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Contra Costa County



TO: BOARD OF SUPERVISORS

FROM: FINANCE COMMITTEE
John Gioia, Chair
Mary N. Piepho

DATE: December 20, 2005

SUBJECT: **General Fund Reserve Policy**

SPECIFIC REQUEST(S) OR RECOMMENDATION(S) & BACKGROUND AND JUSTIFICATION

RECOMMENDATION:

ACCEPT report from the Auditor-Controller and County Administrator regarding the County's fiscal outlook and the need for a General Fund Reserve Policy; ADOPT the attached General Fund Reserve Policy (Resolution 2005/1792).

FISCAL IMPACT:

No impact in current fiscal year. Fiscal year 2006-07 impact will be to increase the Contingency Appropriation by \$2 million. Eventually, following the proposed policy will achieve a minimum unreserved General Fund balance of 5% of budgeted General Fund revenues and a minimum total General Fund balance of 10% of budgeted General Fund revenues.

BACKGROUND:

On December 5 the Finance Committee reviewed and discussed the County's fiscal outlook and the following staff report regarding establishing a General Fund Reserve Policy. The Committee directed the County Administrator to report to the full Board on December 20, 2005 the recommendation to adopt the attached General Fund Reserve Policy (Resolution 2005/ 792).

During the FY 04-05 budget hearings, the Board of Supervisors requested that the Finance Committee review the budget process and identify areas for reform. On October 25, 2004, the Finance Committee considered and recommended changes to Contra Costa County's budget process. On March 1, 2005, the Board of Supervisors adopted the Finance Committee's recommended changes, including the recommendation to develop a policy for the use of fund balance and other one-time resources.

The policy was to address the following issues:

- Avoidance of the use of one-time resources for ongoing expenses
- Allocation of a set portion to a reserve for economic uncertainty
- Allocation of a set portion to one-time projects/expenses
- Allocation of a set portion for capital projects

JOHN GIOIA, DISTRICT I

MARY N. PIEPHO, DIST. III

CONTINUED ON ATTACHMENT: YES

SIGNATURE:

RECOMMENDATION OF COUNTY ADMINISTRATOR APPROVE RECOMMENDATION OF BOARD COMMITTEE OTHER

SIGNATURE(S):
ACTION OF BOARD ON: 12/20/2005

APPROVED AS RECOMMENDED OTHER

see attached addendum

VOTE OF SUPERVISORS

UNANIMOUS (ABSENT none)
AYES: _____ NOES: _____
ABSENT: _____ ABSTAIN: _____

Contact: Lisa Driscoll 335-1023

Cc: Mary Ann Mason, Deputy County Counsel
Steve Weir, County Clerk-Recorder
Jim Sepulveda, Sr. Deputy District Attorney

I HEREBY CERTIFY THAT THIS IS A TRUE AND CORRECT COPY OF AN ACTION TAKEN AND ENTERED ON MINUTES OF THE BOARD OF SUPERVISORS ON THE DATE SHOWN.

ATTESTED
JOHN SWEETEN, CLERK OF THE BOARD OF SUPERVISORS

BY:
DEPUTY

This report will attempt to address the following questions.

- What is a fund balance?
- What level of reserve is generally recommended?
- What ratio of general fund reserve to general fund budget do California counties maintain?
- Do other California Counties have a general fund reserve policy?
- Does Contra Costa County need a general fund reserve policy?
- If so, what might such a policy include?

What is a fund balance?

Per the Governmental Accounting, Auditing, and Financial Reporting guidelines, governmental fund reports depict the difference between their assets and liabilities as fund balance, which is divided into reserved and unreserved portions. The function of reserved fund balance is simply to isolate the portion of fund balance that is not available for the following period's budget. Unreserved fund balance measures current available financial resources.¹

The reservation of fund balance is necessary for two reasons:

- Resources not available for spending²
- Legal restrictions on spending³

Unreserved fund balance may, in turn, be subdivided into designated and undesignated portions. Designations represent management's intended future use of resources (e.g., contingencies, equipment replacement). Designations essentially reflect a government's self-imposed limitations on the use of otherwise available current financial resources.⁴

What level of reserve is generally recommended?

An adequate level of unreserved fund balance in the general fund is necessary to mitigate current and future risks and to preserve service levels. It also is an important element of long-term financial planning. For these reasons, laws and regulations often govern the appropriate levels of fund balance and unreserved fund balance in the general fund. Likewise, fund balance and unreserved fund balance are carefully monitored by credit rating agencies.⁵

The Governmental Accounting, Auditing, and Financial Reporting manual, among others, recommends that the appropriate policy-setting body within a government establish a formal policy on the level of unreserved fund balance to be maintained in the general fund.⁶

The adequacy of unreserved fund balance in the general fund should be assessed based upon a government's own specific circumstances. Nevertheless, the Government Finance Officers' Association (GFOA) formally recommends that the *minimum* level of unreserved fund balance in the general fund be no less than 5 to 15 percent of general fund revenue.

What ratio of general fund reserve to general fund budget do California counties maintain?

Attachment A is a report compiled by the Sonoma County Auditor-Controller's Department reflecting fifty-two (52) California counties' ratio of general fund reserve to general fund budget. The data used for this report are compiled from State Schedules 1, 2, 3, and 8, and reflect individual county reporting as of June 30, 2004. Analysis of the data in this report identifies the fifty-two counties' average cumulative general fund budget as \$708.1 million, their average cumulative general fund reserves/designations as \$69.8 million, and their ratio of reserves/designations to general fund budget as 9.9%. Of note, 7 counties had general fund reserves/designations to general fund budget of 0-5%; 14 counties had 5-10%; 12 had 10-15%; and 19 counties had over 15%. Comparatively, Contra Costa County was close to the average during this same reporting period with 9.7%. However, as of June 30, 2005, Contra Costa County has reduced its reserve ratio to 8.3% and is projected to have a reserve level of 6.3% as of June 30, 2006. In January 2006, when statewide individual county data is available, this report will be updated through June 30, 2005.

¹ Governmental Accounting, Auditing, and Financial Reporting Manual; Classification and Terminology Section.

² Ibid.

³ Ibid.

⁴ Ibid.

⁵ Ibid.

⁶ Ibid.

Do other California Counties have a general fund reserve policy?

Of the fifty-eight counties in California surveyed, only six responded (Contra Costa, Mariposa, San Luis Obispo, Solano, Sonoma, and Yolo). San Luis Obispo and Solano's budget policies both include a formal general fund reserve policy. San Luis Obispo puts five percent of total budget into a contingency appropriation; Solano puts five percent into the general fund reserve and an additional five percent into the general fund contingency appropriation.

Does Contra Costa County need a general fund reserve policy?

As previously stated, the Board of Supervisors recently recommended changes to Contra Costa's budget process, including the recommendation to develop a policy for the use of fund balance and other one-time resources (i.e. a general fund reserve policy). It was noted at that time that creating reserves is easier at a time when resources are growing faster than costs. However, in preparing to brief credit rating agencies for an upcoming Tax and Revenue Anticipation Notes (TRAN) borrowing, the County Administrator concluded that Contra Costa should adopt a reserve policy now, notwithstanding our resource constraint. As was noted in the Auditor's fiscal outlook presentation, the County has been depleting its fund balances and other reserves over the past three years. This use is not sustainable, and the County would be better served by adopting a plan of action to reverse this trend. A general fund reserve policy would be the first step in this direction.

If so, what might such a policy include?

The best reserve policies incorporate three main criteria:

- Establishing a target level of reserves;
- Specifying the appropriate circumstances for drawing down those reserves; and
- Directing the replenishment of reserves.

Establishing a target level of reserves

Per the September 2005 GFOA newsletter on Governmental Accounting, Auditing, and Financial Reporting (GAARF Review), perhaps the most common question posed in connection with local governmental financial statements is "How much unreserved fund balance is enough?" Although there is no single right answer to this question, it is possible to offer some practical guidance. As stated above, the GFOA recommends a minimum level of unreserved fund balance in the general fund of 5 to 15 percent of general fund regular revenues, or one to two months of general fund regular expenditures. In determining which end of the range to target, the GFOA goes on to advise the following:

- Higher levels of unreserved fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations, or if regular expenditures are highly volatile;
- The availability of resources in other funds may reduce the amount of unreserved fund balance needed in the general fund, just as deficits in other funds may require that a higher level of unreserved fund balance be maintained in the general fund;
- A larger amount of unreserved fund balance may be needed to avoid cash flow problems if the average maturity of receivables significantly exceeds the average maturity of payables;
- Governments sometimes designate a portion of unreserved fund balance to reflect tentative plans of management or the governing board. In that case, a government may wish to focus on unreserved, undesignated fund balance rather than on total unreserved fund balance;
- A larger amount of unreserved fund balance may be necessary to compensate for the added risk faced by local governments that must rely heavily upon a single corporate taxpayer or upon a group of corporate taxpayers in the same industry. The same holds true in regions prone to natural disasters; and
- Rapidly growing budgets are also an indicator that greater than normal levels of unreserved fund balance may be necessary in the general fund.

In Contra Costa County it is recommended that the goal of the unrestricted general fund reserve be set at 5% of general fund revenue. It will take Contra Costa several years to achieve this level of reserve. Once achieved, consideration may be given to the merits of increasing this goal.

Specifying the appropriate circumstances for drawing down those reserves

It is to be expected that the reserve or budgetary cushion will temporarily diminish when unforeseen pressures affect the general fund. Therefore, it is important to have a policy for drawing down reserves. The GFOA suggests those circumstances in which invasion of the general reserve may be warranted:

- Emergency
- Non-recurring expenses
- One-time capital cost

There is no "one-size-fits-all" definition of what constitutes an "emergency" for purposes of administering a reserve policy. Ultimately, an "emergency" is what the legislative body determines it to be. It will always reflect a careful balancing of the body's desire to maintain an adequate reserve, with its desire to maintain essential services – and, in some cases, its obligation to maintain statutorily required service levels.

Until the County reaches its general reserve goal, the budget process permits appropriations for one-time projects/expenses and capital projects. In the event the County realizes reserves above the minimum levels defined, the first use of such funds should be a designation for capital projects and other one-time uses, up to an amount equal to a certain percent of general fund revenues.

Directing the replenishment of reserves

If and when reserves are diminished, the legislative body should adopt a plan to replenish reserves to minimum levels within a specific timeframe.

THE BOARD OF SUPERVISORS OF CONTRA COSTA COUNTY, CALIFORNIA

Adopted this Resolution on December 20, 2005 by the following vote:



AYES: Gioia, Piepho, DeSaulnier, Glover and Uilkema
NOES: None
ABSENT: None
ABSTAIN: None

SUBJECT: ESTABLISHING A GENERAL FUND)
RESERVE POLICY)

Resolution No. 2005/792

WHEREAS, the Board of Supervisors has an interest in the County's long-term financial stability; and

WHEREAS, the establishment and maintenance of a reserve is a key element in enhancing the management of the County's finances and maintaining the County's credit quality; and

Whereas, the best reserve policies incorporate three main criteria: establishing a target level of reserves; specifying the appropriate circumstances for drawing down reserves; and directing the replenishment of reserves; and

WHEREAS, the Board of Supervisors acknowledges the importance of building reserves during periods of financial strength so that such reserves can be drawn upon during economic downturns; and

WHEREAS, the Board of Supervisors desires to balance the need to maintain a reserve for severe circumstances with the need to address revenue shortfalls, unanticipated expenses and emergency situations;

It is hereby RESOLVED by the Board that:

1. Effective immediately, Contra Costa County shall strive to achieve a minimum unreserved General Fund balance of 5% of budgeted General Fund revenues and a minimum total General Fund balance of 10% of budgeted General Fund revenues;
2. Until such time as the County has an unreserved General Fund balance equal to at least 5% of budgeted General Fund revenues, no less than \$2 million of year-end fund balance in any fiscal year shall be added to the appropriation for Contingency Reserve;
3. In the event the County realizes reserves above the minimum levels defined by this policy, the first use shall be to annually deposit the funds into an account designated for capital projects and other one-time uses, up to an amount equal to 1% of General Fund revenues per year;
4. Reserves may be drawn below the minimum level in order to address an unforeseen emergency, to fund a non-recurring expense, or to fund a one-time capital cost; but only following the adoption, by a four-fifths vote, of a resolution of the Board of Supervisors specifying the circumstances that justify the invasion of the minimum reserve level; and
5. Should reserves fall below the established minimum levels, a request to utilize reserve funds must be accompanied by recommendations for restoring, within three years, minimum reserve levels (fiscal stabilization plan).

I hereby certify that this is a true and correct copy of an action taken and entered on the minutes of the Board of Supervisors on the date shown

ATTESTED: (Date) 12/20/2005

John Sweeten, Clerk of the Board of Supervisors
And County Administrator

By _____ Deputy

cc: Lisa Driscoll, County Administrator
Steve Ybarra, Auditor

RESOLUTION 2005/792