



Comprehensive Fund Balance and Reserve Policy

Policy Purpose

The City desires to maintain a prudent level of financial resources to guard its stakeholders against service disruption in the event of unexpected temporary revenue shortfalls or unpredicted one-time expenditures. In addition, this policy is intended to document the appropriate Reserve level to protect the City's credit worthiness and provide adequate cash flow based upon the traditional operating cycle. Reserves are accumulated and maintained to provide stability and flexibility to respond to unexpected adversity and/or opportunities and to minimize the costs associated with short-term cash borrowing. Standard & Poor's Global Rating Services and Moody's Investors Service analysis in addition to Government Finance Officers Association (GFOA), recommends the establishment of a formal fund balance policy because they "minimize political considerations of adequate reserve levels and keep the municipalities more focused on providing structural balance in their operations."

This policy will ensure that the City maintains an adequate fund balance in the City's general fund for the purposes of:

- Providing sufficient cash flow for daily operations
- Securing and maintaining a higher investment grade bond rating
- Offsetting significant economic declines or revenue shortfalls
- Providing funds to meet unforeseen emergency expenditures
- Demonstrating a commitment to long-term financial planning objectives

The Governmental Accounting Standards Board ("GASB") issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* ("GASB-54"). One objective of this standard was to improve, including the understandability, the usefulness of fund balance information by providing clear fund balance classifications. GASB-54 abandoned the reserved, unreserved, and designated classifications of fund balance and replaced them with five classifications: nonspendable, restricted, committed, assigned, and unassigned.

GASB-54 requires local governments to focus on the constraints imposed upon resources when reporting fund balance in governmental funds. The fund balance classifications indicate the level of constraints placed upon how resources can be spent and identify the sources of those constraints. The following five classifications serve to inform readers of the financial statements of the extent to which the City is bound to honor constraints on the specific purposes for which resources in a fund can be spent.

For clarification purposes, the terms GAAP fund balance and budgetary fund balance are distinguished in two different uses of the same term. Budget professionals commonly use this same term to describe the net position of governmental funds calculated on a government's budgetary basis. While in both cases fund balance is intended to serve as a measure of the financial resources available in a governmental fund; it is essential that differences between GAAP fund balance and budgetary fund balance be fully appreciated.¹

For the intentions of this policy, budget fund balance will represent net cash reserve position and cash receivables. However, GAAP fund balance must be recognized for Governmental Fund and GASB-54 purposes.

Definitions

Fund Balance Reporting in Governmental Funds

Nonspendable Fund Balance – Fund balance reported as “nonspendable” represents fund balance that is:

- (a) not in a spendable form such as prepaid items; or
- (b) legally or contractually required to be maintained intact such as an endowment.

Classification - Non-spendable amounts will be determined before all other classifications and consist of the following items (as applicable in any given fiscal year):

- a. The City will maintain a fund balance equal to the balance of any long-term outstanding balances due from others (including other funds of the City),
- b. The City will maintain a fund balance equal to the value of inventory balances and prepaid items (to the extent that such balances are not offset with liabilities and actually result in fund balance),
- c. The City will maintain a fund balance equal to the corpus (principal) of any permanent funds that are legally or contractually required to be maintained in-tact, and
- d. The City will maintain a fund balance equal to the balance of any land or other non-financial assets held for sale.

Restricted Fund Balance – Fund balance reported as “restricted” consists of amounts that can be spent only on the specific purposes stipulated by law, enabled legislation or by the external providers of those resources. An example would be debt reserve funds as established by debt covenant or other funds established by laws or legislation.

Committed Fund Balance – Fund balance reported as “committed” are self-imposed limitations set in place prior to the end of the fiscal period. These amounts can be used only for the specific purposes determined by a formal action of the City Commission, which is the highest level of decision-making authority, and that require the same level of formal action to remove the

constraint. An example would be committing hotel/motel tax funds for future construction of a Visitor's Center.

Authority to Commit - Commitments will only be used for specific purposes pursuant to a formal action of the City Council. The action to commit funds must occur prior to fiscal year-end, to report such commitments in the balance sheet of the respective period, even though the amount may be determined subsequent to fiscal year-end. A vote is required to approve a commitment and a majority vote is required to remove a commitment.

Assigned Fund Balance – Fund balance reported as “assigned” consists of amounts that are subject to a purpose constraint that represents an intended use established by the City Commission or by their designated body or official. The City Commission has hereby authorized the City Manager as the official to assign fund balance to a specific purpose. The purpose of the assignment must be narrower than the purpose of the General Fund. Formal action is *not* necessary to impose, remove, or modify a constraint in Assigned Fund Balance. Additionally, this category is used to reflect the appropriation of a portion of existing fund balance to eliminate a projected deficit in the subsequent year’s budget. An example would be encumbrances (i.e. Purchase Orders) for purchase of goods, supplies and/or construction services.

Authority to Assign - The City Commission delegates the responsibility to assign funds not to exceed \$50,000 to the City Manager or their designee to be used for specific purposes. City Council shall have the authority to assign any amount of funds to be used for specific purposes. Such assignments cannot exceed the available (spendable, unrestricted, uncommitted) fund balance in any particular fund. The assignments may occur subsequent to fiscal year-end.

Unassigned Fund Balance – Fund balance reported as “unassigned” represents the residual classification of fund balance and includes all spendable amounts not contained within the other classifications. An example would be spendable funds not classified as non-spendable, restricted, committed or assigned.

Authority

The Canyon City Commission is responsible for the approval of financial policies which establish and direct the operations of the City of Canyon. The City Manager is responsible for carrying out the policy directives of the City Commission and managing the day-to-day operations of the executive departments, including the Department of Finance. This policy shall be administered on behalf of the City Manager by the Director of Finance.

Monitoring Performance

The City will measure its compliance with this policy on an annual basis during the City's budgeting process. During the course of the fiscal year the Department of Finance shall closely monitor the City's revenues and expenditures to ensure Reserves are not used beyond any planned usage. If the target level of Reserves is not met at fiscal year-end or is not likely to be met at any point within a ten-year time horizon, then during the annual budget process a plan to replenish the Reserve levels will be developed by collaboration among affected departments and the Department of Finance based on the requirements outlined in this policy.

Periodic Review of the Targets – At a minimum, during the annual financial planning/budget process staff shall review the current and ten-year projected Reserves to ensure that they are appropriate given the economic and financial risk factors the City is subject to.

Funding the Reserves

Funding of Reserve (unassigned fund balance) targets will generally come from excess revenues over expenditures or one-time revenues.

Excess of Reserves

In the event Reserves exceed the minimum balance requirements, at the end of each fiscal year, any excess Reserves may be used in the following ways:

1. Fund long-term accrued liabilities, including but not limited to debt service, pension liability, and other postemployment benefits (for example, OPEB liability) as directed and approved within the long-term financial plan and the annual budget ordinance. Priority will be given to those items that relieve budget or financial operating pressure in future periods;
2. Appropriated to lower the amount of bonds or debt service payments (all forms of debt);
3. Increase the pay-as-you-go contributions needed to fund capital projects in the City's Capital Improvement Plan;
4. Increase the contributions needed to fund equipment in the City's Capital Equipment Fund;
5. One-time expenditures that do not increase recurring operating costs that cannot be funded through current revenues. Emphasis will be placed on one-time uses that reduce future operating costs; or
6. Start-up expenditures for new programs, provided that such action is approved by the City Council and is considered in the context of multi-year projections of revenue and expenditures as prepared by the Department of Finance.

Designated Reserves

The following fund reserves are utilized by the City of Canyon:

- General Fund Reserve
- CIP General Reserve
- Utility Fund Reserve
- CIP Enterprise Reserve
- Debt Service Reserve

General Fund Reserve

Components of the Reserve:

- Operating Expenses – The City will maintain a Budget Fund Balance in the General Fund equivalent to, at a minimum, twenty-five percent (25%) of regular ongoing operating expenditures (equivalent to 3 months) and, at a maximum, thirty-five percent (35%) of regular ongoing operating expenditures. For the purposes of this policy, current fiscal year’s actual expenditures will exclude significant non-recurring items.¹
- Debt Service – In addition to the aforementioned reserve for operating expenses, the City will typically have a level of Fund Balance in the Debt Service Fund for debt service payments for Bonds.²

General Capital Improvement Program (CIP) Reserve

Components of the Reserve:

- Capital Funding – The City will fund the General Capital Improvement Program (CIP) Fund to, at a minimum, fully fund the General Fund capital projects (excludes other Funds-Utility, Golf, etc.) identified in the next year of the City’s Five-Year Capital Improvement Plan and, at a maximum, to fund all General Fund projects identified in the plan. For the purposes of this policy, any projects to be financed by new issuance of debt will be excluded from this calculation.³

Utility Fund Reserve

Components of the Reserve:

- Operating Expenses – The City will maintain a Budget Fund Balance in the Utility Fund equivalent to, at a minimum, fifteen percent (15%) of regular ongoing operating expenditures and, at a maximum, twenty-five percent (25%) of regular ongoing operating expenditures. For the purposes of this policy, current fiscal year’s actual expenditures will exclude significant non-recurring items and depreciation expense.⁵

Enterprise Capital Improvement Program (CIP) Reserve

Components of the Reserve:

- Capital Funding – The City will fund the General Capital Improvement Program (CIP) Fund to, at a minimum, fully fund the Utility Fund and Golf Fund capital projects (excludes other Funds-General, other governmental-funds, etc.) identified in the next year of the City’s Five-Year Capital Improvement Plan and, at a maximum, to fund all Enterprise Fund projects identified in the plan. For the purposes of this policy, any projects to be financed by new issuance of debt will be excluded from this calculation. ³

Debt Service Reserve

Components of the Reserve:

- Debt Service – Although limited by State legislation effected through the setting of property tax rates, the City will attempt to maintain a minimum level of Fund Balance in the Utility Fund equal to debt service payments due within the next 6 months. ²

Designated Circumstances

The minimum reserves (unassigned fund balance) may be spent under these circumstances:

- Natural disasters, including but not limited to tornados, fire or flood.
- Opportunities for a grant in which the matching portion may require a portion of the minimum unassigned fund balance.
- Shortfall in the budgeted revenue in excess of 20%.
- Unforeseeable expenditures in excess of 20% over budget.
- When unforeseen circumstances or emergencies in another fund require a fund transfer from the General Fund.

Replenishment of Reserves

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1. When designated circumstances have reduced the reserve balance below the targeted minimum level, the replenishment is to occur within 12 months.
 2. Depending on the severity of the reduction of the minimum reserve the following measures will be taken to replenish the reserve fund balance:
 - a. Should calculations reveal that the minimum reserve balance will be replenished through normal activity within the next 12 months no action is necessary
 - b. Reduction of expenditures
 - c. Delay of capital purchases
 - d. Increase in fees and/or taxes
 - e. Salary freeze
 - f. Hiring freeze

A Snapshot of Targeted Reserves vs Actual (actual balances as of 5/31/2022)

Reserve	Minimum 2022 Target	Maximum 2022 Target	Actual
General Fund	\$ 3,139,505 (25%)	\$ 4,395,307 (35%)	\$ 3,606,256
Utility Fund	\$ 1,756,157 (15%)	\$ 2,926,929 (25%)	\$ 1,808,094
Total Reserve Balance	\$ 4,895,662	\$ 7,322,236	\$ 5,414,350
General CIP	N/A	N/A	\$ 581,550
Enterprise CIP	N/A	N/A	\$ 3,001,413
Debt Service Fund Amount (restricted)	N/A	N/A	\$ 367,962

(Note: The minimum reserve fund will be invested, per the Canyon Investment Act. General CIP and Enterprise CIP Reserve balances are for information purposes ONLY.)

References / Sources / Justification

- ¹ The Government Finance Officers Association (GFOA) recommends, at a minimum, that general purpose governments, regardless of size, maintain unrestricted budgetary fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures. GFOA acknowledges that a government’s particular situation may require a level of unrestricted fund balance (aka reserves) in the general fund significantly in excess of this recommended minimum level. The City of Canyon utilizes expenditures as a basis for its minimum calculation because it is more predictable than revenues. The City has established a higher three-month (25%) minimum balance based upon (1) the unpredictability of its revenues, sales tax revenue in particular, (2) the perceived exposure to significant one-time outlays, such as natural disasters, (3) the potential drain upon general fund resources from other funds, (4) the potential impact on the City’s bond ratings, and (5) existing commitments and assignments for pension fund liability, reliever route maintenance, etc.
- ² The Municipal Securities Rulemaking Board (MSRB) states that a typical debt service reserve fund requirement might be a fixed percent of the outstanding par value or the maximum annual debt service of the issue(s). The City of Canyon has chosen to go with the latter.
- ³ Best practice established by the City of Fort Worth, Texas in their 2014-15 Financial Management Policy Statements.

- 4 GFOA's A Risk-Based Analysis of General Fund Reserve Requirements, May 2013. This factor concerns the extreme events (e.g., natural disasters) the City is vulnerable to, the public safety programs that must be funded during the occurrence of an extreme event, and the federal or state programs that would help and how long it would take to get assistance. For example, reimbursement from the Federal Emergency Management Agency (FEMA) does not always occur right away, so it is important to have reserves to absorb the cost in the meantime, and FEMA does not necessarily reimburse 100 percent of the cost of responding to an event.
- 5 GFOA's Determining the Appropriate Levels of Working Capital in Enterprise Funds (Best Practice) recommends that governments develop a target amount of working capital that best fits local conditions for each fund, starting with a baseline of ninety (90) days of working capital and then adjusting the target based on the particular characteristics of the enterprise fund in question. The City of Andrews has set a higher minimum based upon the following considerations: (1) large peaks and valleys in cash position during the year, (2) volatility in demand for services, and (3) difficulty in raising rates and revenues.
- 6 The City of Canyon Fiscal Principles & Policies states "The City maintains a pay-as-you-go philosophy regarding capital expenditures."