

**Introduction:** The City of Costa Mesa's largest financial responsibility to its residents is the care of public funds. Financial and budget policies are developed by the Finance Department and CEO in order to establish the framework for the overall budget planning and financial management of the City of Costa Mesa. These policies shall periodically be reviewed by the City's Finance Advisory Committee and adopted by the City Council. These policies will help City officials plan fiscal strategy using a consistent approach contributing to the City's fiscal stability and will provide adequate funding of the services desired by the public.

The Chief Executive Officer (CEO) will propose a budget within a reasonable amount of time for the City Council and public to review and discuss it before adoption. The budget will be adopted by the City Council by June 30 of each year. If, for some unforeseen reason, the budget is not adopted by June 30, the Council must adopt a continuing appropriations resolution by June 30 that will provide for operations until the budget is adopted.

## **GENERAL REVENUE MANAGEMENT**

**Diversified and Stable Base:** The City will seek to maintain a diversified and stable revenue base to protect the City from short-term fluctuations in any one revenue source.

**Revenues and Grants:** Ongoing revenues will be projected using realistic assumptions. Revenue forecasts will be neither overly optimistic nor overly conservative. They will be as realistic as possible based on the best available information. Should economic downturns develop which could result in revenue shortfalls or fewer available resources, the City will make adjustments in anticipated expenditures to compensate.

One-time revenues shall be limited for use on non-recurring items including start-up costs, reserve stabilization, capital expenses and early debt retirement.

New revenue sources pending legislation or grant approval are not included in the base budget request. They will be considered for addition to the budget during the mid-year budget report process (i.e. when legislation is passed or grants awarded).

**Fees and Charges for Services:** User fees will be imposed to cover the cost of services provided for unique or narrow segments of the community. Fees will normally be set at full cost recovery. Full cost recovery includes direct and indirect costs, overhead and depreciation for the period during which the fee will be in effect. Fees may be set at less than full cost recovery (cost of service may be subsidized) as the City

Council deems necessary. Fees will be reviewed and updated on an ongoing basis to ensure that they keep pace with changes in the cost-of-living as well as changes in methods or levels of service delivery. Fees that are set by State law shall be implemented in accordance with those laws.

## **OPERATING AND CAPITAL BUDGETS**

**Consistency with Council & CEO Priorities:** Base operating budget requests shall be consistent with the priorities and operational plans set forth by the City Council, CEO and the City's Financial Policies. Department heads are responsible for using these priorities and plans along with program outcome indicators to evaluate existing programs and redirect existing resources as needed for greater efficiency, to reduce cost and minimize the requests for additional resources. A certification regarding the evaluation of existing resources is required as part of the budget request submittal.

**Balanced Budget:** A balanced budget means that operating revenues must fully cover operating expenditures, including debt service. Under this policy, it is allowable for total expenditures to exceed revenues in a given year by the use of unassigned fund balance. However, in that situation, beginning unassigned fund balance can only be used to fund capital improvement plan projects or other one-time, non-recurring expenditures. Budgets for funds outside the General Fund are balanced to the fund's own revenue sources without General Fund subsidy unless previously approved by the Council or CEO.

**Salaries & Benefits:** The Finance Department budget staff will set the regular salary and employee benefits base budgets based on known changes in bargaining unit MOUs, retirement rates and other employee benefit costs. (See the City Budget Manual for detailed accounts centrally prepared by Finance and those prepared by the departments.) The vacancy factor will initially be set at zero percent (0%) for each department. The vacancy factor may be modified later in the budget process if necessary to reflect actual, projected or targeted vacancy rates. If the vacancy factor is set above zero percent, the resulting salary savings will be included in the non-departmental section of the budget.

**Services & Supplies:** Services and supplies shall be budgeted at the same level as current year budget to the extent they are necessary to support basic operations, Council and CEO goals. Budgeted base amounts may be reduced if an analysis of actual usage reveals ongoing over-budgeting practices. One-time items applicable only to past years operations may to be removed from the base.

**Percentage of General Fund Budget for Capital Expenditures:** The City will allocate a minimum of five percent (5%) of the General Fund budget to capital expenditures and plan a goal of an additional one and one-half percent (1.5%) dedicated to a Capital Facilities Account. This allocation may be annually reviewed by the Finance Advisory Committee. During an economic downturn or in the event of a disaster these allocated funds could be used as a type of reserve for operations.

For purposes of this policy, Capital Expenditures are defined as: fixed assets (those capital items with value greater than \$5,000), improvements/modifications to buildings/facilities/infrastructure, and improvements/modifications to City owned parks/fields/open space. These expenditures can be budgeted in either the City's General Fund, Capital Improvement Fund.

**Contingencies:** A contingency line-item of approximately \$1,000,000 will be included in the non-departmental section of the budget. This amount will allow the CEO to retain budget flexibility for operations during the fiscal year. The Finance Department and CEO will develop a process to account for requests and approvals of the use of these funds during the fiscal year. Use of these funds, as with all other funds, will comply with the City Purchasing Policy & Procedures. A status report and allocation of the use of these funds will be included in the mid-year budget report.

**Requests for Budget Increase:** All requests for budget increase require outcome indicators that outline the department's intended outcome(s) resulting from the obtaining the additional resources. Multiple requests will be ranked in order of the department's priority for approval. Department heads will certify that all potential alternatives for redirecting existing resources have been examined and that lower priority items have been reduced or eliminated in order to free up existing resources before asking for an increase.

Budget Staff and the CEO will conduct a mid-year review of prior year budget increases to determine what prior year budget increases will be funded. Funding for these increases will continue if the CEO and the department agree that:

- They meet the performance expectations
- They merit continuation
- They are still relevant to the department's mission
- Sufficient funding exists

***Program Budgets Outside the General Fund:*** It is the department head's responsibility to ensure that the proposed use of program funds is consistent with the available financing and legal restrictions on funds, the department's mission and the Council's priorities; and has been coordinated with the appropriate stakeholder groups external to the City.

***Appropriations Limit:*** The Council will annually adopt a resolution establishing the City's appropriations limit calculated in accordance with Article XIII-B of the Constitution of the State of California, Section 7900 of the State of California Government Code, and any other voter approved amendments or state legislation that affect the City's appropriations limit.

#### ***GENERAL EXPENDITURE MANAGEMENT:***

***Mid-Year Budget Reviews:*** The City Council will formally review the budget to actual status of revenues and expenditures as soon as practical when the December actual information is available, and amend the budget if necessary. The mid-year review will also serve as an opportunity for the Council to discuss and provide input on expectations for the next fiscal year budget.

***Budgetary Control:*** The level of budget control exists at the program level. Annual budgets are set at the individual account level however Department Heads will be responsible for not exceeding the overall program budget. The Finance Department will provide monthly budget to actual reports to the City CEO and to each department (Director, Manager or Budget Liaison) for review. It is the responsibility of each department to communicate to Finance when program budgets might be exceeded. This communication is to be before the situation occurs and include the reason or cause for the potential situation. At that time, the most appropriate action will be discussed to resolve any budget shortfalls.

***Budget Transfers and Adjustments:*** Budget transfers are shifts of existing resources between divisions, programs and accounts. Department heads are responsible for the efficient and effective use of the resources within their departmental budgets and are required to reallocate existing resources before requesting budget increases. Therefore they are permitted, with the concurrence of the Finance Department, to make budget transfers of resources among the accounts, programs and divisions within their department. If necessary, the CEO may also transfer resources between departments staying within the total appropriations previously authorized by the City Council. Exceptions to this flexibility are transfers out of salaries and benefits (which require CEO or Finance Department approval) and transfers of specific program funds that have restrictions on their use.

Budget adjustments are changes that affect the total amount of the City budget. These include appropriation of new grants or other revenues that had not been approved or realized at the time of the June budget adoption. These also include increases or

decreases to unassigned fund balance for items were approved but not spent in previous fiscal years or for unanticipated, one-time items that cannot be postponed to the next budget cycle. Budget adjustments must be approved by the City Council.

***Operating Carryover and Surplus:***

Operating program appropriations not spent during the first fiscal year may be carried over for specific purposes into the second fiscal year with the approval of the CEO.

A fiscal year-end surplus may occur when there is a net increase in fund balance or when there is a positive budget variance. Such a Any end-of fiscal-year net operating surplus will be ~~allocated~~ reviewed for potential use using the following priorities:

1. Increase reserves if reserves are below target
2. Assess-Examine opportunities for prepayment and accelerated payoff of debt
3. Increase funds for capital facilities

***Annual Financial Reporting:***

The City will prepare annual financial statements as follows:

1. The City will contract for an annual audit by a qualified independent Certified Public Accountant. The City will strive to conduct its financial operations in such a way as to obtain an unqualified auditors' opinion.
2. The City will use Generally Accepted Accounting Principles (GAAP) in preparing its annual financial statements, and will strive to meet the requirements of the Government Finance Officer Association (GFOA) Award for Excellence in Financial Reporting program.
3. The City will issue an audited Comprehensive Annual Financial Report (CAFR) no later than 180 days after fiscal year-end.

***Five-Year Financial Plan:*** The City will forecast its General Fund revenues and expenditures for each of the next five years and will update this forecast at least every two years. This forecast will be reviewed by the Finance Advisory Committee.

***MINIMUM GENERAL FUND BALANCE/RESERVE/CASH REQUIREMENTS:***

Current General Fund reserves consist of committed and assigned fund balance. They are part of the General Fund balance. As of June 30, 2014 they total \$26,141,092 and consisted of the following:

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\$ 14,125,000	Committed for declared disasters
2,000,000	Committed for self insurance
4,443,799	Assigned for compensated absences
2,262,032	Assigned for Police Retirement 1% Supplemental
3,310,261	Assigned for Optional Post-Employment Benefits (OPEB)
<u>\$ 26,141,092</u>	Total Committed and Assigned Fund Balance (Reserves)
20,629,130	Unassigned Fund Balance
<u><u>\$ 46,770,222</u></u>	Total Unassigned Fund Balance & Reserves

When reserves are combined with the unassigned fund balance, the total reserves are is-\$46,770,222. The following is a brief discussion of each of these items.

**Emergency Reserve/Committed for Declared Disasters:** The \$14,125,000 committed for declared disasters was established by the City Council as an emergency reserve. As set forth by Council Resolution 11-27 (June 21, 2011) and Municipal Code Sections 2-206 and 2-207, use of this reserve is limited to the following purposes:

1. To provide required emergency funding as a result of a declared emergency.
2. To provide required funding for an unanticipated but urgent event threatening the public health, safety and welfare of the City such as earthquakes, major unanticipated infrastructure failures and terrorist events.

This reserve may only be utilized by resolution of the City Council for the reasons stated above. This amount will be shown as committed fund balance on the City's Comprehensive Annual Financial Report (CAFR).

Paired with this reserve is the policy of a minimum monthly cash balance (throughout the fiscal year) in the General Fund of at least \$14,000,000. This keeps the reserve funds liquid rather than having them tied up on longer-term investments. The amount presented on the monthly Treasurer's Report will be used to determine the actual ending monthly cash balance.

**Self-insurance Reserve:** The \$2,000,000 self-insurance reserve is set by Resolution 11-27 and Municipal Code Section 2-154. The City will maintain a minimum \$2,000,000 Committed General Fund Balance to be used to pay actual losses not covered by other

insurance policies or insurance pools. If used, this reserve shall be replenished with funds each fiscal year from the General Fund operating reserve.

**Other Reserves:** The other three categories of reserves listed above are based on specific studies or calculations of what is needed for those programs. The amounts are refreshed annually and recommended to continue as long as required.

**Reserve Study and Goals:** The risks that the City faces, and which should be accounted for in the process of establishing reserves, include economic volatility, major infrastructure failure, natural disasters and other emergencies. A separate study of these risks is prepared and periodically updated to assess each category of risk and recommend an adequate amount of reserves that will enable the City to prepare for them. During the annual budget process, the mid-year budget report and preparation of the five-year financial plan, actual reserve amounts will be compared to recommended amounts. If reserves are below target, recommendations will be made for increasing reserves.

#### **DEBT MANAGEMENT:**

**Debt Issuance:** The City may issue long-term (exceeding twelve months) for capital projects and fixed assets. All General Fund debt issuances shall identify the method of repayment (or have a dedicated revenue source). The term of the debt should not exceed the life of the asset being financed. The City shall not issue General Fund debt to support ongoing operating costs unless such debt issuance achieves net operating cost savings and such savings are verified by independent analysis.

**Unfunded Pension Liability:** Should the City's pension obligations include an unfunded liability, the City shall develop a plan to reduce and eventually eliminate the unfunded liability. In addition to paying the annual required contribution (that includes amortization of the unfunded pension liability), the City will annually allocate a minimum of \$500,000 per year toward reducing the unfunded liability starting with the Fire Side Fund. In addition if the City prepays annual retirement costs, the savings on any prepayment option exercised will be used to make an additional payment to the Fire Side Fund. These actions are intended to pay off the Fire Side Fund in eleven or twelve years; four to five years early.