no later than the second week in June.

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3. **Form and Content of the City Manager's Proposed Budget**

- a. The City Manager's proposed budget, the Preliminary Budget and Financial Plan, shall be presented in a form which is sufficient to allow the City Council to determine and review:
 - Provision of City Council priorities as established at the annual City Council Planning Workshop;
 - Projected revenues by major category;
 - Operating expenditures by department or program, and by fund;
 - Historical Staffing by Division;
 - Service levels;
 - Statements of objectives and accomplishments;
 - Recommendations for policy changes and impact;
 - Capital improvement appropriations by project.
- b. Comparison with the preceding year's actual results and current year's projected results will be provided for each category of revenue and expenditure shown in the budget.
- c. A description of the service levels to be provided under the proposed budget will be included.
- d. A statement of the services reduced or eliminated and the services improved or added, as compared to the current year, will be included.

- e. A schedule showing General Fund Revenue and Expenditure projection for the next five years.

4. **Adoption of the Budget**

The City Council will adopt the budget by resolution no later than June 30th of the previous fiscal year, setting forth the amount of appropriations and authority of the City Manager to administer the adopted budget. Unless otherwise directed, all the funds that are presented in the operating budget document are subject to appropriation.

5. **Budget Authority of the City Manager**

The City Manager shall have the authority to amend appropriations within the various departments and projects within a fund, provided that the amount of the amended appropriation is \$20,000 or less. Interfund transfers or transfers of an appropriation amount within a fund which in any single instance exceed \$20,000 require prior approval of the City Council. No expenditures may be made from any undesignated fund balances without an appropriation by the City Council.

The City Manager shall have the authority to reasonably deviate from the budgeted personnel allocation schedule provided that at no time will the number of permanent, full-time employees authorized by the City Council be exceeded.

6. **Budget Amendments by the City Council**

The City Council may from time to time approve expenditures and identify funding sources not provided for in the adopted budget including those expenditures funded through undesignated fund balances. The Finance Subcommittee shall review any requests for budget amendments prior to submitting to the City Council.

7. **Budget Transfers and Modification Procedures**

Procedures to implement budget transfers or budget modifications are detailed in Standard Procedure No. 21-1, subject to any changes by the Budget Resolution.

8. **Automatic Adjustments and Reappropriations**

- a. Outstanding encumbrances at prior fiscal year-end will automatically be carried over to current year's budgets.
- b. Unspent appropriations that are authorized and funded by grant revenues from prior fiscal year will automatically be carried over to current year's budgets.
- c. Incomplete multiple year project balances will automatically be

reappropriated.

9. **Budget Monitoring and Reporting**

- a. General Monthly Reports - The Director of Financial Services will prepare a monthly budget report including actual expenditures and encumbrances for distribution to the City Manager and Department Heads, to facilitate monitoring of the budget.
- b. Periodic Budget Reports - The Director of Financial Services will periodically prepare a budget status report for presentation to the City Council. At the minimum, the report shall include the status of the General Fund revenues and expenditures, Water and Sewer utility fund revenues, and Redevelopment Project fund revenues.

10. **Reserves**

Various unallocated reserves are desired in each of the City's funds to protect the City in emergencies, economic uncertainties, and to finance unforeseen opportunities and/or requirements. Reserve policies for various funds are described in detail in the document entitled "City of Milpitas Fiscal Policies".

CITY OF MILPITAS FISCAL POLICIES

GENERAL FINANCIAL GOALS

1. To maintain a financially viable city that can maintain an adequate level of municipal services.
2. To maintain financial flexibility in order to be able to continually adapt to local and regional economic change.
3. To maintain and enhance the sound fiscal condition of the City.

OPERATING BUDGET POLICIES

4. The City will adopt a balanced budget by June 30th of each year.
5. An annual base operating budget will be developed by accurately and realistically projecting revenues and expenditures for the current and forthcoming fiscal year.
6. During the annual budget development process, the existing base budget will be thoroughly examined to assure cost effectiveness of the services or programs provided.
7. Annual operating budgets will include the cost of operations of new capital projects.
8. The City will avoid balancing the current budget at the expense of future budgets, unless the use of reserves is expressly authorized by the City Council.
9. The City's operating budget will be prepared on a basis consistent with generally accepted accounting principals (GAAP) except that encumbrances are considered budgetary expenditures in the year of the commitment to purchase and capital project expenditures are budgeted on a project length basis.

REVENUE POLICIES

10. The City will try to maintain a diversified and stable revenue system to avoid over-reliance on any one revenue source.
11. Revenue estimates are to be accurate and realistic, sensitive to both local and regional economic conditions.
12. The City will estimate its annual revenues by an objective, analytical process utilizing trend, judgmental, and statistical analysis as appropriate.

13. User fees will be reviewed annually for potential adjustments to recover the full cost of services provided, except when the City Council determines that a subsidy is in the public interest.
14. The City will actively pursue federal, state, and other grant opportunities when deemed appropriate. Before accepting any grant, the City will thoroughly consider the implications in terms of ongoing obligations that will be required in connection with acceptance of said grant.
15. One-time revenues will be used for one-time expenditures only, including capital outlay and reserves.

EXPENDITURE POLICIES

16. The City will maintain levels of service, as determined by the City Council, to provide for the public well-being and safety of the residents of the community.
17. Employee benefits and salaries will be maintained at competitive levels.
18. Fixed assets will be maintained and replaced as necessary, minimizing deferred maintenance.
19. The City will develop and use technology and productivity enhancements that are cost effective in reducing or avoiding increased personnel costs.

UTILITY RATES AND FEES

20. Water and sewer utility customer rates and fees will be reviewed and adjusted annually, if necessary.
21. All utility enterprise funds will be operated in a manner similar to private enterprise. As such, the City will set fees and user charges for each utility fund at a level that fully supports the total direct and indirect cost of the activity, including depreciation of assets, overhead charges, and reserves for unanticipated expenses and capital projects.

CAPITAL BUDGET POLICIES

22. The City will develop an annual Five-year Capital Improvement Program (CIP) which is designed to develop and maintain infrastructure to support existing residences and businesses and future anticipated development.

23. The CIP will identify the estimated full cost of each project which includes administration, design, development and implementation, and operating costs once the projects are completed.
24. The CIP will identify potential funding sources for each proposed capital project, prior to submitting proposed projects to the City Council for approval. When appropriate, the CIP will seek other funding sources such as State and Federal funds, private funds and leverage these funding sources with public money to help meet the highest priority community needs.
25. The funding for the first year of the Five-year CIP will be legally appropriated as a component of the annual operating budget. Funding for future projects identified in the five year has not been secured or legally authorized and is therefore subject to change.
26. Each CIP project will be assigned to a Project Manager whose responsibilities are to monitor all phases of the project to ensure timely completion of the project and compliance with the project budget and all regulations and laws.

DEBT POLICIES

27. The City will limit long-term debt to only those capital improvements or long-term liabilities that cannot be financed from current revenue sources.
28. The City will utilize debt financing for projects which have a useful life that can reasonably be expected to exceed the period of debt service for the project.
29. The City will protect and enhance the City's general credit rating of "AA".
30. The City may utilize interfund loans rather than outside debt to meet short-term cash flow needs.
31. The City will minimize costs and liabilities to the City when sponsoring debt financing for private sectors.

RESERVE POLICIES

32. The City will periodically review and update reserve guidelines, to ensure that the City has sufficient reserve balances to adequately provide for emergencies, economic uncertainties, unforeseen operating or capital needs, economic development opportunities, and cash flow requirements.
33. The City will maintain unreserved, undesignated fund balance of at least 15% of the annual operating expenditures in the General Fund for emergencies and unforeseen

operating or capital needs.

34. The City will maintain in the General Fund a \$5 million Public Employees Retirement Rate Stabilization Reserve. This reserve may be drawn on if the required employer contribution rates exceed previous year's contribution rates by more than 3% of payroll. The City Council must approve utilization of this reserve at the time of the budget hearing. This reserve will be replenished from the unreserved, undesignated fund balance after the 15% requirement of the operating expenditures has been met.
35. The City will maintain a Storm Drain replacement reserve to replace and repair storm drain pump stations. Beginning in FY 2009-2010, the City will endeavor to set-aside \$500,000 annually from the General Fund reserve for this purpose.
36. The City will maintain a retiree medical benefits account established by an irrevocable trust and fund the required contribution annually.
37. Other reserves designated in the General Fund for investment portfolio market gain, and sick leave payable will be calculated and adjusted annually at appropriate levels.
38. The City will maintain working capital in the Water and Sewer utility enterprise funds to provide for future capital projects and unanticipated emergencies, such as water main break repairs, pump station repairs. The City will attempt to maintain a working capital reserve of approximately 30% of the annual operating and maintenance expenses for Water utility fund and 25% of the annual operating and maintenance expenses for Sewer utility fund.
39. In addition, the City will maintain Infrastructure Replacement funds for both Water and Sewer utilities. The goal is to accumulate at least \$2 million a year from each utility fund to set-aside for replacement of infrastructure as the infrastructure reaches the end of its useful life.
40. The City will maintain at least \$300,000 in the Recycled Water utility fund for the purpose of infrastructure replacement and enhancement.
41. Reserve levels for Debt Service Funds will be established and maintained as prescribed by the bond covenants authorized at the time of debt issuance.
42. A minimum 30% of the estimated annual Gas Tax revenues will be set-aside as a reserve in the Street Fund to provide for street repair emergencies and other unanticipated traffic safety projects.
43. The City will maintain a capital reserve in an Equipment Replacement fund, set up as an internal service fund, to enable the timely replacement of vehicles and depreciable equipment as cost. The City will maintain a minimum fund balance of at least 30% of the replacement costs for equipment accounted for in this fund.

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least 30% of the replacement costs for equipment accounted for in this fund.

44. ~~The City will maintain a capital reserve for technological equipment replacement and will endeavor to set-aside an annual amount of \$250,000 in this fund.~~

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45. The City will maintain unreserved, undesignated fund balance of at least 15% of the annual operating revenues in the Redevelopment Project Fund for unforeseen capital needs and economic development opportunities such as land assemblage and developer assistance.

INVESTMENT POLICIES

46. The Finance Director/City Treasurer will annually render an investment policy for City Council's review and modification as appropriate. The review will take place at a public meeting and the policy shall be adopted by resolution of the City Council.

47. City funds and investment portfolio will be managed in a prudent and diligent manner with emphasis on safety, liquidity, and yield, in that order.

48. Reports on the City's investment portfolio and cash position shall be developed by the Finance Director/City Treasurer and reviewed by the City Council quarterly.

49. Generally Accepted Accounting Principles required that differences between the costs of the investment portfolio and the fair value of the securities be recognized as income or losses in a government's annual financial report. These variances shall not be considered as budgetary resources or uses of resources unless the securities are sold before maturity or the values of the investments are permanently impaired.

ACCOUNTING, AUDITING, AND FINANCIAL REPORTING POLICIES

50. The City's accounting and financial reporting systems will be maintained in conformance with generally accepted accounting principles as they apply to governmental accounting.

51. An annual audit will be performed by an independent public accounting firm with the subsequent issuance of a Comprehensive Annual Financial Report, within six months of the close of the previous fiscal year.

52. Periodic financial reports and status reports will be submitted to the City Council at the end of each quarter and be made available to the public. The report will provide an analysis of budgeted versus actual revenues and expenditures, on a year-to-date basis.