Overview

• Financial Administration: Your Role as Council Member
• Ins and Outs of City Funds: Taxes and Major Revenues
• The Budget and Budget Process
• Financial Reporting and Auditing
• Diagnosing Financial Health
• Milestones in Calif Municipal Finance
• Hot Topic: Pensions and OPEBs
• Financial Policies
• Long Range Planning
• Top Tips
Financial Administration and Your Fiduciary Role

Christina Turner

The Fiduciary Role of Mayors and Councilmembers

Roles of Key Staff

The Importance of Long Term Financial Health

Financial Administration and Your Fiduciary Role

The Fiduciary Role of Mayors and Councilmembers

Oversight
✓ Budget Review/Approval
✓ Public Contracts
✓ Labor Relations

Sound financial policies
✓ Setting parameters
✓ Ensure long and short term financial awareness

Fiscal & Service Impacts of Decisions
✓ Setting precedents and unintended consequences
Roles of Key Staff

City Manager
✓ Budget Preparation
✓ $ Recommendations
✓ Year-round Admin.

Finance
✓ Systems Admin.
✓ Reporting of Expenses and Revenues
✓ Auditing

Dept. Heads / Staff
✓ Budget proposals
✓ Tracking and reporting

The Ins and Outs of City Funds

- Taxes, Fees
- Local Property Taxes
- Local Sales Taxes

Michael Coleman
Cities Vary
... and so do their finances

✓ Geography: proximity, climate, terrain, access
✓ Community Character / Vision: Land use
✓ Size – urban / rural
✓ Governance / service responsibilities
  full service city - vs. not full service

❖ Statewide generalizations often mask trends among sub-groups

The Mechanics of Government Revenue

Who pays?
visitors, residents, businesses, etc.

What rate / base?
$per gallon, % per price, depreciated value, etc.

Who decides?
- Statewide voters / Constitution
- State law / Legislature
- Local voters
- Local law / City Council

How’s it allocated?
situs: pooled/population, etc.

Who collects? & enforces payment?

What is the $ used for?
general, water, roads, parks etc.
Taxes

- Charges which pay for public services and facilities that provide general benefits. No need for a direct relationship between a taxpayer's benefit and the tax paid.
- Cities may impose any tax not otherwise prohibited by state law. (Gov Code § 37100.5)
- The state has reserved a number of taxes for its own purposes including:
  - cigarette taxes, alcohol taxes, personal income taxes.
- General & Special
  - **General Tax** - revenues may be used for any purpose.
    - Majority voter approval required for new or increased local tax
  - **Special Tax** - revenues must be used for a specific purpose.
    - 2/3 voter approval required for new or increased local tax
    - Parcel tax - requires 2/3 vote

Fees and the Rest

Any levy, charge or exaction of any kind imposed by a California government, is a **tax** except:

- **User Fees and Assessments**: for a privilege/benefit, service/product
  - Planning permits, development fees, parking permits, user fees, copying fees, recreation classes, etc.
- **Regulatory Fees**: regulation, permits, inspections
  - Permits for regulated commercial activities (e.g., dance hall, bingo, card room, check cashing, taxicab, peddlers, catering trucks, massage parlor, firearm dealers, etc.); fire, health, environmental, safety permits; police background checks; pet licenses; bicycle licenses.
- **Rents**: charge for entrance, use or rental of government property
  - Facility/room rental fees, room rental fees, equipment rental fees, on and off-street parking, tolls, franchise, park entrance, museum admission, zoo admission, tipping fees, golf green fees, etc.
- **Penalties** for illegal activity, fines and forfeitures, etc.
  - Parking fines, late payment fees, interest charges and other charges for violation of the law.
- **A payment that is not imposed** by government
  - Includes payments made pursuant to a voluntary contract or other agreement that are not otherwise "imposed" by a government's power to coerce.
Taxes and Fees/etc.
Approval Requirements
(California Constitution)

<table>
<thead>
<tr>
<th>Tax Category</th>
<th>Tax- General</th>
<th>Tax- Parcel or Special (earmarked)</th>
<th>G.O.Bond (w/tax)</th>
<th>Fee / fine / rent</th>
</tr>
</thead>
<tbody>
<tr>
<td>City / County</td>
<td>Majority voter approval</td>
<td>Two-thirds voter approval</td>
<td>Two-thirds voter approval</td>
<td>Majority of the governing board.*</td>
</tr>
<tr>
<td>Special District</td>
<td>n/a</td>
<td>Two-thirds voter approval</td>
<td>Two-thirds voter approval</td>
<td>Majority of the governing board.*</td>
</tr>
<tr>
<td>K-14 School</td>
<td>n/a</td>
<td>Two-thirds voter approval (parcel tax)</td>
<td>55% voter approval*</td>
<td>Majority of the governing board.*</td>
</tr>
<tr>
<td>State</td>
<td>For any law that will increase the taxes of any taxpayer, two-thirds of each house of the Legislature ...or approval of majority of statewide voters.</td>
<td>Statewide majority voter approval</td>
<td>Majority of each house.</td>
<td></td>
</tr>
</tbody>
</table>

*Does not include data from the following cities that failed to report: Beaumont, Hawthorne, Imperial, La Habra, Lindsay, Placerville, Stockton, Taft, and Westmorland.

Source: CaliforniaCityFinance.com computations from data from California State Controller (revenues).
Property Tax

- An ad valorem tax imposed on real property and tangible personal property
- Maximum 1% rate (Article XIII A) of assessed value, plus voter approved rates to fund debt
- Assessed value capped at 1975-76 base year plus CPI or 2%/year, whichever is less
- Property that declines in value is reassessed to the lower market value.
- Reassessed to current full value upon change in ownership (with certain exemptions)
- Allocation: shared among cities, counties and school districts according to state law.
Where Your Property Tax Goes

**Shares Vary!**
- Non-Full service cities: portion of city shares go to special districts (e.g. fire)
- Pre-prop13 tax rates

Typical homeowner in a full service city not in a redevelopment area.

Includes Property Tax in-lieu of VLF.

Source: Coleman Advisory Services computations from Board of Equalization and State Controller data.

Sales and Use Tax

✔ **Sales Tax**: imposed on the total retail price of any tangible personal property

✔ **Use Tax**: imposed on the purchaser for transactions in which the sales tax is not collected.
Where Your Sales Tax Goes

For taxable sales in unincorporated areas, the local 1% rate goes to the county.

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
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</thead>
<tbody>
<tr>
<td>City</td>
<td>1.00</td>
</tr>
<tr>
<td>Co Transp</td>
<td>0.25</td>
</tr>
<tr>
<td>Prop 172</td>
<td>0.50</td>
</tr>
<tr>
<td>Co Realign</td>
<td>1.5625</td>
</tr>
<tr>
<td>State GF</td>
<td>3.9375</td>
</tr>
<tr>
<td>Total Base</td>
<td>7.25%</td>
</tr>
</tbody>
</table>

Sales Tax Collections

Source: California State Board of Equalization (Sales Tax), CA Dept of Finance (Populations), CA Dept of Industrial Relations
What is a budget?
What is in a budget?
What is a “fund?”
Capital Improvement Program (CIP)
Budget process

What is a Budget?

• What: A financial plan projecting revenues and expenditures for a defined period of time (usually 1-2 years)
• Types: Operating and Capital

Your budget should:
• Reflect the community’s priorities
• Good estimates of revenues/expenses by fund
• Anchored to Long Term Forecasts (~5 years)
• Provide actual revenue/expense history to gauge accuracy of forecasts!
What is in a Budget?

- A summary or discussion of revenues and expenses
- History of actual revenues and expenses
- Projected revenues by type/source
- Estimates of proposed expenditures by function (typically by Department)
- Separate budgets for each and every fund
- Capital Budget – tied to CIP

What is a “Fund”?

- A fund is a self-balancing set of accounts for all financial transactions of specific activities.

- Most agency budgets include the following types of separate “funds”:
  - General Fund
  - Enterprise Fund(s)
  - Special Revenue Fund(s)
  - Capital Project Fund(s)
  - Others: debt service, trust, agency, internal service, special assessment
Budget Alternatives

Terms:
• Typical: One Fiscal Year (July 1 – June 30)
• Biennial Budget (two fiscal years)

Types:
• Operating
• Capital

Budget Formats:
• Line Item
• Performance
• Program
• Zero Based

Capital Improvement Program (CIP)

• For infrastructure or capital investment
• Funds come from a variety of sources:
  o Impact fees, restricted taxes, enterprise operations
• Subject to State Law--bidding process and prevailing wages
• Capital Improvement Program should look forward five years, preferably 10
CIP – Policy & Guidelines

Policy:
• Statement of plans for capital projects
• Specific goals
  - e.g., PCI for roads
• Use of resources

Guidelines:
• preserve an existing asset?
• mitigate health or safety problem?
• mandated by State or Feds?
• contribute to City’s economic health?
• available funding for capital plus ongoing operations & maintenance?

Budget Process

• A budget takes months to prepare
• Performance standards or measures help ensure investment meets desired outcomes
• Your budget calendar and review process should be meaningful
• Your process should allow for needed input at the appropriate times
• Each agency does it differently!
The Budget Process

<table>
<thead>
<tr>
<th>J</th>
<th>A</th>
<th>S</th>
<th>O</th>
<th>N</th>
<th>D</th>
<th>J</th>
<th>F</th>
<th>M</th>
<th>A</th>
<th>M</th>
<th>J</th>
</tr>
</thead>
</table>

**BUDGET DEVELOPMENT**

Staff = Build Baseline > Dept. Proposals > Recommendations => Proposed Budget.

- Goals, Budget Priorities
- Workshop Long-Range Planning
- Workshop Budget Proposals

**BUDGET ADOPTION**

--- Budget Amendments ---

**BUDGET MONITORING**

- Prior Year End Audit
- Mid-Year Adjust

--- Financial Reporting and Auditing ---

Christina Turner

- The Comprehensive Annual Financial Report (CAFR)
- Letter of Transmittal
- Independent Auditor’s Report
- Management Discussion and Analysis
- Financial Statements and Notes
- Supplementary and Statistical Information
Management’s Discussion and Analysis (MD&A)

• Narrative overview of Basic Financial Statements
  o Explains components
  o Highlights year-over-year changes
  o Analysis of individual funds

• What to look for:
  o Changes in net position
    • Capital assets vs. unrestricted net position
    • Underlying reasons .... One-time occurrences or a trend?
  o Changes in fund balance
    • The change itself is less important than the explanation
  o Analysis of the General Fund
Basic Financial Statements

Government-wide
This is the agency-wide roll-up

Governmental Funds
• General Fund
• Special revenue funds
e.g., impact fee funds

Proprietary Funds
• Enterprise funds
e.g., utilities, etc.

Fiduciary Funds
• Trust funds
e.g., redevelopment dissolution funds, etc.

Introducing:
The League of California Cities’
California Municipal Financial Health Diagnostic

Michael Coleman
Bad Brew in Troubled Cities

- Over-reliance on land development revenue
- Over-reliance on redevelopment revenues
- Unsustainable / intractable employee compensation esp. public safety pension, retiree health care
- Risky financing schemes
- Toxic Relationships
- Fear and Denial
- Unsustainable decline in core revenues
- Ceding of management and policy choices to others

You Need the Financial Health Diagnostic

- **Validate** areas in which your city is *fiscally healthy*
- **Identify problems**, areas to *improve*
- **Act to remedy** problems *before* they get worse or unmanageable
- **Avoid being blind-sided** by problems
- **Add credibility** to your fiscal evaluation
- **Help others** (labor associations, taxpayers and other interested parties) *understand* your financial position
Our Approach

California Municipal Financial Health Diagnostic:

- Get to the primary indicators - useful & essential
  - Leave out extraneous / secondary
  - Add in overlooked & underappreciated factors
- Drill down to the real numbers
- Allow for nuance / clarification / differences
  - Reduce invalid conclusions and comparisons
- Constructive, thoughtful approach

The California Municipal Financial Health Diagnostic

City of  
Fund:

<table>
<thead>
<tr>
<th>Financial Distress Checklist</th>
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<tbody>
<tr>
<td>1. The city has recurring general fund operating deficits.</td>
<td></td>
</tr>
<tr>
<td>2. General fund reserves are decreasing over multiple consecutive years.</td>
<td></td>
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<tr>
<td>3. General fund current liabilities (including short-term debt and accounts payable within 90 days) are increasing. Cash and short-term investments are decreasing.</td>
<td></td>
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<tr>
<td>4. General fund fixed costs, salaries and benefits are increasing over multiple years at a rate faster than recurring revenue growth.</td>
<td></td>
</tr>
<tr>
<td>5. The general fund is subsidizing other enterprises or special funds.</td>
<td></td>
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<tr>
<td>6. The city council’s authority to make changes is constrained by charter, contract, or law. (e.g. binding arbitration, minimum spending, minimum staffing or compensation formulas, etc.)</td>
<td></td>
</tr>
<tr>
<td>7. The general fund budget has been balanced repeatedly with reserves, selling assets, deferring asset maintenance.</td>
<td></td>
</tr>
<tr>
<td>8. The general fund budget has been balanced repeatedly with short-term borrowing, internal borrowing or transfers from special funds.</td>
<td></td>
</tr>
<tr>
<td>9. General fund pension liabilities, post-employment or other non-salary benefits have been repeatedly deferred or costs have not been determined, disclosed or actuarially funded.</td>
<td></td>
</tr>
<tr>
<td>10. General fund debt service payments have been “backloaded” into future years.</td>
<td></td>
</tr>
<tr>
<td>11. Ongoing general fund operating costs are being funded with temporary development revenues.</td>
<td></td>
</tr>
<tr>
<td>12. Financial Reports are not being filed on time. (CAFR, Annual Audit, State Controller’s Financial Transactions Report)</td>
<td></td>
</tr>
<tr>
<td>13. Public service levels are far below standards needed in this community.</td>
<td></td>
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</tbody>
</table>

For detailed indicators related to these points see the Financial Health Indicators
Milestones in Municipal Finance: A Brief History

Michael Coleman

• Plans versus Policies
• Topics for Financial Policies
• Policy versus Practice: Make ‘em Work
• Policies and Financial Ratings

Proposition 13 (1978)

1. One percent rate cap. Property tax rates capped at 1% of full market value

2. Assessment rollback of property values for tax purposes to 1975-76 levels

3. Assessment growth capped at 2% of property value (or CPI)
   - reassessment at full market value only upon change of ownership

4. Special taxes (local) require 2/3 voter approval

5. State tax increases require 2/3 vote of Legislature

6. Authority for allocating property tax revenues transferred to the state
Proposition 13 (1978) revenue impacts

- 57% reduction

The AB8 (1979) Bailout
Shifting Local Property Tax to Cushion Impacts of Prop13
Proposition 13 (1978)
revenue impacts

The AB8 “Bailout”:
State legislature
- increased non-school shares,
- reduced school shares,
- paid more state general fund to schools.


City, County, Special Districts
Property Tax
State General Fund
Schools

Reduced general fund support
Local Revenue Protection: Prop1A(‘04), Prop1A(‘06), Prop22(‘10)

Constitutional Protection for:
1. Property taxes: cities, counties, special districts
   Protection includes Property Tax in lieu of VLF (VLF swap)
   May reallocate among cities, counties, special districts with a 2/3 vote of both houses
2. Local sales tax rate, method of allocation
   Exception: interstate compact or federal law
3. VLF 0.65% rate to cities and counties … unless replaced
   VLF may not be diverted to reimburse a state mandate
4. Transportation Funds to locals - no taking, delay or borrowing
5. Prohibitions against unfunded state mandates strengthened
6. Redevelopment Tax Increment - may not be diverted for other purposes

The State-Local Fiscal Relationship: A Rough Road

Fiscal constraints
Creative Response

Milestones in Municipal Finance History

- Prop 13 Property Taxes 1978
- Prop 4 Spending Limits 1979
- Prop 172 Public Safety Sales Tax 1992
- ERAF (Educational Revenue Augmentation Fund) 1992
- Prop 218 Taxes, Fees, Assessments etc 1996
- VLF “CarTax” cut & backfill 1999
- Prop 62 votes on taxes 1986
- Prop 47 VLF must go to cities/counties 1986
- SB2557 County Fees on Cities 1990
- State Budget Trouble: City&County VLF Taken, Many State Subventions Repealed 1981-1983
- 2002
- Prop 1A local $ protection 2004
- Prop 57 Sales Tax “Triple Flip” 2008-2010
- Prop 1A Property Tax Shifts 2008-2010
- Prop 26 Taxes, Regulatory Fee rules 2011
- SB89 VLF shift to law enforcement grants 2010
- Prop 22 Local $ Protection 2010
- 2011 Redevelopment RIP Realignment

Fiscal road concept stolen from LAO
The State-Local Fiscal Relationship: A Rough

Milestones in Municipal Finance History

State Fiscal retrenchment, revenue & cost shifts
Local revenue protection, constitutional limits

Fiscal road concept stolen from LAO

Pensions and Other Post-Employment Benefits (OPEB)

Christina Turner

• Pension Funding
• Employer Contribution Rates
  What Happened?
• GASB changes
• Other Post Employment Benefits (OPEB)

Credits: Drew Corbett
Pension Funding

Pensions are funded from...

1. CalPERS investment earnings
2. Contributions from employers
   • Variable based on a variety of factors
3. Contributions from employees
   • Fixed based on pension formula

Employer Contribution

Two components

- Normal cost
  • Annual cost of future benefit for current employees
  • Expressed as a percentage of pay
- Payment on unfunded liability
  • Required when plan liabilities exceed plan assets
  • Expressed as a percentage of pay (non-pooled plans)
  or as a dollar amount (pooled plans)
Many factors cause the employer rate to change, including...

- CalPERS investment earnings
- Benefit changes
  - Formula changes applied retroactively
- Changes in actuarial assumptions
  - Economic, such as the rate of investment return
  - Demographic, such as mortality rates
  - Other experience
    - Pay increases exceeding assumptions

**Historic Contribution Rates**

- Miscellaneous
- Safety
What Happened?

CalPERS Investment Returns

Strong investment returns in the late 1990s created momentum for enhancing benefits.

But investment losses combined with more expensive benefits created significant unfunded liabilities.

The Cost of Doing Business

CalPERS Payments on the Rise

Average Employer Contribution Payments

Percentage of Payroll


Safety (police, fire) plans

Miscellaneous plans
Future Contribution Rates

Increases in the near term for demographic assumption changes and changes in actuarial policies; offset in out years as more employees are hired under lower formulas

Other Post-Employment Benefits (OPEB)

- Largely under-the-radar until GASB 45
  - Difference between Actuarial Required Contribution (ARC) and actual contribution on balance sheet
  - No requirement to fund, but creates visibility

- Significant liability for many cities

- Cost continuing to increase
  - More retirees
  - Retirees living longer
  - Increasing healthcare costs
Financial Policies: The Foundation of Fiscal Health

Michael Coleman

• Plans versus Policies
• Topics for Financial Policies
• Policy versus Practice: Make ’em Work
• Policies and Financial Ratings

Plans versus Policies

• Plans can change over time
  (like ... as soon as the ink is dry)

• Policies, however....
  o Act as your “north star,” guiding your actions
  o Make tough decisions easier by formalizing values and procedures before a crisis hits
  o You could decide to do something else
  o Bottom line... good policies always give you a starting point
Financial Policy Topics

• Balanced Budget
• User Fees & Cost Recovery
• Enterprise Funds: To subsidize or not?
• Fund Balance & Reserves
• Budget Amendments
• Budget Carryover

• Revenue Earmarking
• Capital Financing & Debt Management
• Financial Reporting
• Investments
• Purchasing, bidding, contracting
• Travel guidelines
• Credit Card Use

Formal Policies

**Put financial policies in writing so that they:**

• Can outlive the crisis ... or prepare you for one
• Promote stability and continuity
• Create efficiency through standardization
• Save you debt service costs
• Don’t rely on an individual to interpret best practices
• Help with your CAFR process and reduce audit findings
Crucial Point: Policy versus Practice

- Policy should include **specific objective** but not detailed steps in meeting that objective.
- Make policy **brief and concise**.
  - Example: “User fees should be reviewed and adjusted at least annually to avoid sharp changes.”
- Include “how to” steps in **administrative procedure**, if necessary.
- Leave exact steps of review/adjustment to staff.

Long-Term Financial Planning

Combines **financial forecasting** with **financial strategizing** to identify future **challenges** and **opportunities**, fiscal imbalances, and strategies to secure **financial sustainability**.

Why?

- Respond to a financial crisis
- Bring financial perspective to planning
- Stimulate long-term thinking
- Stimulate “big picture” thinking
- Address a particular issue or proposal
- Impose discipline
- Demonstrate good fiscal management
Top Tips for Financial Management

1. Obtain key documents:
   - Annual Operating Budget
   - Capital Improvement Program
   - Comprehensive Annual Financial Report (CAFR)
   - Long Range Financial Plan
   - Interim Financial Reports
   - Investment Reports

2. Develop and Use Financial Policies.

3. Know the difference between a “one-time” solution versus a “defer” solution versus a “sustainable” solution
   - One-time solutions fix a current problem, but not an on-going one.
   - Deferrals “put-off” a problem by fixing a one time problem but create as much or more added costs in future years.
   - A sustainable solution fixes an on-going budget problem now and into the future.

4. Ask hard questions about programs:
   1) What is the purpose of this program? Why is it needed?
   2) What are the specific intended outcomes of this program?
   3) What are the measurable objectives?
   4) What are the cost components: personnel, contracts, supplies, equipment, etc.?
   5) How will the costs of this program change in the future?
   6) What are the alternative service delivery approaches?
   7) Where will the money come from to pay for this?
   8) What are the consequences of not doing this program?

5. Avoid unsustainable budget practices including:
   - Exhaust the reserves
   - Freeze vacant positions
   - Make across the board cuts
   - Defer equipment purchases
   - Defer essential maintenance
   - Long-term formula driven spending
   - Deferred pension or capital funding contributions
   - Eliminate training
   - Borrow from other funds
   - Ignore the small cuts
Resources

- League of California Cities
  - City Advocate Weekly
  - Regional Managers
  - League Alerts
  - Conferences/ Seminars

- Institute for Local Government (ILC)


- Government Finance Officers Association GFOA.com

- The California Municipal Finance Almanac
  - www.CaliforniaCityFinance.com