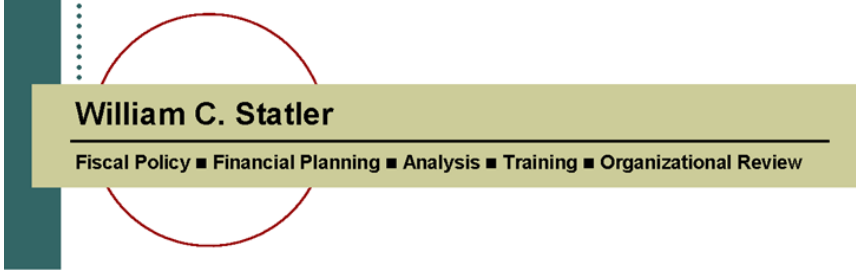




BUDGET AND FISCAL POLICIES REPORT

June 2023



William C. Statler

Fiscal Policy ■ Financial Planning ■ Analysis ■ Training ■ Organizational Review



Budget and Fiscal Policies Report

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Proposed Budget and Fiscal Policies

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City of Carpinteria BUDGET AND FISCAL POLICIES REPORT

The purpose of this report is to present recommended budget and fiscal policies that will help provide a solid foundation for financial decision-making in both good times and bad. It builds on policies and practices already in place while taking into consideration “best practices” used in other agencies as well as those recommended by the Government Finance Officers Association of the United States and Canada (GFOA), California Society of Municipal Finance Officers (CSMFO) and credit rating agencies.

As discussed below, this work is organized into two phases:

- Phase 1: Policies that most directly affect the budget process and administration. This is the focus of this report.
- Phase 2: Other important fiscal policies that will be presented for Council consideration in Fall 2023.

As discussed below, it is recommended that *Budget and Fiscal Policies* be included in the Budget document.

BACKGROUND

The Power of Fiscal Policies

When clearly articulated (and followed), budget and fiscal policies provide an essential foundation for effective financial decision-making and in protecting the City’s fiscal health, in both the short and long-term.

The City’s fiscal health is a lot like personal health: it isn’t what you live for; but it is hard to enjoy your life without it. Cities don’t exist to be fiscally healthy: they exist to make communities better places to live, work and play. However, this requires the fiscal capacity to link community goals with the resources needed to achieve them. In short, fiscal health is not an end in itself; but it is an important part of the tool kit in achieving “ends.”

And like personal health, fiscal health is rarely luck. The strength of the local economy is obviously an important fiscal health factor – just as genes are in personal health. However, regardless of the strength of its local economy, no city is immune from economic downturns or unexpected expenditure needs.

For this reason, clearly articulated policies are a city’s “north star” in guiding the preparation and implementation of budgets and financial plans.

They help make tough decisions easier by stating an organization’s values before they are placed under stress by adverse circumstances. The organization might still choose to do something different – effective policies are guides, not straightjackets – but they are a powerful starting point: but for “this,” the organization should do what?

Formal statements key budget and fiscal policies provide the foundation for assuring long-term fiscal health by establishing a clear framework for effective and prudent financial decision-making.

Stated simply, articulating and then following prudent fiscal policies is the most effective and proven way for cities to ensure their long-term fiscal health.

They are both preventative and curative: clearly articulated policies help prevent problems from arising in the good times; and help respond to bad times when they do occur. They also help provide continuity as elected officials and staff change. Lastly, they are most powerful when put in place before the need for them arrives.

In summary, adopting key budget and fiscal policies is an essential factor for effective stewardship of the City’s resources, both in the short and long-term.

Proposed Budget and Fiscal Policies: Phase 1

“One size does not fit all” in setting fiscal policies. Careful consideration needs to be given in developing policies that are appropriate given the unique circumstances of each city.

As noted above, there are five recommended “Phase 1” policies proposed at this time. These build on current policies and practices; and recommended “best practices” by professional organizations like GFOA and CSMFO as well as credit rating agencies.

“Phase 2” fiscal policy areas that are proposed for later Council consideration are presented in the sidebar.

Budget Purpose and Organization. These include balanced budget (and what that means); budget purpose and objectives; goals and reporting; and formal mid-year budget review.

Phase 2 Fiscal Policies

There are other policies that can also provide a strong foundation for fiscal health but are not directly related to the budget process and administration. In following sage advice on how to eat an elephant (one bite at a time), the following policies are proposed for Council review in Fall 2023:

- User fee cost recovery (review current policy).
- Cash and investments (review current policy).
- Capital improvement plan (CIP) management.
- Capital financing and debt management.
- Use of Section 115 Pension Trust Fund.

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Revenue Management. These address “one-time revenues for one-time purposes;” revenue distribution; grant management; and interfund transfers and loans.

Minimum Fund balance and Reserves. These are based on conceptual and current policies already in place:

- A Reserve for Fiscal Stability, Cash Flow and Contingencies was conceptually approved by the Council on January 24, 2022 based on the comprehensive report presented at that time: https://carpinteria.granicus.com/MetaViewer.php?view_id=2&clip_id=964&meta_id=66139.

While this policy retains the City’s longstanding practice of setting the reserve for this purpose at 40%, it also provides guidance on:

1. *Purpose of reserves.* Reserves exist for a reason. The proposed policy sets forth those purposes in accordance with the risk assessment methodology developed by the GFOA.
 2. *Guidance on when it is appropriate to go below the minimum target.* The proposed policy clarifies the one-time circumstances where taking reserves below the target minimum balances would be appropriate.
 3. *Restoring the reserve if it falls below the target minimum.* The proposed policy provides for restoring reserves to policy levels within five years; and as revenues versus expenditures improve, allocating at least 50% to restoring the reserve.
- Reserves for General Reserve and Major Asset Replacement and Repair Reserve policies currently set forth in Resolution 5786 adopted in April 2018.

Financial Reporting and Budget Administration. These include annual financial reporting; interim financial reporting; budget administration; and fiscal impact review.

Human Resources Management. These address managing staffing costs: regular staffing, temporary staffing, overtime management and contract services.

INCLUDING BUDGET AND FISCAL POLICIES IN THE BUDGET DOCUMENT

Having clear fiscal policies has the greatest value during the budget preparation, review and adoption process. For this reason, it makes sense to include key budget and fiscal policies in the Budget document.

POLICY COMPLIANCE

In considering the proposed *Budget and Fiscal Policies*, it is important to not only clearly articulate the policy, but to assure compliance with it. Stated simply, clearly stating where the City wants to be (versus where it may be today) will significantly enhance the City’s ability to achieve it.

Budget and Fiscal Policies Report

For this reason, each policy area is followed by a brief summary of “compliance status.” Where the City has not yet achieved the goal, a status summary of the City’s progress in doing should be provided. (In this case, the City is in compliance with all of the proposed policies). In short, including the policies in the Budget document and indicating its compliance status will keep the policies in front of the Council, community and organization; and help make the relationship between policy and “actual” transparent for these stakeholders.

NEXT STEPS

If approved by the Council at this time, these policies should initially be adopted by resolution. Following this, Budget and Fiscal Policies (along with any future additions or revisions) will be included with the Preliminary Budget and formally adopted by the Council via budget approval.



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Proposed Budget and Fiscal Policies





BUDGET PURPOSE AND ORGANIZATION

A. **Balanced Budget.** The City will maintain a balanced budget. This means that:

1. Operating revenues should fully cover operating expenditures, including debt service.
2. Ending fund balance must meet minimum policy levels or other target levels established by the Council for the fiscal year.

Under this policy, it is allowable for total expenditures and uses to exceed revenues and other sources in a given year; however, in this situation, beginning fund balance should only be used to fund capital improvement plan projects or other “one-time,” non-recurring expenditures. (See *Fund Balance and Reserves* policy for other circumstances when it would be appropriate to use beginning fund balance.)

B. **Budget Objectives.** Through its Budget, the City will link resources with goals and results by:

1. Identifying community needs for essential services.
2. Organizing the programs required to provide these essential services.
3. Describing programs and activities performed in delivering services.
4. Proposing objectives for improving the delivery of program services.
5. Identifying and appropriating the resources required to perform program activities and accomplish program objectives.

C. **Measurable Objectives.** The Budget will establish measurable program objectives and allow reasonable time to accomplish those objectives.

D. **Budget Adoption by Resolution.** The City’s annual Budget is adopted by Resolution. If the Budget is not approved prior to the end of the fiscal year, the Preliminary Budget, except for capital outlays, becomes the City’s interim budget until the new budget is adopted.

E. **Goal Status Reports.** The status of major program objectives will be formally reported to the Council on an ongoing, periodic basis.

F. **Mid-Year Budget Reviews.** The Council will formally review the City’s fiscal condition, and amend appropriations, if necessary, based on six months of results and emerging trends since the beginning of the fiscal year.

Status: In Compliance. These practices are either in place or the Council has adopted a budget process and document for 2023-24 that meets these policy objectives. However, linking resources to outcomes and measuring performance will always be a work in progress, with ongoing improvements.



REVENUE MANAGEMENT

- A. **Current Revenues for Current Uses; One-Time Revenues for One-Time Purposes.** The City will make all current expenditures with current revenues, avoiding procedures that balance current budgets by postponing needed expenditures, accruing future revenues or rolling over short-term debt. The City will avoid using one-time revenues to fund ongoing program costs.
- B. **Revenue Distribution.** The Council recognizes that generally accepted accounting principles for state and local governments discourage the “earmarking” of General Fund revenues, and accordingly, the practice of designating General Fund revenues for specific programs should be minimized in the City's management of its fiscal affairs. In those cases where it does occur, the basis and methodology for earmarking should be clearly articulated in the City’s Budget and Fiscal Policies.
- C. **Grant Management.** Intergovernmental assistance in the form of grants and loans will be used to finance only:
1. Capital improvements that are consistent with capital improvement plan (CIP) priorities and can be maintained and operated over time.
 2. Technological upgrades or enhancements.
 3. Capital acquisition items.
 4. Operating programs which either can be sustained over time or have a limited horizon.
 5. Other areas as determined by the Council to be in the best interest of the City.
- D. **Interfund Transfers and Loans.** In order to achieve important public policy goals, the City has established various special revenue and capital project funds to account for revenues whose use should be restricted to certain activities. Accordingly, each fund exists as a separate financing entity from other funds, with its own revenue sources, expenditures and fund balance.

Any transfers between funds are clearly set forth in the Budget and can only be made by the Administrative Services Director in accordance with the adopted budget. These transfers, under which financial resources are transferred from one fund to another, are distinctly different from interfund borrowings, which are usually made for temporary cash flow reasons, and are not intended to result in a transfer of financial resources by the end of the fiscal year.

In summary, interfund transfers result in a change in fund balance; interfund borrowings do not, as the intent is to repay the loan in the near term.

From time-to-time, interfund borrowings may be appropriate; however, these are subject to the following criteria in ensuring that the fiduciary purpose of the fund is met:

1. The Administrative Services Director is authorized to approve temporary interfund borrowings for cash flow purposes whenever the cash shortfall is expected to be resolved within 60 days. The most common use of interfund borrowing under this circumstance is for grant programs,



where costs are often incurred before drawdowns are initiated and received. However, receipt of funds is typically received shortly after the request for funds has been made.

2. Any other interfund borrowings for cash flow or other purposes require case-by-case approval by the Council.
3. Any transfers between funds where reimbursement is not expected within one fiscal year shall recorded under one of the following options:
 - a. Where the terms and conditions of repayment are uncertain, they should not be recorded as interfund loans but as interfund transfers that affect fund balance by moving financial resources from one fund to another. In this case, the intent to repay should be documented in the Budget or via Resolution.
 - b. Where repayment is more certain, long-term loans may be recorded as such; and in accordance with generally accepted accounting principles, their balance will be recorded as non-spendable fund balance. In this case, the terms and conditions of loan repayment, including need for the loan, source of repayment funds, interest rate (if any) and amortized repayment schedule, should be documented via Resolution.

***Status: In Compliance.** These practices are in place or the Council has adopted a budget process and document for 2023-24 that meets these policy objectives. There are currently no long-term interfund loans.*

MINIMUM FUND BALANCE AND RESERVES

A. Reserve for Fiscal Stability, Cash Flow and Contingencies

The City will strive to maintain a minimum General Fund unrestricted balance (less encumbrances and reappropriation carryovers) of at least 40% of operating and debt service expenditures plus subsidy transfers to other funds for fiscal stability, cash flow and contingencies such as economic downturns, catastrophic events and unforeseen operating or capital needs. This target is based on financial management best practices and industry standards, including the risk assessment methodology for setting reserve levels developed by the Government Finance Officers Association of the United States and Canada (GFOA) in adequately addressing:

1. Economic uncertainties, local disasters, public health crises and other financial hardships or downturns in the local or national economy.
2. Contingencies for unseen operating or capital needs, including strategic investment opportunities.
3. Unfunded liabilities such as pensions and retiree health obligations.
4. Dependency of other funds on the General Fund.
5. Institutional changes, such as State budget takeaways and unfunded mandates.
6. Cash flow requirements.



Whenever the City's General Fund unrestricted balance falls below this target, the City will strive to restore reserves to this level within five years. As revenues versus expenditures begin moving in a positive direction, the City will allocate at least half to reserve restoration, with the balance available to fund asset replacements, unfunded liabilities, capital improvement projects, service level restorations or new operating programs.

Circumstances where taking reserves below policy levels would be appropriate include responding to the risks that reserves are intended to mitigate, such as:

1. Meeting cash flow needs during the fiscal year.
2. Closing a projected short-term revenue-expenditure gap.
3. Responding to unexpected expenditure requirements or revenue shortfalls.
4. Making investments in unfunded liability reductions, economic development and revenue base improvements, productivity improvements and similar strategic opportunities that will strengthen City revenues, reduce future costs or achieve "one-time" high-priority City goals.
5. Where a forecast shows an ongoing structural gap: providing a strategic bridge to the future by providing time to develop and implement thoughtful solutions.

On the other hand, the City should avoid using reserves to fund ongoing costs or projected systemic "gaps." Stated simply, reserves can only be used once, so their use should be restricted to one-time (or short-term) uses.

- B. **General Reserve.** This reserve is maintained at a level of \$1,000,000 with interest earned on that balance segregated for use at the Council's direction.
- C. **Major Asset Replacement and Repair Reserve.** Similar to the General Reserve Fund, this reserve is maintained at a level of \$1,000,000 with interest earned segregated for use at the Council's direction.
- D. **Future Capital Project or Other Long-Term Goal Assignments or Commitments.** The Council may also commit or assign specific General Fund balance levels above the reserve targets above for fleet, facility, technology and equipment replacements; major repairs; future development of capital projects, unfunded liabilities and similar policy commitments and assignments for future purposes and long-term goals that it determines to be in the best interests of the City.
- E. **Other Commitments and Assignments.** In addition to the minimum targets noted above, unrestricted fund balance levels will be sufficient to meet funding requirements for programs or projects approved in prior years which are carried forward into the new year; debt service reserve requirements; commitments for encumbrances; and other restrictions, commitments or assignments required by contractual obligations, state law or generally accepted accounting principles.

Status: In Compliance. The 2023-24 Budget projects that the ending reserve will meet or exceed policy minimums.



FINANCIAL REPORTING AND BUDGET ADMINISTRATION

A. **Annual Reporting.** The City will prepare annual financial statements as follows:

1. In accordance with best practices and industry standards, the City will contract for an annual audit by a qualified independent certified public accountant. The City will strive for an unqualified auditors' opinion.
2. The City will use generally accepted accounting principles (GAAP) in preparing its annual financial statements. The Administrative Services Director is authorized to establish Accounting Policies as needed to conform with GAAP. The City will strive to meet the requirements of the GFOA's Award for Excellence in Financial Reporting program by issuing an Annual Comprehensive Financial Report.
3. The City will issue audited financial statements within 180 days after year-end.
4. Unexpended operating appropriations lapse at year, provided however that encumbrance balances will be carried-over and reappropriated into the following fiscal year. Project-length budgets are adopted for capital projects and accordingly unexpended/unencumbered balances will be carried over and reappropriated into the following fiscal year.

B. **Interim Reporting.** The City will prepare and issue timely interim reports on the City's fiscal status to the Council and staff. This includes on-line access for authorized users to the City's financial management system; monthly reports to program managers; more formal quarterly reports to the Council and Department Heads; mid-year budget reviews; and interim annual reports.

C. **Budget Administration.** The Council may amend or supplement the budget at any time after its adoption by majority vote of the Council members. Council approval is required for all new appropriations from fund balance. The City Manager has the authority to make administrative adjustments to the budget as long as those changes will not have a significant policy impact nor affect budgeted year-end fund balances.

D. **Agenda Report Review.** A Fiscal Impact Statement will be provided with each staff report submitted to the Council as part of the agenda packet.

Status: In Compliance. These practices are in place.

HUMAN RESOURCE MANAGEMENT

A. **Regular Staffing**

1. Unless otherwise approved by the Council to achieve one-time budgetary savings, the budget will fully appropriate the resources needed for authorized regular staffing and will limit programs to the regular staffing authorized.
2. Regular employees will be the core work force and the preferred means of staffing ongoing, year-round program activities that should be performed by full-time City employees rather than independent



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contractors or temporary employees. The City will strive to provide competitive compensation and benefit schedules for its authorized regular workforce. Each regular employee will:

- a. Fill an authorized regular position.
 - b. Receive salary and benefits consistent with labor agreements or other compensation plans.
3. To manage the growth of the regular work force and overall staffing costs, the City will follow these procedures:
- a. The Council will authorize all regular positions.
 - b. Human Resources will coordinate and approve the hiring of all regular and temporary employees.
 - c. All requests for additional regular positions will include evaluations of:
 - The necessity, term and expected results of the proposed activity.
 - Staffing and materials costs including salary, benefits, equipment, uniforms, clerical support and facilities.
 - The ability of temporary staff, overtime, private industry or other government agencies to provide the proposed service.
 - Additional revenues or cost savings that may be realized.

B. Temporary Staffing

1. The hiring of temporary employees will not be used as an incremental method for expanding the City's regular workforce.
2. Temporary employees include all employees other than regular employees, elected officials and volunteers. Temporary employees will generally augment regular City staffing as extra-help employees, seasonal employees, contract employees, interns and work-study assistants.
3. The City Manager and Department Heads will encourage the use of temporary rather than regular employees to meet peak workload requirements, fill interim vacancies and accomplish tasks where less than full-time, year-round staffing is required. Under this guideline, temporary employee hours will generally not exceed 50% of a regular, full-time position (1,000 hours annually). There may be limited circumstances where the use of temporary employees on an ongoing basis in excess of this target may be appropriate due to unique programming or staffing requirements. However, any such exceptions must be approved by the City Manager based on the review and recommendation of the Human Resources Administrator.
4. Contract employees are defined as temporary employees with written contracts approved by the City Manager who may receive approved benefits depending on hourly requirements and the length of their contract. Contract employees will generally be used for medium-term (generally between six months and two years) projects, programs or activities requiring specialized or augmented levels of staffing for a specific period.

The services of contract employees will be discontinued upon completion of the assigned project, program or activity. Accordingly, contract employees will not be used for services that are anticipated to be delivered on an ongoing basis.

5. Temporary staffing costs are limited by the approved Budget for these positions.



C. Overtime Management

1. Overtime should be used only when necessary and when other alternatives are not feasible or cost effective.
2. All overtime must be pre-authorized by the department head or delegate unless it is assumed pre-approved by its nature. For example, overtime that results when an employee is assigned to standby and/or must respond to an emergency or complete an emergency response.
3. Departmental operating budgets should reflect anticipated annual overtime costs and departments will regularly monitor overtime use and expenditures.
4. When considering the addition of regular or temporary staffing, the use of overtime as an alternative will be considered. The department will consider:
 - a. The duration that additional staff resources may be needed.
 - b. The cost of overtime versus the cost of additional staff.
 - c. The skills and abilities of current staff.
 - d. Training costs associated with hiring additional staff.
 - e. The impact of overtime on existing staff.

D. Private Sector Independent Contractors

Private sector independent contractors are not City employees. They may be used in two situations:

1. Short-term, peak workload assignments to be accomplished using personnel contracted through an outside temporary employment agency (OEA). In this situation, it is anticipated that City staff will closely monitor the work of OEA employees and minimal training will be required. However, they will always be considered the employees of the OEA and not the City. All placements through an OEA will be coordinated through Human Resources and subject to the approval of the Human Resources Administrator.
2. Construction of public works projects and delivery of operating, maintenance or specialized professional services (such as attorneys, architects, fiscal advisors, bond counsel, engineers, scientists and other consultants) not routinely performed by City employees. Such services will be provided without close supervision by City staff, and the required methods, skills and equipment will generally be determined and provided by the contractor. Contract awards will be guided by the City's purchasing policies and procedures.

Status: In Compliance. These procedures are in place.