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OFFICE OF THE CITY CLERK
OAKLAND

CITY OF OAKLAND

AGENDA REPORT

2009 MAY 20 PM 7:22

Office of the City Administrator
ATTN: Dan Lindheim
FROM: Budget Office
DATE: May 26, 2009

RE: **Supplemental Report To The Finance And Management Committee Regarding
The Proposed Amendment To Ordinance No. 12502 C.M.S. To Clarify The
City's Financial Policies**

At the request of the Finance and Management Committee Chairperson, staff is providing two items for the Committee's review:

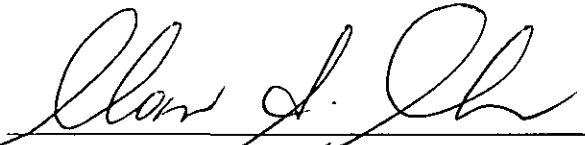
- "Fund Balance: New and Improved." This article was published in the April 2009 issue of *Government Finance Review*. It discusses the latest Governmental Accounting Standards Board (GASB) criterion that will alter the components of fund balance reporting. Government agencies must implement this new standard by the fiscal year ending June 30, 2011.
- A copy of the Negative Funds section, as presented in the Financial Summaries section of the FY 2009-11 Proposed Budget, for Council's review during budget deliberations.

Respectfully submitted,



CHERYL L. TAYLOR
Budget Director

APPROVED FOR FORWARDING TO THE
FINANCE & MANAGEMENT COMMITTEE



Office of the City Administrator

Attachment A: "Fund Balance: New and Improved." *Article from the Government Finance Review* (April 2009).

Attachment B: Listing of Negative Funds

Item: _____
Finance & Management Committee
May 26, 2009

Attachment A:

"Fund Balance: New and Improved." Article from the Government Finance Review (April 2009).

FIND BALANCE

NEW AND IMPROVED



BY STEPHEN J. GAUTHIER

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There is probably no single item in a typical state or local government's financial statements that attracts more attention than fund balance. In February 2009, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This latest GASB standard will not affect the calculation of fund balance, but will fundamentally alter the various components used to report it.

BACKGROUND

Accountants use the term *fund balance* to describe the arithmetic difference between the assets and liabilities reported in a governmental fund (e.g., general fund). The categories that have been used until now to present fund balance have focused on whether resources were *available for appropriation* (i.e., budgeting). Thus, the traditional presentation of fund balance distinguished *unreserved fund balance* (i.e., available for appropriation) from *reserved fund balance* (i.e., not available for appropriation).

Fund balance might not be available for appropriation (i.e., reserved) for a variety of reasons. Some resources of a governmental fund, by their very nature, cannot be spent (e.g., prepaid rent and inventories of supplies). Other resources may convert to spendable form only at a much later date (e.g., the long-term portion of notes receivable). Still other resources may be available for spending, but their use is externally restricted to a purpose narrower than the purpose of the fund in which they are reported.

In addition, governing bodies themselves frequently place their own limitations on how they will use resources otherwise available for appropriation (e.g., "earmarking"). Likewise, a government's management may have tentative plans for all or a portion of those resources. In either case, a government traditionally has had the *option* of indicating these tentative managerial plans and self-imposed limitations by presenting a portion of *unreserved fund balance as designated*.

This traditional approach to classifying fund balance is summarized in Exhibit 1.

Three considerations led the GASB to undertake its recent reexamination of the components used to report fund balance. First, the traditional terminology was not self-explanatory

and has frequently led to misunderstandings. Second, governments often have applied the different categories inconsistently in practice. Finally, some have questioned whether the historic focus on availability for appropriation best serves the needs of financial statement users.

There is probably no single item in a typical state or local government's financial statements that attracts more attention than fund balance.

NEW GUIDANCE

Focus. GASB Statement No. 54 will shift the focus of fund balance reporting from the availability of fund resources for budgeting to "the extent to which the government is bound to honor constraints on the specific purposes for which amounts in the fund can be spent."¹

Components of fund balance. GASB Statement No. 54 establishes five components of fund balance. Because circumstances differ among governments, not every government or every governmental fund will report all of those components.

Constraints on how amounts can be spent are not really an issue for resources that are *inherently nonspendable*. Examples include inventories and prepaids; the long-term portion of loans receivable²; and non-financial assets held for resale.³ Still other resources cannot be spent because *legal or contractual provisions require that they be maintained intact* (e.g., the principal of an endowment). GASB Statement No. 54

directs that the portion of fund balance reflecting both be labeled ***nonspendable fund balance***.

Not all limitations on how resources may be used have the same force. Some limitations are externally enforceable and lie beyond the power of the government to change unilaterally (e.g., restrictions imposed by a grant contract or a bond covenant). Other limitations are self-imposed, but would require formal action at the highest level of the government to remove (e.g., resources legally "earmarked" for a given project by the governing body). Still other limitations are less binding and function more as a declaration of intent. GASB Statement No. 54 has created a separate category to accommodate each of these situations.

■ **Restricted fund balance.** The term *restricted fund balance* will encompass net fund resources subject to externally enforceable legal restrictions. It is no accident that the term *restricted fund balance* so closely resembles the term

Exhibit 1: Traditional Components of Fund Balance

(Focus on Availability for Appropriation)

- Reserved fund balance (not available for appropriation)
 - Portion of net resources that *cannot ever be spent* because of their form
 - Portion of net resources that *cannot yet be spent*
 - Portion of net resources that *cannot be spent for any and all fund-related purposes* because of external limitations
- Unreserved fund balance (available for appropriation)
 - Designated unreserved fund balance (available for appropriation, with a limitation on use imposed by the government itself)
 - Portion of net resources subject to limitations imposed by the governing body
 - Portion of net resources set aside by management in connection with its tentative plans
 - Undesignated unreserved fund balance (available for appropriation, with no external or internal limitation)

restricted net assets used in the context of government-wide financial reporting. In both cases, the *restrictions* concerned would be either 1) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments, or 2) imposed by law through constitutional provisions or enabling legislation.⁴ Note that there is no need for the limitation to be narrower than the purpose of the fund.⁵

- **Committed fund balance.** The term *committed fund balance* will be used to describe the portion of fund balance that represents resources whose use is constrained by limitations that the government imposes upon itself at its highest level of decision making (normally the governing body) and that remain binding unless removed in the same manner. The underlying action that imposed the limitation would need to occur no later than the close of the reporting period. Note, once again, that there is no requirement that the limitation be narrower than the purpose of the fund.⁶

- **Assigned fund balance.** The *assigned fund balance* category will cover the portion of fund balance that reflects a government's *intended use of resources*. Such intent would have to be established at either the highest level of decision making, or by a body (e.g., finance committee) or an official designated for that purpose.⁷ Logically speaking, a government cannot *assign* resources that it does not have; therefore, the amount reported as *assigned fund balance* could never exceed total fund balance less its nonspendable, restricted, and committed components. Once again, note that there is no requirement that the limitation be narrower than the purpose of the fund.

Of course, the general fund, as the principal operating fund of a government, may have net resources in excess of what is properly categorized in one of the four categories just already described. If so, the surplus will be presented as **unassigned fund balance**. A positive amount of unassigned fund balance, however, will never be reported in a governmental fund other than the general fund, because GASB Statement No. 54 prohibits reporting resources in another fund unless they are at least *assigned* to the purpose of that fund. All the same, funds other than the general fund could report a negative amount of unassigned fund balance should the total of nonspendable fund balance, restricted fund balance, and committed fund balance exceed the total net resources of the fund.

The new components of fund balance are summarized in Exhibit 2.

Stabilization arrangements. Governments often establish "rainy day funds" or "contingency funds" to provide a financial cushion against unanticipated adverse financial or economic circumstances. The appropriate classification of such resources within fund balance depends on the specific nature of the arrangement.

On the one hand, if the use of the resources is limited in a way that is *legally enforceable by an outside party*, classification as restricted fund balance would be appropriate. On the other hand, if the limitation was imposed by the highest level of decision making and can only be removed by formal action equivalent to the action taken to impose it, the use of the committed fund balance classification would be appropriate. It would never be appropriate, however, to classify such resources as assigned fund balance.

Exhibit 2: New Components of Fund Balance — GASB Statement No. 54

(Focus on Extent to which Government Is Bound to Honor Constraints on the Specific Purposes for Which Amounts Can Be Spent)

- Nonspendable fund balance (inherently nonspendable)
 - Portion of net resources that cannot be spent because of their form
 - Portion of net resources that cannot be spent because they must be maintained intact
- Restricted fund balance (externally enforceable limitations on use)
 - Limitations imposed by creditors, grantors, contributors, or laws and regulations of other governments
 - Limitations imposed by law through constitutional provisions or enabling legislation
- Committed fund balance (self-imposed limitations set in place prior to the end of the period)
 - Limitation imposed at highest level of decision making that requires formal action at the same level to remove
- Assigned fund balance (limitation resulting from intended use)
 - Intended use established by highest level of decision making
 - Intended use established by body designated for that purpose
 - Intended use established by official designated for that purpose
- Unassigned fund balance (residual net resources)
 - Total fund balance in the general fund in excess of nonspendable, restricted, committed, and assigned fund balance (i.e., surplus)
 - Excess of nonspendable, restricted, and committed fund balance over total fund balance (i.e., deficit)

GASB Statement No. 54, paragraph 20, places serious limits on what qualifies as a *stabilization arrangement* for this purpose:

The formal action that imposes the parameters for spending should identify and describe the specific circumstances under which a need for stabilization arises. Those circumstances should be such that they would not be expected to occur routinely. For example, a stabilization amount that can be accessed “in an emergency” would not qualify to be classified within the committed category because the circumstances or conditions that constitute an emergency are not sufficiently detailed, and it is not unlikely that an “emergency” of some nature would routinely occur. Similarly, a stabilization amount that can be accessed to offset an “anticipated revenue shortfall” would not qualify unless the shortfall was quantified and was of a magnitude that would distinguish it from other revenue shortfalls that occur during the normal course of governmental operations.

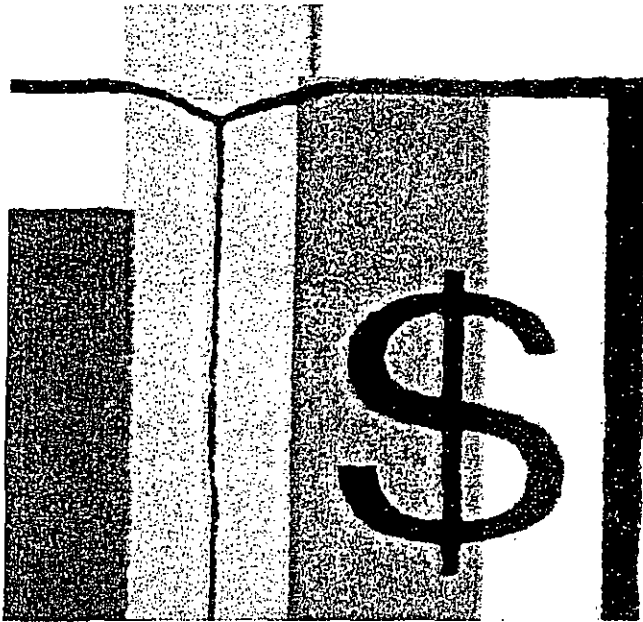
Appropriated fund balance. Not infrequently, governments balance their budget by appropriating a portion of existing fund balance to bridge the gap between appropriations and estimated revenues. The portion of fund balance thus appropriated for the following year would properly be classified as assigned fund balance.

Flow assumptions. Frequently resources for a single project will come from multiple sources. For example, a city may elect to finance a new bridge partially from restricted grant proceeds (*restricted fund balance*), partially from earmarked revenues (*committed fund balance*), and partially from other available resources expressly set aside for the purpose (*assigned fund balance*). In that case, flow assumptions would be needed:

- When both restricted resources and other resources are to be used, how are outlays allocated to each (e.g., restricted resources presumed to be spent first? Spending presumed to occur on a pro rata basis?)
- When committed, assigned, and unassigned resources are to be used, how are outlays allocated among the various categories?

COMPARISON OF OLD AND NEW

Perhaps the best way to gain an understanding of the new fund balance categories is to contrast how certain specific items are reported today with how those same items will be reported in the future under GASB Statement No. 54.



Reserved fund balance. Currently, reserved fund balance comprises three elements:

- Resources that by their very nature cannot be spent (e.g., prepaid rent)
- Resources that are not yet available for spending (e.g., long-term portion of loans receivable)
- Resources externally restricted to a purpose narrower than the fund

The first of these elements will *always* be reported as nonspendable fund balance. The second element *normally* would be reported as nonspendable fund balance (i.e., unless there was a limitation on how the amounts eventually received could be used, in which case the classification would be restricted, committed, or assigned fund balance, as appropriate). The third element will be reported as restricted fund balance.

Designated unreserved fund balance. Currently this category comprises two elements:

- Limitations that the government places upon itself
- Tentative management plans

Net resources currently reflected in the first category will be reported in the future as either committed fund balance or as assigned fund balance, depending upon the source of the limitation. The latter will be reported as either assigned fund balance (if management is designated to make such assignments) or unassigned fund balance.

Undesignated unreserved fund balance. Today this residual category includes resources whose use is limited, but not for a purpose narrower than the purpose of the fund. Under GASB Statement No. 54, there is no requirement that a limitation be narrower than the purpose of the fund. Accordingly, items that are restricted, committed, or assigned simply for the purpose of the fund will be reported as restricted, committed, or assigned fund balance.

Also, reporting designated unreserved fund balance today is optional. Under GASB Statement No. 54, the use of the equivalent category (i.e., assigned fund balance) will be required. Therefore, many governments that today do not report designated unreserved fund balance will report as assigned fund balance a portion of what today is labeled simply unreserved fund balance.

EFFECTIVE DATE

Governments will need to implement GASB Statement No. 54 starting with the fiscal period that ends June 30, 2011. In the statistical section of the comprehensive annual financial report, retroactive implementation is encouraged, but not required. If a government declines to restate amounts from previous years in the statistical section, it will need to provide an explanation. f

Notes

1. GASB Statement No. 54, paragraph 5.
2. Assuming that there are not constraints on the use of the amounts eventually collected.
3. Assuming that there are not constraints on the use of the proceeds of the eventual sale.
4. The criteria for restricted net assets set forth in GASB Statement No. 34, *Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments*, paragraph 34, are identical to the criteria for restricted fund balance in GASB Statement No. 54, paragraph 8.
5. If the use of the amounts to be collected on long-term loans receivable and the amounts resulting from the sale of nonfinancial assets is subject to restrictions, then those items should be reflected in restricted fund balance, rather than in nonspendable fund balance.
6. If the use of the amounts to be collected on long-term loans receivable and the amounts resulting from the sale of nonfinancial assets is committed, then those items should be reflected in committed fund balance, rather than in nonspendable fund balance.
7. If the use of the amounts to be collected on long-term loans receivable and the amounts resulting from the sale of nonfinancial assets is assigned, then those items should be reflected in assigned fund balance, rather than in nonspendable fund balance.

STEPHEN J. GAUTHIER is director of the GFOA's Technical Services Center in Chicago, Illinois.

Attachment B:

Attachment B: Listing of Negative Funds

NEGATIVE FUNDS

Many non-GPF City funds have serious financial issues. Some result from historical overspending and/or under-recovery. Others stem from more recent operational shortfalls (cost increases outpacing revenue growth).

Funds with historical negatives include: Self-Insurance Liability Fund (\$21.3 million projected by the end of FY 2008-09), Kaiser Convention Center Fund (\$4.6 million), Equipment Fund (\$19.8 million), and Facilities Fund (\$31.7 million). These negative balances harm the overall health of the City's assets by borrowing from the available positive funds, such as the General Purpose Fund, internal pension assets, deferred leave balances, etc. Except for the GPF, these other positive funds are mostly restricted, and funds borrowed from them will require repayment.

Funds with recent, operational shortfalls include: Comprehensive Clean-Up (\$0.2 million projected by the end of FY 2008-09), OPRCA Self Sustaining Revolving (\$1.0 million), 2006 FEMA Spring and Winter Storm (\$0.95 million combined), selected U.S. Housing and Urban Development funds (\$7.1 million), California Housing and Community Development (\$0.03 million), California Library Services (\$2.6 million), Bay Area Air Quality Management (\$0.3 million) and ORA Grants (\$0.87 million). Largely, these negative funds will be addressed through grant reimbursements and/or expenditure/carryforward reductions.

In the next several pages, estimated ending fund balances for FY 2008-09 and after the end of the proposed FY 2009-11 budget are presented in terms of strategies for resolving negative balances.

SUMMARY OF NEGATIVE FUNDS AND IDENTIFIED SOLUTIONS

FUND	Assigned Agency/ Department	FY 08-09 Estimated Ending Fund Balance	Mayor's/CAO Proposed Budget Estimated Ending Fund	Notes
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1. Negative Internal Service Funds: Repayment schedules established in FY 05-07; repayment is proposed to be delayed for FY 09-11 for Equipment and City Facilities. For Central Stores and Purchasing, these funds have been re-balanced through efficiencies and rate increases in FY 09-11.

4100	Equipment	PWA	(19,761,922)	(37,299,192)	
4200	Radio/Telecom	DIT	(350,326)	(350,326)	
4400	City Facilities	PWA	(31,661,969)	(62,073,369)	
4500	Central Stores	FMA	(4,331,535)	(3,403,365)	
4550	Purchasing	DCP	(1,366,223)	(868,633)	
Subtotal			(57,471,974)	(103,994,884)	

2. Selected General Funds on existing repayment schedules: Repayment schedules established in FY 05-07 are continued in FY 09-11. Repayment of the Self-Insurance Liability Fund is proposed for full repayment in FY 2009-10 and partial repayment in FY 2010-11. This proposed partial repayment will extend amortization of the fund's negative balance by two years.

1100	Self Insurance Liability	Budget Office	(21,349,288)	(18,314,198)	
1730	Henry J Kaiser Convention Center	Budget Office	(4,584,107)	(3,333,027)	
1760	Telecommunications Reserve	Budget Office	(630,544)	158,456	
1790	Contract Administration Fee	DCP	(4,019,755)	(2,759,715)	
Subtotal			(30,583,694)	(24,248,484)	

**SUMMARY OF NEGATIVE FUNDS AND IDENTIFIED SOLUTIONS
(continued)**

FUND	Assigned Agency/ Department	FY 08-09 Estimated Ending Fund Balance	Mayor's/CAO Proposed Budget Estimated Ending Fund	Notes
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3. Negative Funds NOT requiring one-time revenues: Negatives will be addressed through rate increases, cost reductions and/or transfers from offsetting positive funds.

1700	Mandatory Refuse Program	FMA	(6,259,927)	(3,252,707)	Increased recovery rate proposed for FY 09-11.
1720	Comprehensive Clean-Up	PWA	(161,155)	(161,155)	Reductions in contract spending are proposed for FY 2009-11.
1750	Multipurpose Reserve	CEDA	(1,289,621)	(1,289,621)	Garage parking rate increases and expenditure reductions are proposed for FY 09-11.
7760	Grant Clearing	CEDA/PWA	(3,117,402)	(2,767,372)	Reductions in electrical services, administration, small project design group, as well as position transfer to Measure B (2211) fund are proposed for FY 2009-11.
Subtotal			(10,828,105)	(7,470,855)	

4. Negative Funds requiring one-time revenues

1600	Underground District Revolving	PWA	(2,423,142)	(2,423,142)	
5500	Municipal Capital Improvements	CEDA/CIP	(814,586)	(814,586)	

**SUMMARY OF NEGATIVE FUNDS AND IDENTIFIED SOLUTIONS
(continued)**

FUND	Assigned Agency/ Department	FY 08-09 Estimated Ending Fund Balance	Mayor's/CAO Proposed Budget Estimated Ending Fund	Notes
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4. Negative Funds requiring one-time revenues (continued)

5999	Miscellaneous Capital Projects	CEDA/CIP	(3,889,044)	(3,889,044)	
7400	Security Deposits - California Waste Solutions	OPD	(46,608)	(46,608)	
7660	Museum Preservation Trust	Museum	(137,338)	(137,338)	
7752	Rehabilitation Trust: City Funded	FMA	(1,039,999)	(1,039,999)	
Subtotal			(8,350,717)	(8,350,717)	

5. Negative Grant Funds: Most will be addressed through grant reimbursements and expenditure/carryforward reductions, which are lagging. A minority may require write-offs. Work is in progress by Finance staff in collaboration with departments.

2061	2006 FEMA: 1628 Winter Storms	PWA	(429,712)	(429,712)	
2062	2006 FEMA: 1646 Spring Storm	PWA	(522,952)	(522,952)	
2103	HUD-ESG/SHP/HOPWA	DHS	(7,036,375)	(7,024,655)	
2104	Department of Commerce	CEDA	179,873	180,333	
2105	HUD-EDI Grants	CEDA	(56,713)	(56,713)	
2106	Department of Defense	CEDA	(297,925)	(297,925)	
2108	HUD-CDBG	CEDA	(18,662)	(18,662)	
2114	Department of Labor	DHS	(1,125,336)	(1,125,336)	
2118	National Foundation of the Arts	OPR	(83,697)	(83,697)	

**SUMMARY OF NEGATIVE FUNDS AND IDENTIFIED SOLUTIONS
(continued)**

FUND	Assigned Agency/ Department	FY 08-09 Estimated Ending Fund Balance	Mayor's/CAO Proposed Budget Estimated Ending Fund	Notes
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5. Negative Grant Funds (continued): Most will be addressed through grant reimbursements and expenditure/carryforward reductions, which are lagging. A minority may require write-offs. Work is in progress by Finance staff in collaboration with departments.

2120	Federal Action Agency	DHS	(115,173)	(115,173)	
2124	Federal Emergency Management	Fire	(3,405,073)	(3,405,073)	
2126	Department of Education	PWA	(154,390)	(154,390)	
2134	California Parks and Recreation	CEDA	(2,227,280)	(2,227,280)	
2144	California Housing and Community Development	CEDA	(33,424)	(33,424)	
2148	California Library Services	Library	(2,576,222)	(2,569,362)	
2152	California Board of Corrections	OPD	(715,712)	(715,712)	
2154	California Integrated Waste	PWA	(254,730)	(254,730)	
2162	Metro Transportation Com: TDA	CEDA	(212,704)	(212,704)	
2164	Congestion Mitigation & Air	CEDA	(1,129,228)	(1,129,228)	
2185	Oakland Redevelopment Agency Grants	CEDA	(874,517)	(874,517)	
2190	Private Grants	DHS	(278,873)	(242,853)	
2214	ACTIA Reimbursable Grants	CEDA	(438,256)	(438,256)	
2511	Local Law Enforce Block Grant	OPD	(17,087)	(17,087)	

**SUMMARY OF NEGATIVE FUNDS AND IDENTIFIED SOLUTIONS
(continued)**

FUND	Assigned Agency/ Department	FY 08-09 Estimated Ending Fund Balance	Mayor's/CAO Proposed Budget Estimated Ending Fund	Notes
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5. Negative Grant Funds (continued): Most will be addressed through grant reimbursements and expenditure/carryforward reductions, which are lagging. A minority may require write-offs. Work is in progress by Finance staff in collaboration with departments.

2513	Local Law Enforce Block Grant	OPD	(237,482)	(237,482)	
2810	Rehabilitation Trust Loans	CEDA	(2,499)	(2,499)	
2820	Community Development Rehabilitation	CEDA	(3,172)	(3,172)	
2822	Title I Loans: Revolving	CEDA	(30,431)	(30,431)	
2824	FHA 203k Loan: Revolving	CEDA	(17,808)	(17,808)	
2916	Vice Crimes Protection - Court Ordered to Police	OPD	(1,973)	(1,973)	
2990	Public Works Grants	PWA	(926,494)	(926,494)	
2992	Parks and Recreation Grants	OPR	(2,590,617)	(2,590,617)	
Subtotal			(25,634,645)	(25,579,585)	

**SUMMARY OF NEGATIVE FUNDS AND IDENTIFIED SOLUTIONS
(continued)**

FUND	Assigned Agency/ Department	FY 08-09 Estimated Ending Fund Balance	Mayor's/CAO Proposed Budget Estimated Ending Fund	Notes
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6. Other Negative Funds: These funds require further research.

5012	JPFA Admin Building: Series 1996	CEDA	(1,516,318)	(1,516,318)	
5550	Municipal Capital Improvement: Revenue Bonds	CIP	(102,531)	(102,531)	
6570	6580 - JPFA Pooled Assessment: 1997 Revenue Bonds	Non Dept/Debt Svc	(142,994)	(142,994)	
6580	6580 - JPFA Pooled Assessment: 1997 Revenue Bonds	Non Dept/Debt Svc	(11,232)	(11,232)	

Subtotal (1,773,075) (1,773,075)

Grand Total (134,642,211) (171,417,601)

FINANCE & MANAGEMENT CMTE.

MAY 26 2009