



## MEMORANDUM

TO: MAYOR AND CITY COUNCIL

FROM: Martin P. Black, AICP, ICMA-CM, City Manager  
Jeffery Snyder, CPA, Finance Director

DATE: July 5, 2006

RE: Financial Status and Policies Overview

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### Background

Over the course of the last two years, City Council has received periodic updates on the city's financial condition and policies. While these have typically been provided during the course of the budget process, there have been several occasions used to identify specific issues for City Council direction through individual meetings or through workshop settings. As an example, in a January of 2005 workshop the following policy questions were identified:

- Maintain millage reduction policy or present alternative with no reduction (defining what service enhancements would be obtained)? *[City Council confirmed maintaining at least a 1.5% annual millage rate reduction but with request to identify program impacts]*
- Performance management practices in initial stages of deployment wider application supported by City Council? *[City Council confirmed support and we have been generating organization-wide applications]*
- Modify internal service cost methodology? *[City Council took no specific action]*
- Direct Finance, in concert with other charter officers, to develop recommended changes to existing policy to match best practices as outlined by GFOA? *[City Council confirmed moving to implement best practices, but no formal action has been taken to date]*
- Establish unreserved fund accounts, with minimum and targeted fund balances for general fund and each enterprise fund? *[City Council confirmed support, but no formal action has been taken to date]*

In addition, the following critical considerations for future city budgeting were reviewed:

- Diversity and range of sources.
- Economic conditions impacts.
- Infrastructure and capital asset maintenance and replacement.
- New facility and service costs.
- Disaster fiscal policy.
- Fund balances/cross fund borrowing.

City Council consensus direction on these questions and considerations has served as the basis for developing each of the preceding year budgets. Significant progress on a comprehensive updating of financial policies was delayed pending the hiring of a new Finance Director and bringing the Finance Department up to full staffing.

With the engagement of a permanent Finance Director this spring, we met to review the budget and to prioritize financial data and analysis issues that were in need of attention. Included for review were several of the items that were highlighted from the January 2005 workshop and areas in the city's financial practices and policies that needed attention. Reflecting the cooperative team approach emphasized by City Council and the Mayor during the selection process, the City Manager's Office staff and Finance Department worked together to identify issues and recommended future steps. To date, this has included moving forward with enabling the use of credit cards for payment of city services, completing a review of the historical audits and financial statements, a review of revenue and expense projections by fund type, examination of cost allocation models, and a detailed review of historical city practices involving fund balances and cross fund borrowing. Many of these have included approvals for contracts and other components by City Council.

Recently the City Manager and Finance Director completed a series of one-on-one briefings to bring City Council up to date on the progress made and to confirm our joint recommendation to address a number of outstanding items. With the recent discussions by City Council and the Charter Review Board, there have arisen several misunderstandings regarding the issues we identified and whether the form of government contributed or facilitated these legacy decisions.

#### Legacy Decisions and Recommended Policy Changes

As identified originally in the January 2005 workshop, there were several practices that were targeted for modification as a result of changes to the Governmental Accounting Standards Board requirements, best practices of the Government Finance Officers Association and the International City/County Management Association, and local conditions particular to the city's geography and operations. Specifically, the following areas are highlighted for your consideration:

- Increase minimum reserve balances to three months with targeted reserves for each fund at four months in order to reflect the particular risks associated with being a coastal community [*this is a change to prior policy/practices, but consistent with the January 2005 recommendations*].
  - *The Airport, Stormwater Management, Solid Waste and Building Inspection Funds meet this proposed policy. Both the General Fund and Utilities Fund will require a long-term implementation program to achieve these recommendations.*

- Modify the general administrative charges methodology to reflect a standard federal cost allocation model *[this is a change to prior policy/practices]*.
  - *We have engaged a consultant to develop recommended cost allocation models for all funds and expect to present these for City Council consideration later this summer.*
  
- Require all long-term (greater than one year) inter-fund loans/borrowing (advances) to be with interest and terms to match the city's rate of return on investments *[this is a change to prior policy/practices, but consistent with the January 2005 review]*.
  - *Past practices have been inconsistent. In some cases, re-payment schedules have been defined, while in other cases no re-payment schedule is evident.*
  - *The following examples of historical inter-fund loans/borrowing are reflected in current and prior year City Comprehensive Annual Financial Reports and Auditor's statements and therefore should not be interpreted to be discovery of any heretofore unknown practices.*
  - *One of the highest balances without an apparent re-payment schedule is approximately \$941K loaned to the Group Life and Health Fund to cover health care deficits that were allocated as follows: Pre-1988 - \$141,107; November 2002 - \$200,000; and October 2003 - \$600,000. We recommend that this loan be balanced out utilizing general fund unrestricted funds as part of this year's budget approval and that repayments be made to those funds that advanced funds to cover the deficit. It is not reasonable to expect that the Group Life and Health Fund will generate revenues, so this repayment is considered prudent for more accurately reflecting the General Fund's fiscal health.*
  - *The highest balance is approximately \$9.3M loaned to the Utility Fund from the General Fund that was allocated as follows: Pre-2003 - \$5.3M; and an additional \$4.1M in FY04-05. Fortunately, the last fiscal year has seen the specific set aside of \$1.0M in the Utility Fund for renewal and replacement funds and an increase in cash flow to a net of just over \$750K. We recommend that a formal, long-term repayment schedule be implemented so that neither the Utility Fund, nor the General Fund is unnecessarily adversely impacted.*

- Only permit inter-fund loans/borrowing after specific approval by City Council *[this is a change to prior policy/practices, but consistent with the January 2005 review]*.
  - *Past practices of previous City Managers and Finance Directors dating back to pre-1988, included some cases where City Council approval was sought for these types of actions and some others where no apparent, pre-authorization was provided.*
  - *Since City Council had not established any formal financial policies that would otherwise limit or prohibit these actions, the decisions by the City Manager and Finance Director working in concert did not specifically violate city policy.*
  - *These actions, however, do not reflect current best practices and we recommend that formal policies be adopted that will allow for the independent auditor to specifically report on whether both the City Manager and Finance Director have acted in compliance with these policies.*
  - *This recommendation is independent of any underlying charter authority or perceived balance of accountability since these types of actions would have historically required the cooperation and consent of both the city manager and finance director at the time the inter-fund loans/borrowing occurred and no formal policy existed to establish parameters under which these types of internal financing would be appropriate.*

### **Summary Financial Status**

As previously indicated, the Stormwater Management, Solid Waste, Airport, and Building Inspection Funds all carry sufficient unrestricted reserves to meet or exceed best practices as identified by the Government Finance Officers Association and the International City/County Management Association. The General Fund appears to meet or exceed these practices as well, but a substantial portion of the balance is attributed to the approximately \$9.3M due from the Utility Fund. In effect, the loan balance due from the Utility Fund accounts for the desired operating reserves in the General Fund. Repayment will take approximately 15 years at current rates while still providing for needed funds to maintain a reasonable renewal and replacement program. Continued conservative fiscal practices will be needed to ensure that the outlook for the city's long-term fiscal health remains positive.

**City Council Recommended Action**

We recommend that City Council confirm the following direction for revisiting financial policies and directing the Finance Director and City Manager to coordinate with the City Attorney and City Clerk to present appropriate resolutions and/or ordinances that:

1. Increase minimum reserve balances to three months with targeted reserves for each fund at four months in order to reflect the particular risks associated with being a coastal community.
2. Only permit long-term (greater than one year) inter-fund loans/borrowing after specific approval by City Council.
3. Require all long-term inter-fund loans/borrowing to be with interest and terms to match the city's rate of return on investments.
4. Modify the general administrative charges methodology to reflect a standard federal cost allocation model.
5. Require the independent auditor to specifically report out whether both the City Manager and Finance Director have acted in compliance with these policies.
6. Confirm establishing a repayment program for the funds due from the Utilities Fund to the General Fund.
7. Confirm balancing out the Group Health and Life Fund with General Fund reserves and that repayment will be made to those funds that advanced funds to cover the deficit.

cc: Charter Officers  
Department Directors