REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: November 4, 2019

CAO File No. 0590-00098-5119
Council File No.
Council District:

To: The Mayor
The City Council

From: Richard H. Llewellyn, Jr., City Administrative Officer

Reference: Periodic update of the Financial Policies for the City of Los Angeles, initiated by the City Administrative Officer

Subject: **Revision of the Financial Policies for the City of Los Angeles**

RECOMMENDATIONS

That the City Council, subject to the approval of the Mayor:

1. Adopt the revised sections of the Financial Policies for the City of Los Angeles, which are presented as Attachment 1 to this report; and,

2. Request the City Attorney, with the assistance of the City Administrative Officer, to prepare any necessary ordinances required to codify the revised Financial Policies for the City of Los Angeles.

SUMMARY

As part of the adoption of the 2019-20 Budget, the Council instructed the City Administrative Officer (CAO), with the assistance of the Chief Legislative Analyst (CLA) and the City Attorney, to prepare revisions to the Financial Policies for the City of Los Angeles (Financial Policies). The Mayor and Council originally approved the City's Financial Policies in April 2005.

The Financial Policies currently contain six sections:

- Section 1 – Fiscal Policies
- Section 2 – Fee Waiver Policy
- Section 3 – Capital Improvement Program Funding Policy
- Section 4 – Pension and Retirement Funding Policy
- Section 5 – Reserve Fund Policy
- Section 6 – Debt Management Policy

In the 14 years since the adoption of the policies, City has made changes to the Financial Policies to incorporate City Charter and Los Angeles Administrative Code amendments and the adoption of

new City policies related to the Budget Stabilization Fund, the Reserve Fund, and encumbrances. Additionally, over this time the City has experienced several economic and fiscal challenges that have reaffirmed many of the existing policies and helped identify policies needing clarification and/or modifications. These experiences as well as updates to several "best practices" documents issued by the Government Finance Officers Association (GFOA) related to government financial policies have greatly informed the revisions that this Office is proposing. This report proposes those revisions.

In this report, this Office proposes changes to four of the six sections of the Financial Policies. These sections include the Fiscal Policies, the Fee Waiver Policy, the Pension and Retirement Funding Policy, and the Reserve Fund Policy. This report also recommends adding a new Encumbrance Policy section, which incorporates and revises the current Encumbrance Policy. This Office has also developed recommendations for revisions to the Capital Improvement Program Funding Policy and the Debt Policy, which we will present for consideration separately.

In general, the CAO's proposed revisions to the Financial Policies formalize the City's current practice or policy and/or GFOA best practices through new or restated policies. Additionally, the revisions incorporate other policies and laws to create one single, comprehensive policy document that we reorganized into subsections to improve user experience. In some instances, we propose eliminating policies if they do not directly relate to budget or fiscal practices.

The most significant proposed revisions to the Financial Policies include:

- Establishing a goal of eliminating the City's structural deficit.
- Adding a new policy requiring the City to adequately invest to maintain its infrastructure.
- Establishing a goal to reach and maintain a cumulative General Fund reserve level equal to 10 percent of General Fund revenue.
- Refining the Budget Stabilization Fund policy based on lessons learned since its implementation.

FISCAL IMPACT STATEMENT

There is no fiscal impact from adopting the recommendations in this report. This review and revision of the Financial Policies will ensure that the City continues to be guided by fiscally responsible policies supporting ongoing efforts to provide and improve services.

FINDINGS

Background

In 2004, the City Council instructed the City Administrative Officer (CAO) and the Chief Legislative Analyst (CLA) to submit overarching budgetary and fiscal policies in light of growing concern regarding the City's reported structural deficit (C.F. 04-1822). At the time, the structural deficit was attributed to a combination of the economic downturn that followed the September 11, 2001 terrorist attacks, recent State of California actions to balance its budget using traditionally local government sources of revenue, and rising employee-related costs from pensions, workers' compensation, employee compensation, and health insurance.

In response to that request, the CAO and CLA proposed a comprehensive set of financial policies. The proposal incorporated policies adopted in prior years related to the Reserve Fund, debt management, the use of one-time revenues, and funding for new programs and added new policies related to budgeting, revenues, cost recovery, fee waivers, capital project funding, and pension funding. Based on this proposal, the City Council and Mayor adopted the Financial Policies in April 2005.

The Financial Policies currently contain six sections:

- Section 1 – Fiscal Policies
- Section 2 – Fee Waiver Policy
- Section 3 – Capital Improvement Program Funding Policy
- Section 4 – Pension and Retirement Funding Policy
- Section 5 – Reserve Fund Policy
- Section 6 – Debt Management Policy

In the decade that followed, these policies have signaled that the City prioritizes systematic, responsible financial behavior. Rating agencies have noted the City's fiscal management and policies as a source of strength in their assessment of the City's fiscal condition. This Office has reported on, and the Mayor and City Council have sought, compliance with the Financial Policies especially when making decisions with budgetary implications.

The Financial Policies state that this Office is expected to periodically review and revise them. While the existing policies could continue to guide responsible financial decisions for the foreseeable future, there have been enough changes in the City's policy landscape and the acknowledged best practices in governmental financial management to justify a revision at this time. These changes include:

- The establishment of the Budget Stabilization Fund in the 2009-10 Adopted Budget, followed by its incorporation into the City Charter in 2011 and in the Los Angeles Administrative Code in 2014.
- The City Council and Mayor's adoption of a new General Fund Encumbrance Policy in February 2013.

- Review, revision, and establishment of new or updated Government Finance Officers Association (GFOA) "Best Practices" related to governmental financial activities.

In addition to these changes, the City has also experienced the implementation of the Financial Policies for more than a decade and is now in a position to refine them based on that experience.

In this report, this Office proposes changes to four of the six sections of the Financial Policies. These sections include the Fiscal Policies, the Fee Waiver Policy, the Pension and Retirement Funding Policy, and the Reserve Fund Policy. This report also recommends adding a new Encumbrance Policy section, which incorporates and revises the current Encumbrance Policy. This Office has also developed recommendations for revisions to the Capital Improvement Program Funding Policy and the Debt Policy, including the addition of a formal Disclosure Policy that will codify current practice, which we will present for consideration separately.

The following sections discuss the proposed substantive changes to the Financial Policies. The attachments to this report include all proposed changes in two separate documents, the Proposed Financial Policies document (Attachment 1) and the Proposed Financial Policies – Redlined document (Attachment 2). We have also attached a summary of the proposed Financial Policies that provides a general overview of the every policy (Attachment 3).

Fiscal Policies

The Fiscal Policies Section of the Financial Policies focuses on expenditure and revenue policies required to establish and maintain a balanced budget. While this section continues to focus on budget, it is expanded to include more policies. Many of the additions reflect the City's current practice, policy, or law but are brought into the Financial Policies to ensure that all such policies are included in a single document. Other additions reflect new policies, mirroring current best practices in municipal financial management. Some current policies are recommended for elimination from the Financial Policies if they are not strictly budget-related policies and they simply restate policies, regulations, or laws that are already administered by the City.

The Fiscal Policies are currently divided into the two broad categories of "Budgetary" and "Revenues." In order to make the more numerous policies easier to locate, this Office proposes organizing them into a greater number of more specific categories that reflect their content.

The following includes the proposed Fiscal Policies Section in a redlined format. Following each provision is commentary in italics discussing the basis for the policy and any recommended revisions.

Structurally Balanced Budget

1. The City's goal is to achieve and maintain a structurally balanced budget in which future costs are projected to be fully paid by future revenues.

This proposed new policy establishes and defines a goal of achieving a structurally balanced budget. It is consistent with the GFOA recommendation that governments adopt policies "aimed at

achieving and maintaining a structurally balanced budget."[1] *In April 2014, the City Council adopted as a policy objective the elimination of the structural deficit (C.F. 13-0600-S152), and the Mayor has separately identified its elimination as an objective. Structural balance helps the City preserve financial sustainability, which the GFOA defines both as "a government's ability to manage its finances so it can meet its spending commitment both now and in the future," and whether government finances "ensure future generations of taxpayers do not face an unmanageable bill for government services provided to the current generation."*[2]

2. Current appropriations for all funds are limited to the sum of available~~, unencumbered~~ cash balances and revenues estimated to be received in the current budget year.

This existing policy is an acknowledgment that the City's budget must be balanced – that appropriations must match available funding.

3. ~~General Fund~~ Expenditures ~~and subsidy appropriations~~ for mandated and priority programs are to be made against current revenue sources and not dependent upon uncertain reserves or fluctuating prior-period cash balances.

This existing policy is intended to ensure that high-priority programs are paid for by certain and existing sources of revenues. The reference to "subsidy appropriations" is not necessary since "expenditures" captures all possible appropriations. The policy is amended to apply to all funds, not only the General Fund.

4. The City will avoid using ~~temporary~~ one-time revenues to fund ongoing programs or services. The use of unencumbered prior-year balances in all funds as well as all other one-time revenues shall be scrutinized and carefully limited to be used primarily for one-time expenditures. ~~One-time revenues will only be used for one-time expenditures.~~ One-time expenditures are defined as those that have a clearly recognized termination date connected to the completion of the identified purpose of the expenditure, even if the expenditure crosses multiple fiscal years.

This existing policy limiting the use of one-time revenues is consistent with the GFOA recommendation that "recurring revenues are equal to recurring expenditures in the adopted budget."[3] *Relying on non-recurring revenues for recurring programs makes it difficult to continue those programs in future years.*

The policy further calls for the City to scrutinize the use of one-time revenues. This is also consistent with the City's current practice, as this Office presents a list of one-time General Fund revenues and expenditures in conjunction with the proposed budget. It is also consistent with GFOA best practices, which recommend that governments identify and present non-recurring revenues along

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[1] GFOA. *Best Practice: Achieving a Structurally Balanced Budget.* February 2012.
[2] GFOA. *Best Practice: Role of the Finance Officer in Supporting Fiscal Sustainability.*
[3] GFOA. *Best Practice: Achieving a Structurally Balanced Budget.* February 2012.

with the annual budget.[4]

This Office recommends new language that clarifies that one-time expenditures can include multi-year expenditures when they are related to a project with a clear termination date. This reflects how this Office currently performs this analysis. It is also consistent with GFOA best practices, which state that "recurring expenditures should be those that you expect to fund every year in order to maintain current/status quo service levels."[5]

5. To the extent possible, current operations will be funded by current revenues.

This existing policy helps to maintain current service levels by funding them with existing revenues. Further, by requiring the use of current revenues to fund current operations, this policy ensures that future taxpayers will not be burdened to pay for current services.

6. Multi-year General Fund operating cost projections, which forecast revenues and expenditures, shall be prepared and updated each year, or as necessary, to identify and evaluate the financial condition of the City over a ~~five~~ four year period, at a minimum. This forecast shall be ~~recognized~~ reported to the ~~through~~ City Council as part of the annual budget development process ~~action, along with the adoption of the budget for the next fiscal year~~. Projections shall be developed using available data, historical trends, and an evaluation of anticipated future impacts to revenues and expenditures. Departments shall prepare a forecast for each major special fund and special fund facing structural imbalance that they administer and present it with their annual budget request.

This existing policy is consistent with GFOA best practices that state that governments should prepare a forecast that "extend[s] several years into the future…[and is] presented in the final budget document."[6] *The policy is amended to match current practice by changing the minimum period for the projection from five years to four years and to state the general methodology for the projections. This policy is also consistent with current practice in which this Office presents a Four-Year Outlook with the budget documents that is then updated following the adoption of the budget. The adopted budget Four-year Outlook is included in the City's disclosure documents and this Office's First Financial Status Report. Adopting a multi-year forecast is an essential component of determining whether the budget has achieved structural balance as it identifies whether the future revenues will be sufficient to maintain the current level of services in the coming years.*

While the current policy requires a General Fund Outlook, it is further amended to require special fund administrators to also produce annual forecasts for special funds that they oversee as part of the annual budget process. As with the General Fund Outlook, these special fund forecasts would help decision makers determine whether the City's special funds are in structural balance.

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[4] GFOA. *Best Practice: Achieving a Structurally Balanced Budget.* February 2012.
[5] GFOA. *Best Practice: Achieving a Structurally Balanced Budget.* February 2012.
[6] GFOA. *Best Practice: Financial Forecasting in the Budget Preparation Process.* February 2014.

7. When initiating multi-year projects or adding new items to the budget with future-year expenditure requirements, the City shall consider its ability to continue to pay these future year expenses.

This proposed new policy is consistent with GFOA best practice that states that a key characteristic of the budget process should to "incorporate a long-term perspective."[7] This Policy makes the connection between understanding long-term costs, and using that information to impact actual budgetary decisions. It thereby supports the goal of achieving structural balance.

8. New and expanded unrestricted revenue~~s~~ sources should be first applied to support existing ~~programs~~ obligations prior to funding new programs. This in no way precludes the City from terminating existing programs for any reason, including for the purpose of making resources available for new programs.

This existing policy supports efforts to achieve structural balance by ensuring that current services are fully funded before new services are added to the budget. It also supports efforts to ensure that current services are adequately funded prior to adding new services. The amended language is intended to clarify that the policy does not prevent the City from terminating current programs for the purpose of using resources to advance new priorities and programs.

9. The City will pursue federal, state, and private grants but will carefully analyze the need for, and availability of, required ~~strictly limit~~ financial support of these programs ~~to avoid commitments that continue~~ beyond grant ~~available~~ funding. Any such financial support must be reported at the time that the City considers accepting the grant. Financial support includes, but is not limited to, an obligation for a current or ongoing City match and a need to maintain a service level following the termination of the grant.

This existing policy is consistent with GFOA's best practice that when a government considers applying for a grant it should evaluate whether there are personnel, operating, or maintenance costs that will continue past the period of the grant award.[8] While the existing policy restricts the acceptance of grants that require financial support but lack available funding, the proposed policy requires that the City analyze and report on any financial support at the time of the grant's acceptance. The amended language also clarified the meaning of financial by giving specific examples. The policy supports structural balance as it requires the City to consider the availability of non-grant funding that will be necessary if a grant is accepted. This supports efforts to curtail long-term financial obligations that lack ongoing funding.

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[7] GFOA. *Best Practice: Recommended Budget Practices from the National Advisory Council on State and Local Budgeting.* January 1998.

[8] GFOA. *Best Practice: Establishing a Grants Administration Oversight Committee.* January 2015.

Performance Budgeting

10. Departments are encouraged to develop strategic plans that state how and when the City will achieve organizational goals and the resources that will be required and available to do so. Strategic plans should also identify the data that will be used to measure progress toward these goals.

This is the first of three proposed new policies that will formalize the City's focus on performance management, which are intended to ensure that financial decisions are informed by the degree to which they support the City's priorities and strategies and the anticipated outcomes that they will produce. These three policies would institutionalize current City practice to ensure that performance management continues to inform decisions on an ongoing basis.

This first policy encourages City departments to develop strategic plans. These plans are an essential component of performance budgeting in that they connect the broad organizational goals with specific operational steps, resources, and measurable outcomes. Many departments have already developed strategic plans consistent with this proposed policy.

This proposed policy is also consistent with GFOA best practices, which recommend that governmental agencies prepare strategic plans that link the organization's mission to specific goals and identify how those goals are to be achieved.[9] Further, the strategic plan should be linked to a concrete financial plan, identifying what resources are required and available to achieve organizational goals, currently and in the future.[10] Finally, GFOA recommends that strategic plans include performance measures, which are discussed in more detail in the following policy.[11]

11. Budget documents shall present information illustrating the resources used to achieve organizational goals.

The second of three proposed performance management policies ensures that budget information is presented in such a way that decision makers can evaluate the costs of achieving the City's organizational goals, which is an essential component of performance budgeting. This information is currently presented annually in the budget documents by identifying the services and costs associated with each of the City's budgetary programs. The proposed policy ensures that the budget "establishes linkages to broad organizational goals," which is one of GFOA's key characteristics of the budget process.[12]

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[9] GFOA. *Best Practice: Establishment of Strategic Plans.* March 2005.
[10] GFOA. *Best Practice: Long-Term Financial Planning.* February 2008.
[11] GFOA. *Best Practice: Performance Management for Decision Making.* March 2007.
[12] GFOA. *Best Practice: Recommended Budget Practices from the National Advisory Council on State and Local Budgeting.* January 1998.

12. Budgetary decisions shall be informed by data that measures the City's delivery of services against established targets for performance.

The final of these three new policies requires budgetary decisions to be informed by data illustrating how well programs are performing against measures tracked by the City. This policy requires that the data that measure how effectively core services are being performed be chosen and presented to decision makers in order to inform their budget decisions. This policy codifies existing practice as budget documents currently include at least one key metric with both historical data and projected outcomes for each budgetary program.

The use of performance measures and their connection with the budget process is consistent with GFOA's best practices, which state that "performance measures [should] be developed and used as an important component of long term strategic planning and decision making which should be linked to governmental budgeting."[13]

Employee Costs

13. The City shall evaluate accurate and thorough employee compensation and count data when budgeting for employee-related costs.

This is the first of three new policies to ensure that data related to employee costs are available for analysis, that the costs are appropriately budgeted, and that compensation packages are determined with an understanding of the City's fiscal condition. The ability to accurately track employee counts and costs is essential given the high portion of the City's budget that is dedicated to employee-related costs. This new policy is consistent with the City's current use of its payroll, budgeting, and financial management systems to track employee data, and is consistent with GFOA best practices.[14] *Adopting this policy would also promote current efforts to link these systems more closely together and efforts to implement an enterprise-wide position control system, which would make financial and vacancy information readily available regarding every position in the City.*

14. The inclusion of unfunded positions in the budget is discouraged. Full funding for all positions in the budget, however, is not required if it can be demonstrated that a department is unlikely to be fully staffed throughout the fiscal year.

This new policy discourages the occasional practice of adding positions to the budget without funding. This practice both establishes the unrealistic expectation that a department should perform a service without resources, and creates structural imbalances in the budget as these positions must be paid for once they are filled or in future years when they are funded. This policy also recognizes the current practice of adjusting the amount of funds provided for positions to take into account vacancies, the time required for hiring, or other salary savings that accrue during the

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[13] GFOA. *Best Practice: Performance Management for Decision Making.* March 2007. See also: GFOA. *Best Practice: Performance Management.* October 2011 and GFOA. *Best Practice: Recommended Budget Practices from the National Advisory Council on State and Local Budgeting.* January 1998.
[14] GFOA. *Best Practice: Effective Budgeting of Salary and Wages.* March 2010.

course of the fiscal year, which is consistent with GFOA best practices.[15] The policy requires that any such underfunding be able to be demonstrated as appropriate.

15. The City Administrative Officer, or the employee authorized by the CAO to act in that capacity, shall be designated as the City's management representative in formal relationships with recognized employee organizations. In addition to the other components of this role, the CAO must report to the Mayor and City Council on the potential costs of employee agreements, including but not limited those from salaries, retirement, and other benefits.

This proposed new policy replicates the current Los Angeles Administrative Code section that designates this Office as the representative for City management before employee organizations.[16] This existing provision is recommended to be added to the Financial Policies to demonstrate that the City's practice is consistent with the GFOA best practice that the finance officer plays this role. Among the purposes for this involvement is the ability of the finance officer to calculate the potential current and long-term costs or savings associated with matters negotiated through collective bargaining.[17]

Budget Control

16. The City will consider ~~General Fund~~ requests for new or expanded programs during the course of the annual budget development process. Only in extreme circumstances will such requests be considered on an interim basis during the course of the fiscal year.

This existing policy recognizes the challenge that while each individual service that the City provides is important and deserving of resources, the City's limited resources are best appropriated in the context of the entire budget, when services can be prioritized against each other. The policy is amended to apply to all funds, not only the General Fund.

17. Changes to budget appropriations during the fiscal year shall be limited and subject to the review and approval of the Mayor and the City Council.

This new corollary to the above policy reflects the current City Charter and Los Angeles Administrative Code, which require that transfers between funds and accounts be approved by the Mayor and, depending on the amount, the City Council.[18] Restating the general policy here reaffirms the City's commitment that adjustments to the budget appropriations during the fiscal year should be limited.

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[15] GFOA. *Best Practice: Effective Budgeting of Salary and Wages.* March 2010.
[16] Los Angeles Administrative Code Section 4.870(a)(1).
[17] GFOA. *Role of Finance Officer in Collective Bargaining.* January 2015.
[18] Los Angeles City Charter Section 342 and Section 343; Los Angeles Administrative Code Section 5.35 and Section 5.36.

Revenues

18. The City will continuously seek new revenues and pursue a diverse revenue base in order to limit ~~the dependence on one or only a few revenue sources. This revenue diversity will shelter~~ the impact to the City from short-~~time~~ term fluctuations in any one revenue source.

This existing revenue policy recognizes the importance of having a diverse revenue stream. With diverse revenue sources, each source is impacted by different economic factors and a downturn in one area of the economy is less likely to negatively impact the entire revenue system, which enhances stability. Further, as argued by the National Conference of State Legislatures, a broad and diverse revenue system spreads the tax burden across multiple actors leading to more competitive tax rates as compared to jurisdictions that rely on revenues generated from fewer sources.[19]

19. Any ~~revenue~~ tax-rate reductions or exemption for ~~both the~~ any General Fund ~~and~~ or special funds revenue source shall only be approved as a temporary adjustments with a sunset clause. Permanent ~~revenue~~ reductions or exemptions should not be implemented due to ~~Proposition 218~~ State tax-rate restrictions that prohibit increasing tax rates ~~revenue~~ without voter approval.

This existing policy recognizes that it is difficult to increase or implement new taxes in California. Therefore, it is the City's policy to protect current sources of revenue.

20. Unrestricted General Fund revenue streams shall not be designated as restricted or special funds. This is no way precludes the City from making appropriations from unrestricted revenues to achieve specific policy goals either as part of the budget process or during the fiscal year.

The policy restricts the dedication of General Fund revenue streams to meet specific policy purposes. While dedicating General Fund revenue for specific purposes does make a strong statement of current priorities, priorities can change over time. Therefore, keeping the General Fund unrestricted preserves City leaders' ability to prioritize the use of resources annually through the budget process.

21. City actions that may result in a reduction in revenue during the fiscal year shall be limited and subject to the review and approval of the Mayor and City Council. Expenditure reductions must be identified to fully offset any such revenue reduction.

This proposed new policy builds on the prior one by stating that the City may only take an action that reduces revenues with approval of the Mayor and City Council. Further, any such reduction during the fiscal year must be offset by a commensurate reduction in an appropriation in order to ensure that the budget remains in balance.

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[19] National Conference of State Legislatures, *Principles of a High-Quality State Revenue System*, Fourth edition, June 2001 updated June 2007.

Fees for Service

22. The City will charge fees for services where such an approach is permissible by state and federal law, and where a group of beneficiaries who can pay such fees is identifiable. For the purposes of these provisions, fees for service are those set by the City in amounts no more than the reasonable cost of providing the service in accord with California Constitution, Article 13C, Section 1(e)(1), (e)(2), and (e)(3).

This existing policy establishes the criteria for appropriately charging a fee for service, which are if a particular beneficiary of a service can be identified and if it is permissible by law. These criteria are consistent with GFOA best practices, which state that "governments should consider charges and fees on the direct recipients of those that receive benefits from such services."[20] Since the City's policies related to fees for services were initially adopted, California voters passed Proposition 26, which established all governmental charges as taxes and thus subject to voter approval unless they fall into several categories of exceptions. Therefore, this Office recommends amended language that states that the Fees For Services provisions of the Financial Policies apply to fees for service that are permitted by Proposition 26. More specifically, the provisions apply to those fees that the City sets in an amount that is based on the reasonable cost of providing the service.

23. Sufficient ~~user charges and~~ fees for service shall be ~~pursued and~~ levied ~~to support the full cost of operations~~ based on the reasonable cost of providing the service for which fees are charged, including ~~all~~ the operating (direct and indirect), ~~and~~ capital, and appropriate projected future costs. All ~~user charges and~~ fees for service for the City shall be monitored annually to determine that rates meet, but do not exceed, the reasonable cost of providing the service. ~~are adequate and each source is maximized~~. If a current or proposed fee is not recovering the reasonable cost of providing the service, the department that administers that service shall consider proposing a new fee based on the reasonable cost of the service as part of its annual budget submission.

This existing policy identifies the appropriate components of fees and states that existing fees must be reviewed annually to ensure that they remain adequate to recover the costs of the service. This Office recommends two revisions. The first is to clarify that in addition to operating and capital costs, fees may incorporate the current portion of projected future costs associated with the service. This is consistent with GFOA best practices.[21] The second revision adds that if fees do not fully recover costs, the administering department should consider submitting a proposed fee adjustment with its annual budget submission. This revision is consistent with current practice. This Office also recommends replacing the term "full cost of operations" with "reasonable cost of providing the service" in order to mirror the language use for permissible costs in Proposition 26.

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[20] GFOA. *Best Practice: Establishing Government Charges and Fees.* February 2014.
[21] GFOA. *Best Practice: Establishing Government Charges and Fees.* February 2014.

24. If, upon careful review of policy considerations, the Mayor and City Council determine to set the amount of a fee for service below the level required to recover the reasonable cost of providing that service, ~~If fees or charges are not set at 100 percent full cost recovery,~~ the Mayor and City Council ~~will~~ must take specific action ~~specifically recognize the subsidy and shall take specific action~~ to appropriate the necessary funds to fully pay for that ~~subsidize the fee for~~ service. The amount of any such appropriation shall be reported annually through the budget process.

The existing policy states that if a fee is not set at full cost recovery, the Mayor and City Council must recognize that the service is subsidized and appropriate funds to pay for the balance of the service. The policy is recommended for revision to clarify that Mayor and City Council may set fees below full cost recovery upon their review of policy considerations related to the fee that they deem appropriate. This addition is consistent with GFOA best practices that state that when a government decides that fees should not fully recover costs, a "rationale…should be provided."[22] The policy is also recommended for revision to require that fee subsidies be reported annually as part of the budget process. This addition is intended to facilitate implementation of the existing portion of the policy, which requires the Mayor and City Council to recognize fee subsidies and appropriate any funding necessary for the service. This Office also recommends replacing the term "100 percent full cost recovery" with "reasonable cost of providing that service" in order to mirror the language use for permissible costs in Proposition 26.

25. In rare circumstances, when permitted by law and based on a finding of clear public benefit, ~~From time to time,~~ the City Council may decide to waive fees for service for an individual user. ~~when it can be demonstrated that a direct public benefit can be obtained.~~ If the fee to be waived is for a service funded through a source of funds generated by the collection of that fee, a General Fund appropriation may be required to prevent other service users from improperly subsidizing such fee.

This is an existing policy that permits the City Council to decide to waive fees. The current policy is a separate section of the Financial Polices, Section 2, Fee Waiver Policy. Since the pertinent portion is short and related to fees for service, it is recommended to be moved as a single policy within the Fiscal Policies section. The policy is recommended for revision to reflect the current practice of appropriating funds from the General Fund for fee waivers that would otherwise result in a subsidy from paying users to users who receive a fee waiver.

Special Funds

26. Special ~~Revenue~~ ~~F~~funds are supported by special levies and fees, grants, or intergovernmental revenues. Expenditures in these funds are strictly limited to the mandates of the funding source. Special ~~Revenue~~ ~~F~~funds are not to be used to subsidize other funds, except as required or permitted by program regulations.

This existing policy demonstrates the City's commitment to using dedicated revenue sources solely for the purposes for which they are received. This policy is consistent with the legal restrictions

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[22] GFOA. *Best Practice: Establishing Government Charges and Fees.* February 2014.

associated with each of those sources of revenues. These restrictions protect special funds and those that pay for their services by ensuring that all revenues associated with the funds will only be used to pay for that activity.

27. Enterprise ~~F~~funds are a subset of special funds that ~~are expected to~~ derive 100 percent of their revenues from charges, user fees, and interest. Functions that are funded using ~~E~~enterprise funds ~~agencies or departments~~ should be 100 percent ~~self~~ supporting ~~entities~~ through annual reviews of their ~~its~~ fee structures, charges for services, and other operating revenues and expenditures.

This existing policy relates to enterprise funds. Enterprise funds are those that are established to ensure that revenues generated by a specific activity will be devoted entirely to paying for that activity. This policy states that enterprise funds should be fully supported by the fees that they generate, protecting the General Fund from having to subsidize activities that can be funded through fees.

28. It shall be the goal for all special funds to fully reimburse the General Fund for all direct expenditures and related costs provided to support their programs. Related cost reimbursements shall be calculated using the most current Cost Allocation Plan rate, unless otherwise restricted by an ordinance or policy that has been approved by the Mayor and City Council. In the event that a special fund does not fully reimburse the General Fund, any remaining subsidy shall be reported annually through the budget process.

This new policy matches the current practice that special funds are expected to not only pay their direct costs, but also reimburse the General Fund to the degree that the General fund supports those services. For example, while a special fund may be used to pay employee salaries, the General Fund pays for the City's portion of pensions and other benefits. Further, the General Fund may pay for administrative support both within the department and in internal support departments of an otherwise special-funded service. These and other related costs are captured in the Cost Allocation Plan, which is prepared annually by the Controller to meet standards for federal grant overhead reimbursements. At times, special funds may not fully pay their related costs. In those situations this policy requires that any such subsidy by the General Fund be recognized and reported through the budget process.

29. Special fund administrators are encouraged to establish a reserve policy for their funds where permitted and appropriate. These policies should set a target minimum reserve level that accounts for the unique characteristics and risks to the fund. The policies should also establish the appropriate uses of the reserves and set a timeframe both for meeting reserve targets if they have not yet been achieved and for replenishing reserves should they fall below the target minimum level.

This proposed new policy would encourage departments that administer a special fund to establish a target minimum reserve level for that fund and a timeframe for achieving and replenishing that level. The reserve policies should also establish the appropriate uses of the fund. These components of a reserve policy are consistent with GFOA best practices for establishing a fund

balance in the General Fund.[23] *GFOA best practices also recommend that adoption of working capital targets, which are similar to reserves, for funds other than the General Fund.*[24] *Establishing a reserve for a special fund will protect the General Fund, since the General Fund may be required to subsidize any such funds that face fiscal challenges. Adequate reserves in a special fund could delay or even prevent such a subsidy. Special fund administrators will be required to determine what level of reserve is permitted under the restrictions related to the use of the fund's receipts. They will further be required to determine if it is appropriate to establish a reserve, and may consider whether the special fund is already subsidized by the General Fund.*

Similar to the GFOA recommended methodology of establishing the target General Fund reserve level,[25] *special fund administrators should consider the unique risks that each fund faces when determining the appropriate minimum reserve level. For example, funds with exposure to economic downturns may set a target reserve level that permits continued operation during the period of downsizing that would accompany a recession. Funds that heavily invest in infrastructure may want to ensure adequate reserves to rebuild following a natural disaster. In addition, GFOA recommends that working capital targets take into account the specific nature of the revenue streams, customer base, and other demands.*[26]

30. Special fund administrators must regularly evaluate and manage the balances within the fund to ensure that they are spent timely to achieve the fund's intent.

This proposed new policy is intended to ensure that special fund administrators actively manage the balances within special funds to ensure that they are spent timely and appropriately.

Transparency

31. Due to the scale, scope, and complexity of the City's finances, in order to further transparency and thus facilitate public participation, the City will publish clear and accurate budgetary and financial documents highlighting significant components including salaries, pensions and other benefits, capital projects, contracts, and equipment purchases.

This proposed new policy is a statement of the City's commitment to public participation in fiscal decisions. It is consistent both with the current practice and law for all City decisions. Further, it is among the key characteristics of the budget process recommended by the National Advisory Council on State and Local Government.[27] *It also reflects GFOA best practices, which "recommends that governments incorporate public participation efforts in planning, budgeting, and performance management results processes."*[28] *In addition, the proposed policy includes a*

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[23] GFOA. *Best Practice: Fund Balance Guidelines for the General Fund.* September 2015.
[24] GFOA. *Best Practice: Adopting Financial Policies.* September 2015. See also: GFOA. *Working Capital Targets for Enterprise Funds.* February 2011.
[25] GFOA. *Best Practice: Fund Balance Guidelines for the General Fund.* September 2015.
[26] GFOA. *Working Capital Targets for Enterprise Funds.* February 2011.
[27] GFOA. *Best Practice: Recommended Budget Practices from the National Advisory Council on State and Local Budgeting.* January 1998.
[28] GFOA. *Best Practice: Public Participation in Planning, Budgeting, and Performance Management.* February 2009.

statement of the City's commitment to presenting clear and accurate budgetary and financial information to facilitate effective participation. This component of the policy will not require the presentation of additional information, but will encourage efforts to make it more clear.

32. Reports to the Mayor and City Council shall include Fiscal Impact Statements that include the full cost of the program or service in the current year, plus the future annual costs.

This existing policy requires that reports submitted to the Mayor and City Council include a fiscal impact statement. This requirement enables City leaders and the public to evaluate the costs associated with the proposed policy decisions and therefore complies with the GFOA best practices that state that governments must provide relevant information in order to support public participation.[29]

33. ~~All~~ Reports to the Mayor and City Council ~~motions for consideration before Council~~ shall include a statement that is easily identifiable indicating whether or not the ~~motion or~~ requested action complies with ~~conforms~~ the City's adopted financial policies. To the extent possible, City Council motions with financial impacts shall also be evaluated for compliance with the financial policies.

This revised policy requires that reports submitted to the Mayor and City Council include a statement of whether the proposed actions are in compliance with these Financial Policies. The current policy that applies this requirement to City Council motions may be impractical for routine motions that are submitted and approved without a formal report, leaving no time or venue for a compliance statement to be prepared. Shifting the applicability of this policy to reports and motions with a financial impact will both target appropriate proposals and facilitate compliance. Since departments are usually asked to prepare reports on issues that include significant financial decisions, these decisions will increasingly be informed by their compliance with the Financial Policies. This policy enables City leaders and the public to evaluate the fiscal responsibility of proposed policy decisions and reflects GFOA best practices related to reporting to support public participation, as discussed above.

~~34. The Comprehensive Annual Financial Report, prepared by the Controller will include debt information on a consolidated basis for the entire City. The City Administrative Officer will also review the outstanding debt of the City and prepare a detailed report to Council, in conjunction with the annual budget.~~

This existing policy requires that information related to the City's debt be reported both in the Comprehensive Annual Financial Report (CAFR) and as part of the City budget. This Office is currently preparing a proposed revision to the Debt Policy section of the Financial Policies. Therefore, reporting requirements related to debt will be moved into that section of the Financial Policies.

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[29] GFOA. *Best Practice: Public Participation in Planning, Budgeting, and Performance Management.* February 2009.

34. The CAO shall prepare periodic reports to the Mayor and City Council regarding the condition of the current year's budget. These reports will forecast year-end expenditure and revenue balances, identify major issues of concern facing the current year's budget, and recommend necessary budgetary adjustments.

This proposed new policy requires periodic reporting during the fiscal year regarding the condition of the current budget. This policy reflects current practice in which this Office prepares periodic Financial Status Reports that include the information identified in this policy. These reports are currently requested by the City Council through the adoption of the annual budget and are consistent with this Office's City Charter duties, which include periodic reporting on the condition of the City's finances and revenues and on proposed appropriations adjustments.[30] This policy enables City leaders and the public to evaluate the City's fiscal condition and complies with GFOA best practices related to reporting to support public participation, as discussed above.

Disposition of Assets

35. Any surplus equipment and vehicles will be sold at current market rates ~~to both profit and non-profit agencies except~~. The City Council may make exceptions to this policy as delineated in the Administrative Code[31] to achieve public policy objectives, avoid a financial loss, or support a Sister City or otherwise designated government. ~~for agencies that are performing specific work for and in the City of Los Angeles.~~

This existing policy ensures that the City will get an appropriate value for surplus equipment that is sold and identifies when exceptions to this policy may be made. The proposed revisions to the policy update it to reflect recent changes to Los Angeles Administrative Code Section 22.547, which is the basis for this policy.

36. Disposition of any real property not required for City use must be in accordance with Government Code Section 54220 and at fair market value. The City's Asset Evaluation Framework provides the parameters for this process. The City Council may make exceptions to this policy for non-profits and governmental entities that are furthering the work provided by the City subject to a community benefits analysis that concludes that the value of the proposed services meets or exceeds the fair market value of the property.

We recommend adding this existing policy related to the disposition of the City's surplus real property (C.F. 12-1549-S3) to the Fiscal Policies so that both City policies related to the disposition of surplus property are included. The policy requires that the City must sell real property at market value, and that the City Council may approve exceptions to this policy if it finds that the value of the services that will be provided exceed value of the property.

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[30] Los Angeles City Charter Section 291(a), (d), and (f).
[31] Los Angeles Administrative Code Section 22.547.

Asset Management

~~37. To the extent possible, the City shall annually budget one percent of General Fund revenue to fund capital or infrastructure improvements. This policy recognizes the importance of maintaining the City's capital assets on a regular basis to avoid major deferred maintenance and to extend the useful life of the asset.~~

This existing policy requires that the annual budget include appropriations for capital or infrastructure improvements equal to one percent of General Fund revenues. The changes that this Office has proposed to the Capital Improvement Program Funding Policy, if adopted, will supersede this policy and it is therefore recommended for elimination from this section of the Financial Polices. This Office will continue to track and report on compliance with the policy as part of the annual budget process.

37. The City shall make adequate investments to maintain real property and equipment at appropriate levels.

This new policy requires that City to maintain its assets in order to preserve their value and usefulness. This policy statement is broad, but the expectation is that additional detail defining "adequate investments" in, and "appropriate levels" of, maintenance will be developed in the coming years following the adoption of the revised Capital and Technology Improvement Policy. That proposed Policy states that the intent is that capital investment decisions will be driven by the intent to achieve and maintain standards for the quality of the City's infrastructure

Liabilities

38. As a primarily self-insured entity, the City must set aside funding each year for judgments and settlements that require payments on claims made against the City. Therefore, the budget shall include an appropriation to the Liability Claims Account for this purpose.

This new policy reflects the current practice of funding the City's Liability Claims Account. Setting aside these funds each year even though the actual liabilities are uncertain ensures that the City is prepared to make these payments, which can be significant, without impacting its reserves. The current Financial Policies require funding for liabilities in the Reserves Section. Since the Liability Claims Account is not truly a reserve account (see discussion below), the funding requirement is moved to this new policy in the Fiscal Policies Section.

39. The CAO, in collaboration with the City Attorney, shall report periodically on payments made on claims by City department and type of case.

The new policy reflects the current practice and helps City leaders and department heads to understand the major sources of liability in the City. With this information, managers are expected to take steps to reduce future risks, where possible.

Other Deleted Policies

~~39. The City recognizes the importance of emergency reserves that can provide a financial cushion in years of poor revenue receipts or in the event of a major emergency. A Reserve Fund Policy has previously been developed and approved by the Mayor and Council. The revised Reserve Fund Policy is incorporated herein in Section 5.~~

This policy is recommended for elimination from this section of the Financial Policies. The content is revised and moved to the General Fund Reserves Policy section of the Financial Policies.

~~40. All City funds shall be reconciled at the close of the fiscal year. This reconciliation will compare all fund revenue and liabilities to determine the available cash balance at year-end.~~

This existing policy is recommended for elimination. This ongoing practice, led by the Office of the Controller with support from all City departments, will continue. It is performed in accordance with the framework of local government accounting policies, rules, and laws and beyond the scope of the Financial Policies.

Fee Waiver Policy

This Office recommends revising the Fee Waiver Policy for accuracy and moving it to the Fiscal Policies section. Specifically, we recommend removing the references to specific fee waiver policies that were under development in 2005, as those policies are not being actively developed at this time.

Pension and Retirement Funding Policy

The revised Pension and Retirement Funding Policy will continue to state that the City is committed to fully funding both its pension systems based on annual actuarial studies. This Office recommends adding language to discourage any mechanisms to defer current year required contributions to future years. The mechanisms could include spreading approved increases in the annual contribution over several years or issuing debt, such as pension obligation bonds, to cover current payments. These approaches are problematic because they move current obligations to future generations. Further, regarding pension obligation bonds, the GFOA has issued an advisory recommending that local governments not issue them because of the risk and costs that they carry.[32] Therefore, if these approaches are to be considered, the policy requires that the City consult with independent experts before proceeding. The policy recognizes that amortizing the systems' gains or losses over a period of time, as recommended by an actuary, continues to be an appropriate practice.

The current policy also requires that in the event that either pension system is overfunded resulting in a City contribution less than the normal cost of retirement, the City may not use the savings generated for ongoing purposes. Normal cost is defined as the annual cost of providing retirement benefits for services performed by today's members. This Office recommends amending the policy

[32] GFOA. *Advisory: Pension Obligation Bonds.* January 2015.

to further limit the use of those savings to the unfunded portion of pension or healthcare costs for retirees.

Finally, in recent years the City Employees Retirement System has been performing annual true-ups by comparing actual required contribution to the amount paid through the budget. If the City has overpaid, the City can reduce its subsequent year's contribution and if the City underpaid, it must increase it. This Office recommends adding a provision to the policy that states that the City may use half of any true-up credit adjustment to reduce an unfunded portion of the retirement system, as designated by the Mayor and City Council through the budget process.

The remaining proposed changes to the policy are stylistic rather than substantive. Most significantly, the current policy includes a chart that uses actual data from the 2005-06 Proposed Budget to illustrate how the calculation of the savings resulting from the overfunding envisioned in the policy is performed. This Office recommends revising the chart with amounts that do not reflect actual data but that illustrate one example of when the policy would be enacted, and one in which it would not be.

The GFOA recommends that governments adopt pension and other postemployment benefit (OPEB) policies related to asset smoothing, amortization, and investment.[33] Pursuant to the California Constitution, the board that oversees each of the City's pension systems has "authority and fiduciary responsibility for investment of moneys and administration of the system."[34] Accordingly, each board has developed, adopted, and implemented, and continues to oversee, these policies for its system. Therefore, since these policies are already in place for the City, they are not recommended for inclusion in the Financial Policies.

General Fund Reserves Policy

This Office recommends amending the Reserve Fund Policy to include all General Fund reserves, which include not only the Reserve Fund but also the Budget Stabilization Fund and the Unappropriated Balance line item for mid-year adjustments. To reflect the broader focus, this Office recommends renaming the section the "General Fund Reserves Policy."

Expanding this Policy serves three purposes. First, the Budget Stabilization Fund and its associated policy were established after the original Financial Policies were adopted. It is now appropriate to include those policies in the Financial Policies. Second, the City now regularly reports cumulative General Fund reserve levels, rather than just the Reserve Fund level. This proposed policy reflects that current practice. Finally, it is consistent with the GFOA description of reserves, or unrestricted fund balance, which includes all of the financial resources available to the government and not otherwise dedicated for specific purposes.[35]

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[33] See: GFOA. *Best Practice: Core Elements of a Funding Policy.* April 2014. GFOA. *Best Practice: Sustainable Funding Practices for Defined Benefit Pensions and Other Postemployment Benefits (OPEB).* January 2016. GFOA. *Best Practice: Investment Policies for Defined Benefit Plans.* September 2017.
[34] California Constitution Article XVI Public Finance, Section 17.
[35] GFOA. *Best Practice: Fund Balance Guidelines for the General Fund.* September 2015.

The proposed policy establishes target levels for the reserves where appropriate, states when funds from the reserves may be used, and identifies the means through which the reserves will be replenished if used. These components were also included in the original Reserve Fund Policy, but only for the Reserve Fund and not for the Budget Stabilization Fund or the Unappropriated Balance line item for mid-year adjustments. The GFOA recommends including these components in a reserve policy.

The major proposed changes to the policy include:

- Expanding and changing the items included in the cumulative reserves.
- Establishing a 10 percent cumulative reserves target.
- Adjusting the method for calculating the annual required contribution to, or permitted withdrawal from, the Budget Stabilization Fund.
- Reducing the maximum contribution to the Budget Stabilization Fund to 25 percent of the excess growth amount.
- Limiting the exceptions to when the budget must include an appropriation to the Budget Stabilization Fund.
- Establish a discretionary cap on the Budget Stabilization Fund of 2.75 percent of the adopted General Fund budget.

The components of the cumulative reserves. The current Reserve Fund Policy includes both the Reserve Fund and the Liabilities Claims Fund (now called the Liability Claims Account) as part of the City's total reserves. This Office recommends revising the policy to include funds that are appropriated without a designated use in the annual budget. The proposed policy notes that these funds may not all be intended for use to address operational shortfalls or challenges throughout the year, but they are all available to do so following appropriate action by the City Council and Mayor.

The Liability Claims Account does not conform to this definition and is therefore recommended for elimination from the Reserve Section. Funding is appropriated to Liability Claims to pay for settlements or judgments brought against the City. While the specific payments may not be known at the time of the adoption of the budget, the appropriation is intended to cover the specific payments that become required during the year. Since it is fiscally responsible to continue to fund the Liability Claims Account, policies related to it are moved to the Fiscal Policies Section.

The Reserve Fund, Budget Stabilization Fund, and Unappropriated Balance line item for mid-year adjustments do fall into the reserves category pursuant to the proposed definition. The Reserve Fund includes two accounts, the Contingency Reserve and the Emergency Reserve. Both may be used to address needs that emerge during the fiscal year, although the requirement for accessing the Emergency Reserve is stricter, requiring a finding of urgent economic necessity and a two-thirds vote of the City Council (or three-fourths to override a Mayoral veto).[36] The Budget Stabilization Fund is intended only for use at the time of the adoption of the budget to offset below-

[36] Los Angeles City Charter Section 302(b)(3).

average revenue growth, but the policy restricting its use can be suspended and it too can be accessed during the fiscal year through the City Council and Mayor's action.[37] Finally, in recent years the adopted budget has included a line item in the Unappropriated Balance for mid-year adjustments, which can be and has been used as an operating reserve. The proposed policy includes this Unappropriated Balance line item as a reserve to formalize this practice and to designate this line item as the first source of funds to be accessed in the case of operating shortfalls or challenges.

Including these three items as cumulative reserves is consistent with the recent practice of the City. For several years, this Office has been reporting on the balances in these three items in its discussions of the City's reserves as part of the annual budget and in other reports and presentations to City leaders, the public, ratings agencies, and investors. Amending this policy as proposed will codify this practice.

Establishing Reserves Targets. Having established the definition of cumulative reserves, the proposed policy establishes a target for the value of these reserves at ten percent of all General Fund receipts anticipated in the adopted budget. In April 2014, the City Council adopted this ten percent target as a goal (C.F. 13-0600-S152), and it is therefore recommended for inclusion in the Financial Policies. The proposed Financial Policies retain the current policy threshold for the Reserve Fund of five percent of General Fund revenues.

While the GFOA recommends that the standard minimum reserve target should be equivalent to two months of operating revenues, or approximately 17 percent, the GFOA acknowledges that this rule may not apply to America's largest governments.[38] Therefore, in establishing the reserve target, this Office evaluated the City's unique risk profile and determined that a lower target is appropriate. While the City does face the risk of significant disruption from a natural or human-caused disaster, the City benefits from stable financial structures. Most notably, the City has a broad and diverse revenue stream, which is therefore relatively stable. Further, federal and state funding does enable the City to provide important services, most notably in the areas of human services, community development, and infrastructure, but in the absence of those funds the City would maintain funding for many other core services.

Budget Stabilization Fund Policy Revisions. The City Council and Mayor first adopted the current policies regarding the Budget Stabilization Fund in June 2013 (C.F. 13-0455) and then added it to the Los Angeles Administrative Code as Section 5.120.4 in April 2014. This Office recommends revising the current policy and incorporating it into the Financial Policies. The proposed revisions adjust the method by which the deposits into, and withdrawals from, the Fund are to be calculated, limit the exceptions to the deposit policy, reduce the maximum deposit level, and add a cap to the Fund. If this proposed policy is approved, it is recommended that the City Attorney be requested to prepare an amended ordinance reflecting these changes.

Pursuant to the current Budget Stabilization Fund policy, all receipts from the seven major General

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[37] Los Angeles Administrative Code Section 5.120.4(c) and 5.120.4(d).
[38] GFOA. *Best Practice: Fund Balance Guidelines for the General Fund.* September 2015.

Fund tax revenues that exceed a threshold growth rate of 4.5 percent are to be deposited into the Fund. The Mayor and Council may reduce any required appropriation to the Budget Stabilization Fund in order to maintain the Reserve Fund at five percent of the General Fund, to comply with the City's Capital Policy, or as they otherwise determine. This portion of the policy protects the City from using extraordinary revenues that may not be sustainable for ongoing appropriations.

If growth from the seven General Fund tax revenues falls short of 4.5 percent, the Budget Stabilization Fund may transfer a designated amount to the budget. The amount of the permitted transfer is calculated as a sliding scale increasing to up to 25 percent of the Fund's value based on the size of the revenue shortfall. This portion of the policy provides funding to lessen the need for extreme spending reductions during the initial stages of an economic downturn, thus allowing the City to have a soft landing.

The growth threshold is to be recalculated at least every five years. The calculation is to be based on the previous five years of growth in the seven tax revenues. Consistent with this provision of the ordinance, in the 2019-20 Adopted Budget the City Council requested the City Attorney to revise the threshold to 4.5 percent. The Mayor and City Council amended the ordinance, which was enacted in September 2019.

This Office has identified several areas of this policy that could benefit from adjustment or clarification. Therefore, the proposed General Fund Reserves Policy incorporates and includes the following revisions to the Budget Stabilization Fund Policy:

- Calculation of the Average Annual Ongoing Growth Threshold. The Office recommends changing the 4.5 percent growth standard and its method of being calculated (every five years based on the prior five years of growth) to an annual calculation based on the prior 20 years of growth. The longer timeframe for the calculation will result in a more stable and realistic growth target. The proposed policy requires this Office to perform and present this calculation to the City Council after the release of the Controller's *Preliminary Financial Report* and prior to its consideration of the proposed budget. This regular review will ensure that the target remains stable and adjusts gradually. This new target is called the "Average Annual Ongoing Growth Threshold" (Growth Threshold). If the Growth Threshold were calculated at this time based on the proposed methodology, it would be 4.1 percent.

- Growth Calculations Limited to Ongoing Growth. The Growth Threshold and the annual calculation of actual growth will include only ongoing revenue growth. This has been the practice for the past several years, and the proposed policy continues that practice.

- Withdrawal Rule. As with the current policy, appropriations from the Budget Stabilization Fund will be permitted when ongoing revenue growth is below the Growth Threshold. The withdrawal amount will continue to increase on a sliding scale, growing if revenues fall further below the growth threshold.

  Current policy recommends an appropriation up to five percent of the Budget Stabilization Fund balance for each one-tenth of one percent below the Growth Threshold up to a

maximum of 25 percent of the Fund balance. This Office recommends two changes to this approach. First, this Office recommends that the amount of the withdrawal be based on the value of the difference between the Anticipated Growth and the Growth Threshold, not to exceed the available balance of the Budget Stabilization Fund. This change recognizes that the actual need for funds is based on the value of the lost revenue rather than the balance of the Fund.

Second, this Office recommends increasing the increment below the Growth Threshold that triggers an additional five percent withdrawal from one-tenth of one percent to one percent. This ensures that the maximum withdrawal will only occur in the most serious economic downturns.

- Deposit Rule. Current policy requires that all revenues above the Growth Threshold be transferred to the Budget Stabilization Fund. This Office recommends that instead, for every five-tenths of one percent that the revenues exceed the Growth Threshold, the budget must appropriate five percent of the value of the excess revenues up to a maximum value of 25 percent of the total excess revenues to the Budget Stabilization Fund.

  The intent of the deposit rule is to constrain the spending of extraordinary revenues on ongoing expenditures that will not be sustainable once growth falls below average levels, as it inevitably does. Gradually increasing the contribution recognizes that the greatest risk comes when the expanded expenditures are largest, as large reductions are more difficult to achieve.

  The deposit increment of five-tenths of one percent is lower that the withdrawal increment of one percent so that over time, deposits exceed withdrawals allowing the Fund to grow gradually. Based on our statistical analysis, we project that under this policy the Fund will grow at an average of 3.1 percent per year.

- Clarification of Exceptions to the Deposit Rule. Current policy permits that instead of an appropriation to the Budget Stabilization Fund, the City Council and Mayor may instead use excess revenues to comply with the Reserve Fund five percent policy, the Capital Infrastructure one percent policy, or in the case of a fiscal emergency. These exceptions are in place as a statement of the relative importance of the City's various financial policies, ranking compliance with the Capital and Reserve Fund policies above the Budget Stabilization Fund Policy.

  When applied over the past several years, however, these exceptions have dramatically reduced the required appropriation to the Budget Stabilization Fund. For example, due to the use of these exceptions the appropriation was less than 10 percent of the total requirement in 2018-19, and 0.5% in 2017-18. Therefore, this Office recommends the elimination of the exceptions for capital expenditures and maintaining the Reserve Fund, leaving only the fiscal emergency exception.

- Cap. Under the proposed withdrawal and deposit structure, the Budget Stabilization Fund will grow over time. Therefore, this Office recommends a discretionary cap on the Fund of 2.75 percent of the adopted General Fund budget. This amount equals the cap on the

Emergency Reserve. The proposed cap provision states that the City must use any excess appropriation for one-time purposes. Based on our statistical analysis, this Office anticipates that the Budget Stabilization Fund will meet the 2.75 percent cap in 2057.

General Fund Encumbrance Policy

In February 2013, the Mayor and City Council adopted an Encumbrance Policy to ensure that City staff regularly reviewed and released prior-year encumbrances when no longer necessary in order to make funding available for current priorities (C.F. 12-0600-S29). It is now appropriate to include the Encumbrance Policy in the Financial Policies as part of this proposed revision. The revisions change the format and style to be consistent with the Financial Policies, and remove portions of the Policy that were specific to the original February 2013 release date.

The single proposed substantive revision to the existing policy is to clarify that encumbrances for supplies, equipment, or other items purchased through the City's procurement system may be retained for three rather than one year. This modification reflects that expenditures for projects may cross multiple fiscal years and that the time involved with procuring certain items may exceed a single year. This adjustment is consistent with current practice.

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Attachments

ATTACHMENT 1

FINANCIAL POLICIES FOR THE CITY OF LOS ANGELES

ADD DATE

CITY OF LOS ANGELES
FINANCIAL POLICIES

Table of Contents

CITY OF LOS ANGELES
FINANCIAL POLICIES

INTRODUCTION

The City of Los Angeles enjoys strong credit ratings from each rating agency that tracks the City's credit.[1] These high ratings reflect a variety of factors, including the strength and diversity of the regional economy, moderate City debt levels, and historically strong fiscal management, including the provision of adequate reserves. The City is committed to implementing and maintaining strong financial policies and fiscal stewardship. The City last prepared an update of its financial policies in April 2005. Since 2005, the City has established a Budget Stabilization Fund (BSF), policies related to the BSF, and a General Fund Encumbrance Policy. These comprehensive Financial Policies for the City of Los Angeles (Financial Policies) present these new policies as well as revisions to the existing policies to reflect current best practices.

As part of the City Administrative Officer's (CAO) continuing responsibility to ensure the financial stability of the City, these Financial Policies will be periodically updated and maintained.

[1] The City's current credit ratings can be found at the Debt Management section of the Office of the City Administrative Officer's website: http://cao.lacity.org/debt/index.htm

SECTION 1
FISCAL POLICIES

OBJECTIVE

The City is supported by various financial resources and must function within the limits of these financial resources each fiscal year. A balance must be maintained between revenues and expenditures so that the public can realize the benefits of a strong and stable local government. It is important to understand that these policies are to be applied over a period of time that extends beyond the current-year appropriations. By law, the annual budget cannot exceed available resources, defined as revenues generated in the current year added to balances carried forward from prior years. Temporary operating deficits measured against current revenue can and do occur, but they will not be tolerated as extended trends. The City cannot develop a legacy of operating deficits or a legacy of using one-time revenues for ongoing expenditures and expect either to achieve structural balance or to continue the delivery of high quality services to City residents.

POLICIES

Structurally Balanced Budget

1. The City's goal is to achieve and maintain a structurally balanced budget in which future costs are projected to be fully paid by future revenues.

2. Current appropriations for all funds are limited to the sum of available cash balances and revenues estimated to be received in the current budget year.

3. Expenditures for mandated and priority programs are to be made against current revenue sources and not dependent upon uncertain reserves or fluctuating prior-period cash balances.

4. The City will avoid using one-time revenues to fund ongoing programs or services. The use of unencumbered prior-year balances in all funds as well as all other one-time revenues shall be scrutinized and carefully limited to be used primarily for one-time expenditures. One-time expenditures are defined as those that have a clearly recognized termination date connected to the completion of the identified purpose of the expenditure, even if the expenditure crosses multiple fiscal years.

5. To the extent possible, current operations will be funded by current revenues.

6. Multi-year General Fund operating cost projections, which forecast revenues and expenditures, shall be prepared and updated each year, or as necessary, to identify and evaluate the financial condition of the City over a four year period, at a minimum. This forecast shall be reported to the City Council as part of the annual budget development process. Projections shall be developed using available data, historical trends, and an evaluation of anticipated future impacts to revenues and expenditures. Departments shall prepare a forecast for each major special fund and special fund facing structural imbalance that they administer and present it with their annual budget request.

7. When initiating multi-year projects or adding new items to the budget with future-year expenditure requirements, the City shall consider its ability to continue to pay these future year expenses.

8. New and expanded unrestricted revenue sources should be first applied to support existing obligations prior to funding new programs. This in no way precludes the City from terminating existing programs for any reason, including for the purpose of making resources available for new programs.

9. The City will pursue federal, state, and private grants but will carefully analyze the need for, and availability of, required financial support of these programs beyond grant funding. Any such financial support must be reported at the time that the City considers accepting the grant. Financial support includes, but is not limited to, an obligation for a current or ongoing City match and a need to maintain a service level following the termination of the grant.

Performance Budgeting

10. Departments are encouraged to develop strategic plans that state how and when the City will achieve organizational goals and the resources that will be required and available to do so. Strategic plans should also identify the data that will be used to measure progress toward these goals.

11. Budget documents shall present information illustrating the resources used to achieve organizational goals.

12. Budgetary decisions shall be informed by data that measures the City's delivery of services against established targets for performance.

Employee Costs

13. The City shall evaluate accurate and thorough employee compensation and count data when budgeting for employee-related costs.

14. All position authorities shall be supported by funding. Full funding for all positions in the budget, however, is not required if it can be demonstrated that a department is unlikely to be fully staffed throughout the fiscal year.

15. The City Administrative Officer, or the employee authorized by the CAO to act in that capacity, shall be designated as the City's management representative in formal relationships with recognized employee organizations. [2] In addition to the other components of this role, the CAO must report to the Mayor and City Council on the potential costs of employee agreements, including but not limited those from salaries, retirement, and other benefits.

Budget Control

16. The City will consider requests for new or expanded programs during the course of the annual budget development process. Only in extreme circumstances will such requests be considered on an interim basis during the course of the fiscal year.

17. Changes to budget appropriations during the fiscal year shall be limited and subject to the review and approval of the Mayor and the City Council.[3]

Revenues

18. The City will continuously seek new revenues and pursue a diverse revenue base in order to limit the impact to the City from short-term fluctuations in any one revenue source.

19. Any tax-rate reduction or exemption for any General Fund or special fund revenue source shall only be approved as a temporary adjustment with a sunset clause. Permanent reductions or exemptions should not be implemented due to State tax-rate restrictions that prohibit increasing tax rates without voter approval.

20. Unrestricted General Fund revenue streams shall not be designated as restricted or special funds. This is no way precludes the City from making appropriations from unrestricted revenues to achieve specific policy goals either as part of the budget process or during the fiscal year.

21. City actions that may result in a reduction in revenue during the fiscal year shall be limited and subject to the review and approval of the Mayor and City Council. Expenditure reductions must be identified to fully offset any such revenue reduction.

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[2] Los Angeles Administrative Code Section 4.870(a)(1).

[3] Los Angeles City Charter Section 342 and Section 343; Los Angeles Administrative Code Section 5.35 and Section 5.36.

Fees for Service

22. The City will charge fees for services where such an approach is permissible by state and federal law, and where a group of beneficiaries who can pay such fees is identifiable. For the purposes of these provisions, fees for service are those set by the City in amounts no more than the reasonable cost of providing the service in accord with California Constitution, Article 13C, Section 1(e)(1), (e)(2), and (e)(3).

23. Sufficient fees for service shall be levied based on the reasonable cost of providing the service for which they are charged, including the operating (direct and indirect), capital and appropriate projected future costs. All fees for service for the City shall be monitored annually to determine that rates meet, but do not exceed the reasonable cost of providing the service. If a current or proposed fee is not recovering the reasonable cost of providing the service, the department that administers that service shall consider proposing a new fee that is based on the reasonable cost of the service as part of its annual budget submission.

24. If, upon careful review of policy considerations, the Mayor and City Council determine to set the amount of a fee for service below the level required to recover the reasonable cost of providing that service, the Mayor and City Council must take specific action to appropriate the necessary funds to fully pay for that service. The amount of any such appropriation shall be reported annually through the budget process.

25. In rare circumstances, when permitted by law and based on a finding of clear public benefit, the City Council may decide to waive fees for service for an individual user. If the fee to be waived is for a service funded through a source of funds generated by the collection of that fee, a General Fund appropriation may be required to prevent other service users from improperly subsidizing such fee.

Special Funds

26. Special funds are supported by special levies and fees, grants, or intergovernmental revenues. Expenditures in these funds are strictly limited to the mandates of the funding source. Special funds are not to be used to subsidize other funds, except as required or permitted by program regulations.

27. Enterprise funds are a subset of special funds that derive 100 percent of their revenues from charges, user fees, and interest. Functions that are funded using enterprise funds should be 100 percent self-supporting through annual reviews of their fee structures, charges for services, and other operating revenues and expenditures.

28. It shall be the goal for all special funds to fully reimburse the General Fund for all direct expenditures and related costs provided to support their programs. Related cost reimbursements shall be calculated using the most current Cost Allocation Plan rate, unless otherwise restricted by an ordinance or policy that has been approved by the Mayor and City Council. In the event that a special fund does not fully reimburse the General Fund, any remaining subsidy shall be reported annually through the budget process.

29. Special fund administrators are encouraged to establish a reserve policy for their funds where permitted and appropriate. These policies should set a target minimum reserve level that accounts for the unique characteristics and risks to the fund. The policies should also establish the appropriate uses of the reserves and set a timeframe both for meeting reserve targets if they have not yet been achieved and for replenishing reserves should they fall below the target minimum level.

30. Special fund administrators must regularly evaluate and manage the balances within the fund to ensure that they are spent timely to achieve the fund's intent.

Transparency

31. Due to the scale, scope, and complexity of the City's finances, in order to further transparency and thus facilitate public participation, the City will publish clear and accurate budgetary and financial documents highlighting significant components including salaries, pensions and other benefits, capital projects, contracts, and equipment purchases.

32. Reports to the Mayor and City Council shall include Fiscal Impact Statements that include the full cost of the program or service in the current year, plus the future annual costs.

33. Reports to the Mayor and City Council shall include a statement that is easily identifiable indicating whether or not the requested action complies with the City's adopted financial policies. To the extent possible, City Council motions with financial impacts shall also be evaluated for compliance with the financial policies.

34. The CAO shall prepare periodic reports to the Mayor and City Council regarding the condition of the current year's budget. These reports will forecast year-end expenditure and revenue balances, identify major issues of concern facing the current year's budget, and recommend necessary budgetary adjustments.

Disposition of Assets

35. Any surplus equipment and vehicles will be sold at current market rates. The City Council may make exceptions to this policy as delineated in the Administrative Code[4] to achieve public policy objectives, avoid a financial loss, or support a Sister City or otherwise designated government.

36. Disposition of any real property not required for City use must be in accordance with Government Code Section 54220 and at fair market value. The City's Asset Evaluation Framework provides the parameters for this process. The City Council may make exceptions to this policy for non-profits and governmental entities that are furthering the work provided by the City subject to a community benefits analysis that concludes that the value of the proposed services meets or exceeds the fair market value of the property.

Asset Management

37. The City shall make adequate investments to maintain real property and equipment at appropriate levels.

Liabilities

38. As a primarily self-insured entity, the City must set aside funding each year for judgments and settlements that require payments on claims made against the City. Therefore, the budget shall include an appropriation to the Liability Claims Account for this purpose.

39. The CAO, in collaboration with the City Attorney, shall report periodically on payments made on claims by City department and type of case.

[4] Los Angeles Administrative Code Section 22.547.

SECTION 3
PENSION AND RETIREMENT FUNDING POLICY

OBJECTIVE

The City has made a commitment to its past and current employees to provide ongoing pension payments and healthcare subsidies to them during their retirement. To fulfill this commitment, the City must make annual contributions to the Los Angeles City Employees' Retirement System (LACERS) and the Los Angeles Fire and Police Pension System (LAFPP) as part of the budget. It is important that the City continue to meet this commitment to ensure that the costs associated with current services are borne at the current time. This policy restates that commitment, establishes a discretionary use for any true-up credit adjustment, and dictates the City's use of any savings that are generated in the case that either pension system is overfunded.

POLICY

I. Funding Policies

A. City to Fully Fund Retirement Systems

The City is committed to its employee workforce and will execute its Charter requirements by fully funding both its pension and retirement systems based on the annual actuarial studies. These actuarial studies may change from year to year based on recent experience data, actuarial assumption changes, actuarial funding method changes, market conditions, future Governmental Accounting Standards Board reporting requirements, or other factors that may influence the actuarial process. It should be noted and understood by the City that market conditions affect both LACERS and LAFPP over time. These market conditions affect the funding ratio calculated at the end of each fiscal year through the actuarial process for both systems. Over time, depending on market conditions and the actuarial computed contribution rates, the City's annual contribution rate will increase and decrease.

B. Deferring Contributions

At times, opportunities may arise in which the City can request a phase-in of assumption changes approved by the respective retirement boards that increase the City's annual contributions. A phase-in of assumption changes essentially spreads the payments over several years and increases the overall cost to the City. Opportunities may also arise in which the City can seek debt mechanisms to cover current payments. Use of debt mechanisms to cover pension payments are both risky and can lead to higher overall costs for the City.

In most cases, these approaches to funding move current obligations to future periods and increase the overall costs to the City. Due to these risks, the City should consult with independent experts before using these mechanisms.

This policy does not restrict the systems' ability to amortize gains or losses over a period of time as recommended by an actuary and approved by either system's board.

C. Use of a True-Up Credit Adjustment

The City's annual contributions to the retirement systems is calculated using a projected employee payroll amount. During the course of the fiscal year, the systems may choose to recalculate the City's required contribution using actual payroll data. As a result of this recalculation, the City may be required to true up its contribution by either increasing or reducing the amount in the subsequent year. If the City is informed that it may take a true-up credit adjustment, it may use half of that credit to reduce an unfunded portion of the retirement system, as designated by the Mayor and City Council through the budget process.

II. Use of Savings if the Systems are Overfunded

During those fiscal years when either LACERS or LAFPP are over-funded (greater than 100% funded) and therefore the total annual required contribution, as adopted by the respective Boards, is less than the amount required to fund the normal cost of retirement and health benefits for employees, the City will limit the extent to which it will recognize these savings (negative unfunded actuarial accrued liability) in the budget. Specifically, the amount budgeted for retirement and health contributions will be no less than the amount derived by reducing the normal cost contribution rate to 90 percent. An adopted contribution rate that would allow the City to contribute an amount less than 90 percent of the normal cost shall trigger this provision that prohibits the City from using these savings to fund the City's ongoing service and program costs. Any savings or reduction in funding calculated due to the incremental contribution rate below the 90 percent threshold will only be budgeted to pay down unfunded pension or healthcare costs for retirees or, in the event the all such costs are fully funded, as an appropriation to the Budget Stabilization Fund.

This policy would only be triggered when either system has a total, negative unfunded actuarial accrued liability (UAAL) that would cause the actual contribution rate to be below the 90 percent threshold of the normal cost amount. When the total UAAL is positive, the City will continue to fully fund both the normal cost and UAAL as required by the City Charter.

Examples are provided below to illustrate this funding policy. The example uses hypothetical rates chosen to illustrate how this policy is applied.

Provision Calculation	Rate as a Percent of Pay Example 1	 Example 2
Normal Cost:		
Pension/Retirement Benefits	18	18
Health Benefits	2	2
Total Normal Cost	20	20
(A) Funding Threshold (Normal Cost times 90 percent)	18	18
(B) Normal Cost and Unfunded Actuarial Accrued Liability	25	15
(A - B) Credit (to be calculated against estimated salaries and used for one-time expenditures) or Cost of Unfunded Actuarial Accrued Liability	(7)	3

In example 1, the credit amount is negative meaning that the City's contribution is more than 90 percent of the normal cost of retirement and health benefits for employees. Therefore, funding would not be set aside for one-time uses pursuant to this policy. In example 2, on the other hand, the credit amount is positive and the policy goes into effect. The amount that must be set aside for one-time uses would be calculated by multiplying the credit of 3 percent by the covered payroll for the ensuing year's budget for the employees within the system.

The City Administrative Officer will be required to complete this analysis in preparation of the Proposed Budget. Any subsequent changes approved by the Mayor and City Council that affect the annual contribution rate for either system will then require the City Administrative Officer to re-calculate the funding threshold for the final Adopted Budget amount.

SECTION 4
GENERAL FUND RESERVES POLICY

OBJECTIVES

The General Fund Reserves Policy is intended to provide guidelines on the purpose, the sizing, the uses, and the restoration requirements of the Reserve Fund (both the Emergency and Reserve accounts), the Budget Stabilization Fund, and the Unappropriated Balance line item set aside for mid-year adjustments. Taken together, these three accounts compose the City's General Fund reserves. The Policy is further intended to ensure that sufficient reserves are maintained for unanticipated expenditures or revenue shortfalls, to preserve flexibility throughout the fiscal year to make adjustments in funding for programs approved in connection with the annual budget, and to prepare the City for potential revenue challenges in future years. The objective is for the City to be in a strong fiscal position to weather future economic downturns and financial challenges. Maintaining strong reserves is important since the City is bound by the requirements of Proposition 218, which prevents the City from raising taxes without voter approval. Furthermore, with strong reserves the City is better able to:

- Mitigate state or federal budget actions that may reduce City revenue.
- Mitigate economic downturns that the City may face in the future.
- Absorb large liability settlements without the need for issuing judgment obligation bonds.
- Purchase capital assets without the need to finance the purchase of assets.
- Front-fund or completely fund, if necessary, disaster recovery costs or costs associated with the City being self-insured.
- Absorb unanticipated budget shortfalls during the fiscal year that cannot be addressed by other means.
- Access the capital market at a lower cost by demonstrating the City's fiscal strength and ability to address unanticipated financial challenges.

The Government Finance Officers Association (GFOA) recommends that governments establish a formal policy on the level that should be maintained in the unrestricted fund balance of the General Fund. The GFOA does not specify that level, but recommends that it be determined taking into consideration vulnerability to natural disasters and the level of dependence on volatile revenue sources or on state and federal funding that is subject to being cut. While the GFOA sets a standard minimum balance as equivalent to two months of operating revenues, it states that this rule may

not apply to America's largest governments.[5] Since the City of Los Angeles falls into this category, it is appropriate for the City to establish its own minimum level of reserves rather than using the GFOA's general recommendation for maintaining reserves at least equal to two month of operations.

The City's reserves target should be based on its unique risk profile. The most significant catastrophic risk to Los Angeles is from a natural or human-caused disaster. Los Angeles' location in an active earthquake zone is the most obvious source of this risk and does provide justification for the City to maintain healthy reserves. Financially, however, the City benefits from stable financial structures that mitigate the need for unusually high reserves. For example, Los Angeles is a large government with a diverse, and therefore relatively stable, revenue base. Further, federal and state funding does enable the City to provide important services, most notably in the areas of human services, community development, and infrastructure, but in the absence of those funds the City would maintain funding for many other core services.

The rating agencies that evaluate the City's capacity to repay its debt have consistently stated that establishing and meeting minimum reserve levels is an important component of their review of the City's fiscal health. Thus, in addition to serving as a contingency for unforeseen challenges that arise during the fiscal year, the level of the City's reserves is also reviewed by investors that are considering purchasing the City's debt.

POLICIES

I. Total Reserves

A. Composition

The City's total reserves shall include funds that are appropriated without a designated use in the annual budget. Reserves may or may not be intended for use for unanticipated operational shortfalls or challenges, but they must be accessible for these purposes through an action of the City Council and Mayor. The total reserves include the Reserve Fund, the Budget Stabilization Fund, and the Unappropriated Balance line item set aside for mid-year adjustments.

B. Required Level

Other than the required funding levels for the Reserve Fund, which is not less than five percent of all General Fund receipts anticipated for that fiscal year in the adopted budget, there is no set required level of funding for the City's total reserves. It shall be the goal of the City that the cumulative value of the Reserve Fund, the Budget Stabilization Fund, and the Unappropriated Balance

[5] Government Finance Officers Association. *Best Practice: Fund Balance Guidelines for the General Fund.*

line item for mid-year adjustments be ten percent of all General Fund receipts anticipated for that fiscal year in the adopted budget.

C. Use of Excess Reserves

In the event the combined balance in the Reserve Fund and the Budget Stabilization Fund exceeds 15 percent of the adopted General Fund budget, the City Council and Mayor may consider appropriating the excess funds to other funding priorities that are considered to be one-time expenditures such as:

- Capital spending to meet the Capital and Technology Improvement Policy;
- Prepayment of General Fund debt;
- The unfunded portion of the City's civilian and sworn retirement systems; or
- Other obligations.[6]

This provision in no way relieves the City of its obligation to comply with the five percent Reserve Fund threshold requirement.

D. General Fund Reversions

Prior-year funds and surpluses will revert to their original funding sources.[7] Those reverting to the General Fund will first revert to the Reserve Fund to ensure the funding level of the Reserve Fund is at least five percent of the General Fund and to ensure sufficient funds are available in the Reserve Fund for year-end closing transfers. The balance of funds may be deposited into the Budget Stabilization Fund.

Reappropriations of current year funding to the subsequent year that are not approved through the budget development or year-end reporting process are discouraged. Requests for reappropriations of funds from the prior fiscal year shall be viewed as requests for new appropriations and subject to the provisions of the City's Financial Policies related to interim requests for funding and the uses of the City's reserves.

II. Reserve Fund

A. Purpose and Composition

The Reserve Fund shall include funding for unanticipated expenditures and revenue shortfalls in the City's General Fund. It shall include two accounts

[6] Los Angeles Administrative Code Section 5.120.4(c).
[7] Los Angeles City Charter Section 344.

within the fund, the Contingency Reserve Account and the Emergency Reserve Account.[8]

B. Required Level

The Reserve Fund shall be not less than five percent of all General Fund receipts anticipated for that fiscal year in the adopted budget.[9] The amount placed in each of the Reserve Fund accounts shall be determined as follows:

1. Contingency Reserve Account

The Contingency Reserve Account shall include all monies in the Reserve Fund over and above the amount required to be allocated to the Emergency Reserve. The amount, however, is not expected to be less than 2.25 percent of all of the receipts anticipated for that fiscal year in the adopted budget. The amount may also be higher depending on recent experience with the need for supplemental funding during the year for programs approved in conjunction with the budget.

2. Emergency Reserve Account

The City Council shall annually allocate an amount to the Emergency Reserve Account that shall bring the balance in that Account to not less than 2.75 percent of all General Fund receipts anticipated for that fiscal year in the adopted budget.[10]

C. Uses

1. Contingency Reserve Account

In the event that during the year there are unanticipated expenses or revenue shortfalls impacting programs already approved in conjunction with the current year budget, and appropriations within the Unappropriated Balance or surpluses within other City programs are not available, the Contingency Reserve Account will be the source of any additional funding for those programs. Funds must be appropriated by a vote of at least a majority of the City Council, with Mayoral concurrence, or by a two-thirds vote of the City Council in the event of a Mayoral veto.[11] The Contingency Reserve Account shall not be used to fund new programs or positions added outside of the current year budget. Such funding must come from other non-Reserve Fund sources.

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[8] Los Angeles City Charter Section 302(b).
[9] Los Angeles Administrative Code Section 5.120
[10] Los Angeles City Charter Section 302(b)(2).
[11] Los Angeles Administrative Code Section 5.120(b).

2. Emergency Reserve Account

Transfers from the Emergency Reserve Account of the Reserve Fund shall require approval by a two-thirds vote of the City Council with the concurrence of the Mayor, or, in the event of a Mayoral veto, by a three-fourths vote of the City Council. Concurrent with the transfer, the City Council shall make a finding of urgent economic necessity. The basis on which a finding of urgent economic necessity may be made includes, but shall not be limited to, a significant economic downturn after the budget is adopted, a natural disaster, such as an earthquake, civil unrest, or other significant unanticipated events requiring the expenditure of General Fund resources.[12]

D. Restoration

In fiscal years where it becomes necessary for the City to use monies in the Reserve Fund such that the Reserve Fund balance drops below the five percent level, the City will initiate action in the subsequent year to replenish the Reserve Fund to the level of five percent of General Fund receipts. If use of Reserve Fund monies is less than one percent of General Fund receipts, the City shall attempt to replenish the five percent balance in the subsequent fiscal year. If use of Reserve Fund monies is more than one percent of General Fund revenue, the City shall attempt to replenish the five percent balance by one percent per year over a period of years as necessary to restore the Reserve Fund balance to the level of five percent of General Fund revenue.

Notwithstanding this provision, if the Emergency Reserve Account must be used, the City shall, in the subsequent fiscal year, restore the Emergency Reserve Account to 2.75 percent of all General Fund receipts anticipated for that fiscal year in the adopted budget. In the event of a catastrophic event which requires use of the Emergency Reserve Account spanning more than one fiscal year, the City Council may, by a two-thirds vote with the concurrence of the Mayor or, in the event of a Mayoral veto, by a three-quarters vote, temporarily suspend the restoration requirements provided, however, that concurrent with the action of the City Council to suspend the requirement, the City Council adopts findings detailing the necessity for continued access to the Emergency Reserve Account and setting forth a date on which the restoration requirements shall be reinstated.[13]

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[12] Los Angeles City Charter Section 302(b)(3)(ii).
[13] Los Angeles City Charter Section 302(b)(4) and Section 302(b)(5).

III. Budget Stabilization Fund

A. Purpose

The Budget Stabilization Fund (BSF) is established to provide a method to prevent overspending during prosperous years and to provide resources to help maintain service levels during lean years.[14]

B. Required Level

1. No Minimum Balance

The BSF does not have a minimum balance that it must maintain. The deposit and withdrawal rules established herein will ultimately dictate the available balance in the BSF. When General Fund tax growth is projected to exceed average annual ongoing growth, a portion of that growth must be deposited into the BSF. If growth is projected to fall short of average annual ongoing growth, a portion of the BSF may be appropriated to the subsequent year's budget.

2. Establishment of the Average Annual Ongoing Growth Threshold

The Average Annual Ongoing Growth Threshold (Growth Threshold) shall be calculated by the Office of the City Administrative Officer and presented to the Mayor and City Council for approval following the release of the Controller's *Preliminary Financial Report* and prior to the release of the Mayor's Proposed Budget on an annual basis. If a Growth Threshold is not approved prior to the release of the Mayor's Proposed Budget, the prior year's Growth Threshold will be used.

The Growth Threshold shall be the percentage equal to the 20-year average of the actual annual growth of cumulative ongoing receipts from the following seven sources:[15]

1. Property Tax
2. Utility Users' Tax
3. Business Tax
4. Sales Tax
5. Transient Occupancy Tax
6. Documentary Transfer Tax
7. Parking Users' Tax

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[14] Los Angeles Administrative Code Section 5.120.4
[15] Los Angeles Administrative Code Section 5.120.4(a).

References to the General Fund taxes in the remainder of this Section shall refer to these seven sources.

C. Withdrawal Criteria

Savings in the BSF will primarily be used to mitigate revenue shortfalls due to economic downturns and address the resulting short-term budgetary shortfall. The BSF should not be used to pay for increased or enhanced services. While the BSF does not provide long-term relief from the implementation of structural reductions or solutions, it will provide a soft landing and transition for difficult and painful reductions to discretionary programs.

During the development of the budget for the upcoming fiscal year, a transfer from the BSF to the General Fund may be incorporated as part of the adopted budget for that fiscal year when the anticipated ongoing combined growth (Anticipated Growth) of the General Fund taxes falls short of the Growth Threshold. The Anticipated Growth calculation will be based on the comparison between the ongoing General Fund tax receipts in the adopted budgets for the current fiscal year and the ensuing fiscal year.

For each one percent that the Anticipated Growth falls short of the Growth Threshold, the amount of the permitted transfer from the BSF shall be equal to five percent of the value of the anticipated shortfall. The maximum appropriation shall be equivalent to 25 percent of the value of the difference between the Anticipated Growth and the Growth Threshold, and may not exceed the available balance of the BSF.

The amount of the transfer from the BSF in any year may exceed the amount calculated pursuant to this methodology, subject to the availability of funds, if the City Council and Mayor have declared a fiscal emergency for the City or have suspended the BSF funding based on findings that it is in the best interest of the City to suspend the policy.

Any transfer authorized by this policy is permitted but not required.

D. Deposit Criteria

A budget appropriation to the BSF shall be included as part of the adopted budget for the following fiscal year when the Anticipated Growth exceeds the Growth Threshold.

For each five-tenths of one percent that the Anticipated Growth exceeds the Growth Threshold, the amount of the required appropriation to the BSF shall be equal to five percent of the value of the anticipated excess growth. The maximum appropriation shall be equivalent to 25 percent of the value of the growth above the Growth Threshold.

The required deposit to the BSF may be forgone in its entirety in the event that the City Council and Mayor declare a fiscal emergency or suspend the BSF funding policy based on findings that it is in the best interest of the City to suspend the policy.

Mid-year deposits to the BSF or deposits above the required amount may be authorized by the City Council, subject to the approval of the Mayor, at any time during the year from various General Fund sources. Consideration should be given to depositing unanticipated and unbudgeted receipts that are not otherwise required to balance the current year budget.

E. Use of Excess

In the event that the Budget Stabilization Fund exceeds 2.75 percent of the adopted General Fund budget, the City Council and Mayor may consider appropriating the excess funds to other one-time funding priorities.

IV. Unappropriated Balance – Line Item for Reserve for Mid-Year Adjustments

A. Composition and Purpose

Each year, the City Council and Mayor shall appropriate funds to a line item in the Unappropriated Balance intended for use as a reserve for mid-year adjustments. The purpose of this line item shall be to address shortfalls that arise during the fiscal year that cannot be otherwise addressed through service adjustments or account transfers. This line item shall be used to address these shortfalls prior to the Reserve Fund.

B. Required Level

There shall be no required amount for the appropriation to the Unappropriated Balance line item for mid-year adjustments. The appropriation amount shall be determined by the Mayor and City Council through the annual budget development process. When determining the appropriation to this line item, consideration shall be given to the nature of the risks to the subsequent year's budget and their likelihood and potential magnitude.

C. Uses

Transfers may be made from the Unappropriated Balance line item for mid-year adjustments during the fiscal year subject to the approval of the Mayor and City Council. Such transfers should be consistent with the purposes of this line item as determined by this Policy and that year's adopted budget.

D. Restoration

Transfers may be made to the Unappropriated Balance line item for mid-year adjustments during the fiscal year subject to the approval of the Mayor and City Council. Appropriate sources for such transfers include, but are not limited to, transfers of budgetary savings generated during the fiscal year in other General Fund accounts.

SECTION 5
GENERAL FUND ENCUMBRANCE POLICY

OBJECTIVE

An encumbrance is a reservation of funds to cover purchase orders, contracts, or other goods and services that are chargeable to an appropriation. It records obligations before goods are received or services are rendered. Encumbrances are often recorded based on estimates of the cost of goods or services being purchased.

An employee or officer of the City may not obligate the City to make payment for goods, services, or any other purpose until the employee has determined that funds are actually available in the proper account for the specific purpose. The City's encumbrance accounting system controls spending based on the appropriations, allotments, expenditure budget, or a combination of them. By requiring the government entity to commit to an expenditure through an encumbrance prior to the disbursement of funds, an encumbrance system provides a warning as the authorized expenditure level is approached and thus protects the entity from over-spending an appropriation.

While establishing encumbrances is an important accounting tool, retaining encumbrances past the point at which the associated expenditure is necessary restricts funds that could otherwise be used for pressing needs. Therefore, the objective of this policy is to establish the limitations on reprogramming prior-year encumbrances, and to ensure that the unnecessary encumbrances are released in a timely manner.

POLICY

I. Use of Current-Year Encumbered Funds

Once funds have been encumbered, they cannot be expended for anything other than what was authorized under the original encumbering authority, which could include a purchase order, contract, authority for expenditure, or travel authority. City departments may disencumber and re-encumber funds within the same fiscal year.

II. Adjustments to Prior-Year Encumbrances

City departments may not increase a prior-year encumbrance, but they may disencumber one. Notwithstanding this Policy, prior-year encumbrances in special funds and for capital projects may be increased.

Only the Mayor and City Council may reprogram prior-year disencumbered funds. At the end of a fiscal year, all unencumbered funds will revert to their respective originating funding source or, if the originating source is the General fund, to the Reserve Fund.

III. Release of Prior-Year Encumbrances

If funds are not disencumbered they will continue to be regarded as obligated balances, thereby reducing the available unobligated account balances. Consequently, the timely disencumbrance of funds is necessary to reflect an accurate and updated status on the availability of funds.

As a rule, any encumbered funds that remain unspent for a period longer than one fiscal year shall be reverted. An exception to this policy applies to encumbrances for commodities procurements, which include supplies or equipment. These encumbered funds shall revert if they remain unspent for a period longer than three years.

The City Controller and the City Administrative Officer are authorized to implement this Policy and to ensure funds are disencumbered at the appropriate time.

IV. Consideration of Exceptions to the Policy

A. In extraordinary circumstances, departments may request a reappropriation of funds when it can be clearly demonstrated that it is in the best interest of the City to do so. There must be at least one of the following conditions present before a request for reappropriation will be recommended for approval:

1. A legal obligation or liability. The goods or services must have been provided, but not yet paid.

2. A contingent liability. Items that are likely to become liabilities as a result of conditions undetermined at a given date, such as guarantees, pending lawsuits, judgments under appeal, unsettled disputed claims, unfilled purchase orders, and uncompleted contracts.

3. A legislative appropriation for a specific project which cannot be completed within the allowable time frame. Such appropriations, however, cannot be carried on indefinitely and the City Administrative Officer will reevaluate the continuation of the encumbrance if the project has not been completed.

B. This policy does not apply to prior-encumbrances for the Capital Improvement Expenditure Program (CIEP). These encumbrances are reviewed as part of the CIEP Year-end Reappropriations Report.

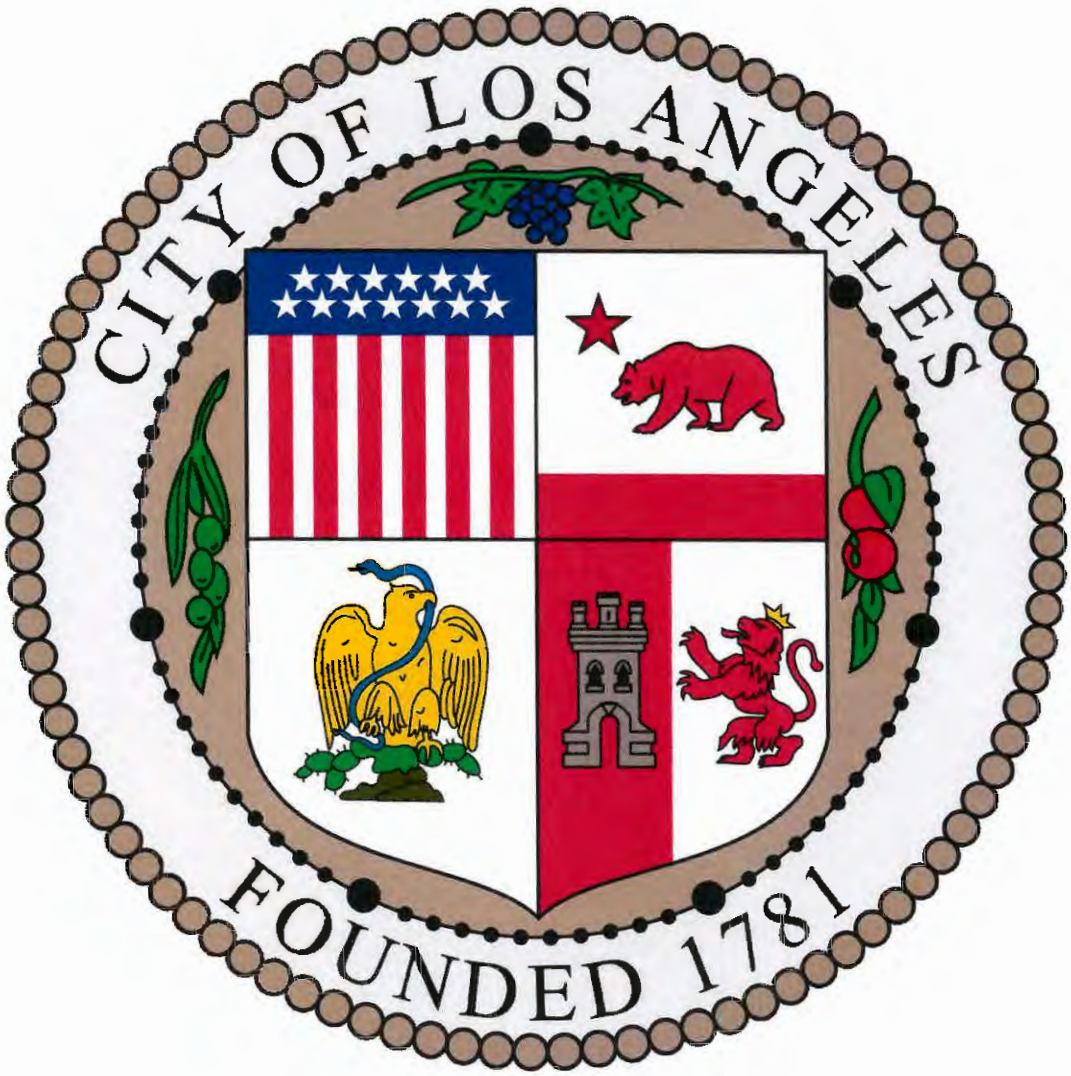
V. In the event that this policy creates the need for Direct Expenditures, departments must follow the applicable guidelines set forth in the Controller's manual.

ATTACHMENT 2

FINANCIAL POLICIES FOR THE CITY OF LOS ANGELES

REDLINED

~~April 2005~~



CITY OF LOS ANGELES
FINANCIAL POLICIES

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CITY OF LOS ANGELES
FINANCIAL POLICIES

INTRODUCTION

The City of Los Angeles enjoys strong ~~some of the highest~~ credit ratings from each rating agency that tracks the City's credit.[1] ~~of any major urban area in the nation.~~ These high ratings reflect a variety of factors, including the strength and diversity of the regional economy, moderate City debt levels, and historically strong fiscal management, including the provision of adequate reserves. The City is committed to implementing and maintaining strong ~~fiscal~~ financial policies and fiscal stewardship. ~~financial discipline. In previous years, the City has established a Reserve Fund Policy, a Debt Management Policy, a one-time funding policy, and an ongoing funding policy for new programs. These existing policies have been updated and incorporated into one comprehensive City Financial Policy document as contained herein.~~ The City last prepared an update of its financial policies in April 2005. Since 2005, the City has established a Budget Stabilization Fund (BSF), policies related to the BSF, and a General Fund Encumbrance Policy. These comprehensive Financial Policies for the City of Los Angeles (Financial Policies) present these new policies as well as revisions to the existing policies to reflect current best practices.

As part of the City Administrative Officer's (CAO) continuing responsibility to ensure the financial stability of the City, these Financial Policies will be periodically updated and maintained.

[1] The City's current credit ratings can be found at the Debt Management section of the Office of the City Administrative Officer's website: http://cao.lacity.org/debt/index.htm

SECTION 1
FISCAL POLICIES

OBJECTIVE

The City is supported by various financial resources and must function within the limits of these financial resources each fiscal year. A balance must be maintained between revenues and expenditures so that the public can realize the benefits of a strong and stable local government. It is important to understand that these policies are to be applied over a period of time that extends beyond the current-year appropriations. By law, the annual budget cannot exceed available resources, defined as revenues generated in the current year added to balances carried forward from prior years. Temporary operating deficits measured against current revenue can and do occur, but they will not be tolerated as extended trends. The City cannot develop a legacy of operating deficits or a legacy of ~~mixing~~ using one-time revenues for~~against~~ ongoing expenditures and expect either to achieve structural balance or to continue the ~~continued~~ delivery of high quality services to City residents.

~~As part of the City Administrative Officer's (CAO) continuing responsibility to ensure the financial stability of the City, these Policies will be continuously updated and maintained as needed. Any recommendation put forth to the Mayor and Council that is not in compliance with these Policies will be indicated as part of any report.~~

~~BUDGETARY~~ POLICIES

Structurally Balanced Budget

1. The City's goal is to achieve and maintain a structurally balanced budget in which future costs are projected to be fully paid by future revenues.

2. Current appropriations for all funds are limited to the sum of available~~, unencumbered~~ cash balances and revenues estimated to be received in the current budget year.

3. ~~General Fund~~ Expenditures ~~and subsidy appropriations~~ for mandated and priority programs are to be made against current revenue sources and not dependent upon uncertain reserves or fluctuating prior-period cash balances.

4. The City will avoid using ~~temporary~~ one-time revenues to fund ongoing programs or services. The use of unencumbered prior-year balances in all funds as well as all other one-time revenues shall be scrutinized and carefully limited to be used primarily for one-time expenditures. ~~One-time revenues will only be used for one-time expenditures.~~ One-time expenditures are defined as those that have a clearly recognized termination date connected to the completion of the identified purpose of the expenditure, even if the expenditure crosses multiple fiscal years.

5. To the extent possible, current operations will be funded by current revenues.

6. Multi-year General Fund operating cost projections, which forecast revenues and expenditures, shall be prepared and updated each year, or as necessary, to identify and evaluate the financial condition of the City over a ~~five~~ four year period, at a minimum. This forecast shall be ~~recognized~~ reported to the ~~through~~ City Council as part of the annual budget development process ~~action, along with the adoption of the budget for the next fiscal year~~. Projections shall be developed using available data, historical trends, and an evaluation of anticipated future impacts to revenues and expenditures. Departments shall prepare a forecast for each major special fund and special fund facing structural imbalance that they administer and present it with their annual budget request.

7. When initiating multi-year projects or adding new items to the budget with future-year expenditure requirements, the City shall consider its ability to continue to pay these future year expenses.

8. New and expanded unrestricted revenues sources should be first applied to support existing ~~programs~~ obligations prior to funding new programs. This in no way precludes the City from terminating existing programs for any reason, including for the purpose of making resources available for new programs.

9. The City will pursue federal, state, and private grants but will carefully analyze the need for, and availability of, required ~~strictly limit~~ financial support of these programs ~~to avoid commitments that continue~~ beyond grant ~~available~~ funding. Any such financial support must be reported at the time that the City considers accepting the grant. Financial support includes, but is not limited to, an obligation for a current or ongoing City match and a need to maintain a service level following the termination of the grant.

Performance Budgeting

10. Departments are encouraged to develop strategic plans that state how and when the City will achieve organizational goals and the resources that will be required and available to do so. Strategic plans should also identify the data that will be used to measure progress toward these goals.

11. Budget documents shall present information illustrating the resources used to achieve organizational goals.

12. Budgetary decisions shall be informed by data that measures the City's delivery of services against established targets for performance.

Employee Costs

13. The City shall evaluate accurate and thorough employee compensation and count data when budgeting for employee-related costs.

14. All position authorities shall be supported by funding. Full funding for all positions in the budget, however, is not required if it can be demonstrated that a department is unlikely to be fully staffed throughout the fiscal year.

15. The City Administrative Officer, or the employee authorized by the CAO to act in that capacity, shall be designated as the City's management representative in formal relationships with recognized employee organizations.[2] In addition to the other components of this role, the CAO must report to the Mayor and City Council on the potential costs of employee agreements, including but not limited those from salaries, retirement, and other benefits.

Budget Control

16. The City will consider ~~General Fund~~ requests for new or expanded programs during the course of the annual budget development process. Only in extreme circumstances will such requests be considered on an interim basis during the course of the fiscal year.

17. Changes to budget appropriations during the fiscal year shall be limited and subject to the review and approval of the Mayor and the City Council.[3]

Revenues

18. The City will continuously seek new revenues and pursue a diverse revenue base in order to limit ~~the dependence on one or only a few revenue sources. This revenue diversity will shelter~~ the impact to the City from short-~~time~~ term fluctuations in any one revenue source.

19. Any ~~revenue~~ tax-rate reductions or exemption for ~~both the~~ any General Fund ~~and~~ or special funds revenue source shall only be approved as a temporary adjustments with a sunset clause. Permanent ~~revenue~~ reductions or exemptions should not be implemented due to ~~Proposition 218~~ State tax-rate restrictions that prohibit increasing tax rates ~~revenue~~ without voter approval.

20. Unrestricted General Fund revenue streams shall not be designated as restricted or special funds. This is no way precludes the City from making appropriations from unrestricted revenues to achieve specific policy goals either as part of the budget process or during the fiscal year.

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[2] Los Angeles Administrative Code Section 4.870(a)(1).

[3] Los Angeles City Charter Section 342 and Section 343; Los Angeles Administrative Code Section 5.35 and Section 5.36.

21. City actions that may result in a reduction in revenue during the fiscal year shall be limited and subject to the review and approval of the Mayor and City Council. Expenditure reductions must be identified to fully offset any such revenue reduction.

Fees for Service

22. The City will charge fees for services where such an approach is permissible by state and federal law, and where a group of beneficiaries who can pay such fees is identifiable. For the purposes of these provisions, fees for service are those set by the City in amounts no more than the reasonable cost of providing the service in accord with California Constitution, Article 13C, Section 1(e)(1), (e)(2), and (e)(3).

23. Sufficient ~~user charges and~~ fees for service shall be ~~pursued and~~ levied ~~to support the full cost of operations~~ based on the reasonable cost of providing the service for which fees are charged, including ~~all~~ the operating (direct and indirect), ~~and~~ capital, and appropriate projected future costs. All ~~user charges and~~ fees for service for the City shall be monitored annually to determine that rates meet, but do not exceed, the reasonable cost of providing the service. ~~are adequate and each source is maximized~~. If a current or proposed fee is not recovering the reasonable cost of providing the service, the department that administers that service shall consider proposing a new fee based on the reasonable cost of the service as part of its annual budget submission.

24. If, upon careful review of policy considerations, the Mayor and City Council determine to set the amount of a fee for service below the level required to recover the reasonable cost of providing that service, ~~If fees or charges are not set at 100 percent full cost recovery,~~ the Mayor and City Council ~~will~~ must take specific action ~~specifically recognize the subsidy and shall take specific action~~ to appropriate the necessary funds to fully pay for that ~~subsidize the fee for~~ service. The amount of any such appropriation shall be reported annually through the budget process.

[NOTE – THE FOLLOWING POLICY REGARDING FEE WAIVERS IS MOVED FROM THE CURRENT SECTION 2 OF THE FINANCIAL POLICIES, FEE WAIVER POLICY, WHICH IS REMOVED IN ITS ENTIRETY.]

25. In rare circumstances, when permitted by law and based on a finding of clear public benefit, ~~From time to time,~~ the City Council may decide to waive fees for service for an individual user. ~~when it can be demonstrated that a direct public benefit can be obtained.~~ If the fee to be waived is for a service funded through a source of funds generated by the collection of that fee, a General Fund appropriation may be required to prevent other service users from improperly subsidizing such fee.

Special Funds

26. Special ~~Revenue~~ ~~F~~funds are supported by special levies and fees, grants, or intergovernmental revenues. Expenditures in these funds are strictly limited to the mandates of the funding source. Special ~~Revenue~~ ~~F~~funds are not to be used to subsidize other funds, except as required or permitted by program regulations.

27. Enterprise ~~F~~funds are a subset of special funds that ~~are expected to~~ derive 100 percent of their revenues from charges, user fees, and interest. Functions that are funded using ~~E~~enterprise funds ~~agencies or departments~~ should be 100 percent self-supporting ~~entities~~ through annual reviews of their ~~its~~ fee structures, charges for services, and other operating revenues and expenditures.

28. It shall be the goal for all special funds to fully reimburse the General Fund for all direct expenditures and related costs provided to support their programs. Related cost reimbursements shall be calculated using the most current Cost Allocation Plan rate, unless otherwise restricted by an ordinance or policy that has been approved by the Mayor and City Council. In the event that a special fund does not fully reimburse the General Fund, any remaining subsidy shall be reported annually through the budget process.

29. Special fund administrators are encouraged to establish a reserve policy for their funds where permitted and appropriate. These policies should set a target minimum reserve level that accounts for the unique characteristics and risks to the fund. The policies should also establish the appropriate uses of the reserves and set a timeframe both for meeting reserve targets if they have not yet been achieved and for replenishing reserves should they fall below the target minimum level.

30. Special fund administrators must regularly evaluate and manage the balances within the fund to ensure that they are spent timely to achieve the fund's intent.

Transparency

31. Due to the scale, scope, and complexity of the City's finances, in order to further transparency and thus facilitate public participation, the City will publish clear and accurate budgetary and financial documents highlighting significant components including salaries, pensions and other benefits, capital projects, contracts, and equipment purchases.

32. Reports to the Mayor and City Council shall include Fiscal Impact Statements that include the full cost of the program or service in the current year, plus the future annual costs.

33. ~~All~~ Reports to the Mayor and City Council ~~motions for consideration before Council~~ shall include a statement that is easily identifiable indicating whether or not the ~~motion or~~ requested action complies with ~~conforms~~ the City's adopted financial policies. To the extent possible, City Council motions with financial impacts shall also be evaluated for compliance with the financial policies.

34. ~~The Comprehensive Annual Financial Report, prepared by the Controller will include debt information on a consolidated basis for the entire City. The City Administrative Officer will also review the outstanding debt of the City and prepare a detailed report to Council, in conjunction with the annual budget.~~

34. The CAO shall prepare periodic reports to the Mayor and City Council regarding the condition of the current year's budget. These reports will forecast year-end expenditure and revenue balances, identify major issues of concern facing the current year's budget, and recommend necessary budgetary adjustments.

Disposition of Assets

35. Any surplus equipment and vehicles will be sold at current market rates ~~to both profit and non-profit agencies except~~. The City Council may make exceptions to this policy as delineated in the Administrative Code[4] to achieve public policy objectives, avoid a financial loss, or support a Sister City or otherwise designated government. ~~for agencies that are performing specific work for and in the City of Los Angeles.~~

36. Disposition of any real property not required for City use must be in accordance with Government Code Section 54220 and at fair market value. The City's Asset Evaluation Framework provides the parameters for this process. The City Council may make exceptions to this policy for non-profits and governmental entities that are furthering the work provided by the City subject to a community benefits analysis that concludes that the value of the proposed services meets or exceeds the fair market value of the property.

Asset Management

~~37. To the extent possible, the City shall annually budget one percent of General Fund revenue to fund capital or infrastructure improvements. This policy recognizes the importance of maintaining the City's capital assets on a regular basis to avoid major deferred maintenance and to extend the useful life of the asset.~~

37. The City shall make adequate investments to maintain real property and equipment at appropriate levels.

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[4] Los Angeles Administrative Code Section 22.547.

Liabilities

38. As a primarily self-insured entity, the City must set aside funding each year for judgments and settlements that require payments on claims made against the City. Therefore, the budget shall include an appropriation to the Liability Claims Account for this purpose.

39. The CAO, in collaboration with the City Attorney, shall report periodically on payments made on claims by City department and type of case.

Other Deleted Policies

~~39. The City recognizes the importance of emergency reserves that can provide a financial cushion in years of poor revenue receipts or in the event of a major emergency. A Reserve Fund Policy has previously been developed and approved by the Mayor and Council. The revised Reserve Fund Policy is incorporated herein in Section 5.~~

~~40. All City funds shall be reconciled at the close of the fiscal year. This reconciliation will compare all fund revenue and liabilities to determine the available cash balance at year-end.~~

~~SECTION 2~~

~~FEE WAIVER POLICY~~

~~OBJECTIVE~~

~~From time to time, Council may decide to waive fees when it can be demonstrated that a direct public benefit can be obtained. Separate fee waiver policies are included in this section so that they can be defined and presented for clarification purposes. These policies are not intended to replace or supersede Revenue Policy III stating "Sufficient user charges and fees shall be pursued and levied to support the full cost of operations for which fees are charged, including all operating (direct and indirect) and capital costs. All user charges and fees for the City shall be monitored annually to determine that rates are adequate and each source is maximized. If fees or charges are not set at 100 percent full cost recovery, the Mayor and Council will specifically recognize the subsidy and shall take specific action to appropriate the necessary funds to subsidize the fee for service."~~

~~Fee Waiver Policies~~

~~I. Special Event Fee Waivers~~

~~A proposed policy is currently in review and will be incorporated into this document at a subsequent date.~~

~~II. Non-Profit Lease Agreements~~

~~A proposed policy will be developed and submitted for approval for incorporation into this document at a subsequent date.~~

~~III. Development Fee Waivers~~

~~A proposed policy will be developed and submitted for approval for incorporation into this document at a subsequent date.~~

~~IV. Convention Center Fee Waivers~~

~~A proposed policy will be developed and submitted for approval for incorporation into this document at a subsequent date.~~

SECTION 43
PENSION AND RETIREMENT FUNDING POLICY

OBJECTIVE

The City has made a commitment to its past and current employees to provide ongoing pension payments and healthcare subsidies to them during their retirement. To fulfill this commitment, the City must make annual contributions to the Los Angeles City Employees' Retirement System (LACERS) and the Los Angeles Fire and Police Pension System (LAFPP) as part of the budget. It is important that the City continue to meet this commitment to ensure that the costs associated with current services are borne at the current time. This policy restates that commitment, establishes a discretionary use for any true-up credit adjustment, and dictates the City's use of any savings that are generated in the case that either pension system is overfunded.

POLICY

I. Funding Policies

A. City to Fully Fund Retirement Systems

The City is committed to its employee workforce and will execute its Charter requirements by fully funding both its pension and retirement systems based on the annual actuarial studies. These actuarial studies may change from year to year based on recent experience data, actuarial assumption changes, actuarial funding method changes, market conditions, future Governmental Accounting Standards Board reporting requirements, or other factors that may influence the actuarial process. It should be noted and understood by the City that market conditions affect both LACERS and LAFPP ~~the Los Angeles City Employees' Retirement System and the Fire and Police Pension System are affected by market conditions~~ over time. These market conditions affect the funding ratio calculated at the end of each fiscal year through the actuarial process for both ~~S~~systems. Over time, depending on market conditions and the actuarial computed contribution rates, the City's annual contribution rate will increase and decrease.

B. Deferring Contributions

At times, opportunities may arise in which the City can request a phase-in of assumption changes approved by the respective retirement boards that increase the City's annual contributions. A phase-in of assumption changes essentially spreads the payments over several years and increases the overall cost to the City. Opportunities may also arise in which the City can seek debt mechanisms to cover current payments. Use of debt mechanisms to cover

pension payments are both risky and can lead to higher overall costs for the City.

In most cases, these approaches to funding move current obligations to future periods and increase the overall costs to the City. Due to these risks, the City should consult with independent experts before using these mechanisms.

This policy does not restrict the systems' ability to amortize gains or losses over a period of time as recommended by an actuary and approved by either system's board.

C. Use of a True-Up Credit Adjustment

The City's annual contributions to the retirement systems is calculated using a projected employee payroll amount. During the course of the fiscal year, the systems may choose to recalculate the City's required contribution using actual payroll data. As a result of this recalculation, the City may be required to true up its contribution by either increasing or reducing the amount in the subsequent year. If the City is informed that it may take a true-up credit adjustment, it may use half of that credit to reduce an unfunded portion of pension or healthcare costs for retirees, as designated by the Mayor and City Council through the budget process.

II. Use of Savings if the Systems are Overfunded

During those fiscal years when either LACERS or LAFPP ~~the Los Angeles City Employees' Retirement System or the Fire and Police Pension System~~ are over-funded (greater than 100% funded) and therefore the total annual required contribution, as adopted by the respective Boards, is less than the amount required to fund the normal cost of retirement and health benefits for employees, the City will limit the extent to which it will recognize these savings (negative unfunded actuarial accrued liability) in the budget. Specifically, the amount budgeted for retirement and health contributions will be no less than the amount derived by reducing the normal cost contribution rate to ~~ninety (90)~~ percent. An adopted contribution rate that would allow the City to contribute an amount less than ~~ninety (90)~~ percent of the normal cost shall trigger this provision that prohibits the City from ~~utilizing this~~ using these savings to fund the City's ongoing service and program costs. Any savings or reduction in funding calculated due to the incremental contribution rate below the ~~ninety (90)~~ percent threshold~~,~~ will only be budgeted to pay down unfunded pension or healthcare costs for retirees ~~for one-time expenditures, such as capital projects, capital asset renovations, deferred capital maintenance, reduction of outstanding debt,~~ or, in the event that all such costs are fully funded, as an appropriation to the Budget Stabilization Fund. ~~to build future reserves to offset future market conditions.~~

This policy would only be triggered when either ~~S~~system has a total, negative unfunded actuarial accrued liability (UAAL) that would cause the actual contribution rate to be below the ~~ninety (90)~~ percent threshold of the normal cost amount. When the total UAAL is positive, the City will continue to fully fund both the normal cost and UAAL as required by the City Charter.

~~An example is~~ Examples are provided below ~~on the next page~~ to illustrate this funding policy. The example uses hypothetical rates chosen to illustrate how this policy is applied. ~~rates computed from the June 30, 2004 actuarial studies for both the Fire and Police Pension System (F&PPS) and the Los Angeles City Employees Retirement System (LACERS). These rates will be used to calculate the City's contributions in the 2005-06 Proposed Budget. The ninety (90) percent funding threshold would be applied to both F&PPS and LACERS as follows:~~

Provision Calculation	Rate as a Percent of Pay ~~F&PPS~~ Example 1	~~LACERS~~ Example 2
Normal Cost:		
Pension/Retirement Benefits ~~(1)~~	~~14.92~~18	18~~8.44~~
Health Benefits ~~(1)~~	~~1.76~~2	2~~2.03~~
Total Normal Cost	~~16.68~~20	20~~10.47~~
(A) Funding Threshold (Normal Cost times 90%percent)	~~15.01~~18	18~~9.42~~
(B) Normal Cost and Unfunded Actuarial Accrued Liability ~~(1)~~	~~(15.69)~~25	15~~(18.96)~~
(A - B) Credit (to be calculated against estimated salaries and used for one-time expenditures) or Cost of Unfunded Actuarial Accrued Liability ~~(2)~~	~~(0.68)~~(7)	3~~(9.54)~~

~~(1) These percentages are available in both LAFPP F&PPS' and LACERS' annual actuarial reports.~~

~~(2) If the rate is positive, then the City must set aside the calculated amount based on estimated salaries for one-time expenditures. If the rate is negative, a credit is not earned and funding would not be set aside per this provision.~~

In example 1, the credit amount is negative meaning that the City's contribution is more than 90 percent of the normal cost of retirement and health benefits for employees. Therefore, funding would not be set aside for one-time uses pursuant to this policy. In example 2, on the other hand, the credit amount is positive and the policy goes into effect. The amount that must be set aside for one-time uses would be calculated by multiplying the credit of 3 percent by the covered payroll for the ensuing year's budget for the employees within the system.

~~Since the contribution rates (including normal costs and unfunded actuarial accrued liability) for F&PPS and LACERS were over the funding threshold of 15.01 percent and 9.42 percent, respectively, incremental savings were not~~

~~available to fund one-time expenditures, such as capital projects, renovations, or deferred capital maintenance.~~

The City Administrative Officer will be required to complete this analysis in preparation of the Proposed Budget. Any subsequent changes approved by the Mayor and City Council that affect the annual contribution rate for either ~~S~~system will then require the City Administrative Officer to re-calculate the funding threshold for the final Adopted Budget amount.

SECTION ~~5~~4
GENERAL FUND RESERVES ~~FUND~~ POLICY

OBJECTIVES

The General Fund Reserves ~~Fund~~ Policy is intended to provide guidelines ~~during the preparation of and deliberations on the annual budget~~ on the purpose, the sizing, the uses, and the restoration requirements of the Reserve Fund the Budget Stabilization Fund, and the Unappropriated Balance line item set aside for mid-year adjustments. Taken together, these three accounts compose the City's General Fund reserves. The Policy is further intended to ensure that sufficient reserves are maintained for unanticipated expenditures or revenue shortfalls, ~~and~~ to preserve flexibility throughout the fiscal year to make adjustments in funding for programs approved in connection with the annual budget, and to prepare the City for potential revenue challenges in future years. The objective is for the City to be in a strong fiscal position ~~that will be better able~~ to weather ~~negative~~ future economic downturns and financial challenges. ~~trends. This~~ Maintaining strong reserves is important since the City is bound by the requirements of Proposition 218, which prevents the City from raising taxes without voter approval. ~~Factors for maintaining~~ Furthermore, with strong ~~sufficient~~ reserves the City is better able to: ~~Funds include the ability to:~~

- Mitigate state or federal budget actions that may reduce City revenue~~;~~
- Mitigate economic downturns that the City may face in the future~~;~~.
- ~~Absorb escalating pension, retirement, and health insurance costs for the City.~~
- ~~Fund the City's expenditures during the first few months of the year instead of issuing tax and revenue anticipation notes, which cost the City close to $3 million per year.~~
- Absorb large liability settlements without the need for issuing judgment obligation bonds~~;~~
- Purchase capital assets without the need to finance the purchase of assets ~~; and,~~
- Front-fund or completely fund, if necessary, disaster recovery costs or costs associated with the City being self-insured.
- Absorb unanticipated budget shortfalls during the fiscal year that cannot be addressed by other means.
- Access the capital market at a lower cost by demonstrating the City's fiscal strength and ability to address unanticipated financial challenges.

~~The Debt Management Policy for the City of Los Angeles recognizes the importance of emergency reserves and calls for the establishment of a Reserve Fund Policy. The Reserve Fund Policy was developed by the City Administrative Officer, in consultation with the City Controller and Chief Legislative Analyst, and was originally approved by the Mayor and City Council in connection with the approval of the Debt Management Policy, on August 4, 1998.~~

~~According to Ian Allan, Government Finance Officers Association's (GFOA) Government Finance Research Center Manager, in his article *Unreserved Fund Balance and Local Government Finance*, "Of particular importance to the credit rating agencies are the size of "fund balance" [the Reserve Fund] (resources available for contingencies) and the trend in the size of fund balance. A fund balance that decreases in size from year to year can be seen as an indicator of fiscal weakness. A small fund balance (under five (5) percent of annual operating expenditures) could also be looked upon negatively if the government has experienced financial difficulties in the past due to external factors, such as a slump in the economy."[1] The GFOA recommends a minimum of five (5) percent to be held in a unreserved fund balance. Below is a discussion of how each of the three credit rating agencies uses the Reserve Fund balance as a criterion for rating the City's financial condition.~~

The Government Finance Officers Association (GFOA) recommends that governments establish a formal policy on the level that should be maintained in the unrestricted fund balance of the General Fund. The GFOA does not specify that level, but recommends that it be determined taking into consideration vulnerability to natural disasters and the level of dependence on volatile revenue sources or on state and federal funding that is subject to being cut. While the GFOA sets a standard minimum balance as equivalent to two months of operating revenues, it states that this rule may not apply to America's largest governments.[5] Since the City of Los Angeles falls into this category, it is appropriate for the City to establish its own minimum level of reserves rather than using the GFOA's general recommendation for maintaining reserves at least equal to two month of operations.

The City's reserves target should be based on its unique risk profile. The most significant catastrophic risk to Los Angeles is from a natural or human-caused disaster. Los Angeles' location in an active earthquake zone is the most obvious source of this risk and does provide justification for the City to maintain healthy reserves. Financially, however, the City benefits from stable financial structures that mitigate the need for unusually high reserves. For example, Los Angeles is a large government with a diverse, and therefore relatively stable, revenue base. Further, federal and state funding does enable the City to provide important services, most notably in the areas of human services, community development, and infrastructure, but in the absence of those funds the City would maintain funding for many other core services.

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[5] Government Finance Officers Association. *Best Practice: Fund Balance Guidelines for the General Fund.*

~~Fitch Ratings (Fitch) indicates that a Reserve Fund provides a government with available resources in the event of unforeseeable occurrences. "Most [Fitch] analysts look to a fund balance [Reserve Fund] of about 5% of revenues as a prudent level to allow for a reasonable degree of error in budget forecasting. . . " but recognize that the "appropriate level may vary according to a city's needs."[2]~~

~~Moody's Investors Service (Moody's) uses the size of the Reserve Fund as well as a percentage of unreserved fund balance to revenues as an indicator of financial strengthen. "As a general rule of thumb, Moody's likes to* see a General Fund balance equal to at least 5% of revenues. . ."[3]~~

~~Standard and Poor's (S&P) states that a key credit rating factor for cities is the percentage of unreserved fund balances to budget. "The average [Reserve Fund] balance as a percentage of the budget for all "AAA" rated municipalities is very strong, at 25%. This financial cushion gives local governments great flexibility in dealing with unforeseen events such as an unexpected shortfall in revenues or rise in expenses."[4]~~

The rating agencies that evaluate the City's capacity to repay its debt have consistently stated that establishing and meeting minimum reserve levels is an important component of their review of the City's fiscal health. Thus, in addition to serving as a contingency for unforeseen challenges that arise during the fiscal year, the level of the City's reserves is also reviewed by investors that are considering purchasing the City's debt.

POLICIES

I. Total Reserves

A. Composition

The City's total reserves shall include funds that are appropriated without a designated use in the annual budget. Reserves may or may not be intended for use for unanticipated operational shortfalls or challenges, but they must be accessible for these purposes through an action of the City Council and Mayor. The total reserves include ~~two funds~~ the Reserve Fund, the Budget Stabilization Fund, and the Unappropriated Balance line item set aside for mid-year adjustments.

B. ~~Sizing of Total Reserves~~ Required Level

Other than the required funding levels for the Reserve Fund, which is not less than five percent of all General Fund receipts anticipated for that fiscal year in the adopted budget, there is no set required level of funding for the City's total reserves. It shall be the goal of the City that the cumulative value of the Reserve Fund, the Budget Stabilization Fund, and the Unappropriated Balance

line item for mid-year adjustments be ten percent of all General Fund receipts anticipated for that fiscal year in the adopted budget.

C. Use of Excess Reserves

In the event the combined balance in the Reserve Fund and the Budget Stabilization Fund ~~BSF will~~ exceeds 15 percent of the adopted General Fund budget, the City Council and Mayor may consider appropriating the "excess" funds to other funding priorities that are considered to be "one-time" expenditures such as:

- ~~One time expenses such as c~~Capital spending to meet the Capital and Technology Improvement ~~and Expenditure Program~~ Policy ~~(CIEP)~~;
- Prepayment of General Fund debt;
- The unfunded portion of the City's civilian and sworn retirement systems; or,
- Other obligations.[6]

This provision in no way relieves the City of its obligation to comply with the five percent Reserve Fund threshold requirement.
~~Any balance within the BSF will not be counted toward meeting the five percent Reserve Fund policy level.~~

D. General Fund Reversions

~~Pursuant to the City Charter.~~ P~~p~~rior-year funds and surpluses will revert to their original funding sources.[7] Those reverting to the General Fund will first revert to the Reserve Fund to ensure the funding level of the Reserve Fund is at ~~5~~ least five percent of the General Fund and to ensure sufficient funds are available in the Reserve Fund for year-end closing transfers. The balance of funds may be deposited into the Budget Stabilization Fund~~BSF~~.

Reappropriations of current year funding to the subsequent year that are not approved through the budget development or year-end reporting process are discouraged. Requests for reappropriations of funds from the prior fiscal year shall be viewed as requests for new appropriations and subject to the provisions of the City's Financial Policies related to interim requests for funding and the uses of the City's reserves.

[6] Los Angeles Administrative Code Section 5.120.4(c).
[7] Los Angeles City Charter Section 344.

II. Reserve Fund

A. Purpose and Composition

The Reserve Fund shall include funding for unanticipated expenditures and revenue shortfalls in the City's General Fund. It shall ~~also~~ include two accounts within the fund, the Contingency Reserve Account and the Emergency Reserve Account.[8]

B. Required Level

The Reserve Fund shall be not less than five ~~(5)~~ percent of all General Fund receipts anticipated for that fiscal year in the adopted budget.[9] ~~the General Fund budget.~~ The amount placed in each of the Reserve Fund ~~A~~accounts shall be determined as follows:

1. Contingency Reserve Account

   The Contingency Reserve Account shall include all monies in the Reserve Fund over and above the amount required to be allocated to the Emergency Reserve. ~~However, t~~The amount, however, is not expected to be less than ~~two and one-fourth (~~2.25~~)~~ percent of all of the receipts anticipated for that fiscal year in the adopted budget.~~the total Reserve Fund.~~ The amount may also be higher depending on recent experience with the need for supplemental funding during the year for programs approved in conjunction with the budget~~,but the amount is expected to remain relatively constant and will be determined as a percent of General Fund revenues of the adopted budget~~.

2. Emergency Reserve Account

   The City Council shall annually allocate an amount to the Emergency Reserve Account that shall bring the balance in that Account to not less than ~~two and three-fourths (~~2.75~~)~~ percent of all General Fund receipts anticipated for that fiscal year in the adopted budget.[10]

~~C. Accessing City Reserves~~Uses

1. Contingency Reserve Account

   In the event that during the year there are unanticipated expenses or revenue shortfalls impacting programs already approved in conjunction

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[8] Los Angeles City Charter Section 302(b).
[9] Los Angeles Administrative Code Section 5.120
[10] Los Angeles City Charter Section 302(b)(2).

with the current year budget, and appropriations within the Unappropriated Balance or surpluses within other City programs are not available, the Contingency Reserve Account will be the source of any additional funding for those programs. Funds must be appropriated by a vote of at least a majority of the City Council, with Mayoral concurrence, or by a two-thirds vote ~~super-majority~~ of the City Council in the event of a Mayoral veto.[11] The Contingency Reserve Account shall not be used to fund new programs or positions added outside of the current year budget. Such funding must come from other non-Reserve Fund sources.

2. Emergency Reserve Account

Transfers from the Emergency Reserve Account of the Reserve Fund shall require approval by a two-thirds vote of the City Council with the concurrence of the Mayor, or, in the event of a Mayoral veto, by a three-fourths vote of the City Council. Concurrent with the transfer, the City Council shall make a finding of urgent economic necessity. The basis on which a finding of urgent economic necessity may be made includes, but shall not be limited to, a significant economic downturn after the budget is adopted, a natural disaster, such as an earthquake, civil unrest, or other significant unanticipated events requiring the expenditure of General Fund resources.[12]

~~To utilize funds from the Emergency Reserve Account, a finding by the Mayor, with confirmation by the Council, of "urgent economic necessity" will be required, as well as a determination that no other viable sources of funds are available. A finding of urgent economic necessity would be based on a significant economic downturn after the budget is completed or an earthquake or other natural disaster.~~

D. Restoration ~~of Reserve Fund Balance to Five (5) Percent~~

In fiscal years where it becomes necessary for the City to ~~utilize~~ use monies in the Reserve Fund ~~on an interim basis or to offset a significant negative economic event wherein~~ such that the Reserve Fund balance drops below the five ~~(5)~~ percent level, the City will initiate action in the subsequent year to replenish the Reserve Fund to the level of five ~~(5)~~ percent of General Fund receipts ~~revenue~~. If ~~utilization~~ use of Reserve Fund monies is less than one ~~(1)~~ percent of General Fund receipts ~~revenue~~, the City shall attempt to replenish the five ~~(5)~~ percent balance in the subsequent fiscal year. If ~~utilization~~ use of Reserve Fund monies is more than one ~~(1)~~ percent of General Fund revenue, the City shall attempt to replenish the five ~~(5)~~ percent balance by one ~~(1)~~

[11] Los Angeles Administrative Code Section 5.120(b).
[12] Los Angeles City Charter Section 302(b)(3)(ii).

percent per year over a period of years as necessary to restore the Reserve Fund balance to the level of five ~~(5)~~ percent of General Fund revenue.

Notwithstanding this provision, if the Emergency Reserve Account must be used, the City shall, in the subsequent fiscal year, restore the Emergency Reserve Account to 2.75 percent of all General Fund receipts anticipated for that fiscal year in the adopted budget. In the event of a catastrophic event which requires use of the Emergency Reserve Account spanning more than one fiscal year, the City Council may, by a two-thirds vote with the concurrence of the Mayor or, in the event of a Mayoral veto, by a three-quarters vote, temporarily suspend the restoration requirements provided, however, that concurrent with the action of the City Council to suspend the requirement, the City Council adopts findings detailing the necessity for continued access to the Emergency Reserve Account and setting forth a date on which the restoration requirements shall be reinstated.[13]

~~Phased-In Reserve Fund Sizing~~

~~Increasing and maintaining the overall Reserve Fund balance to five (5) percent may need to be phased in over a period of several years. The 2004-05 Adopted Budget set aside $112.7 million or approximately 3.1 percent of the General Fund budget. Due to the structural deficit between estimated revenues and expenditures in 2005-06, it may not be feasible to increase the Reserve Fund balance to the full five (5) percent. Depending on resolution of the structural deficit, a targeted annual increase should be established to increase the Reserve Fund balance to five (5) percent within ten years. For 2005-06, the Emergency Account shall be set at two percent, with any additional funds placed in the Contingency Account. For each subsequent year, the Reserve Fund balance shall be increased no later than 2006-07. However, should the performance of revenues and expenditures during the 2004-05 and 2005-06 be better than expected, the City shall increase the Reserve Fund by the amount available in conjunction with the adoption of the 2006-07 Budget.~~

[13] Los Angeles City Charter Section 302(b)(4) and Section 302(b)(5).

[NOTE – THE BUDGET STABILIZATION FUND WAS NOT INCLUDED IN THE 2005 FINANCIAL POLICIES, BUT IS ADDED HERE. THE REDLINING REFLECTS PROPOSED CHANGES TO THE APPROVED BUDGET STABILIZATION FUND POLICY.]

III. Budget Stabilization Fund

A. Purpose

The Budget Stabilization Fund (BSF) is established to provide a method to prevent overspending during prosperous years and to provide resources to help maintain service levels during lean years.[14]

~~The City's general tax revenues are sensitive to economic conditions as well as actions taken by outside entities including the state and federal governments. Unanticipated revenue shortfalls during a fiscal year are usually addressed through reductions in critical services and operations. Given this revenue uncertainty, as part of the 2009-10 budget process, the Mayor and City Council established a Budget Stabilization Fund (BSF). Subsequent to this action, in March 2011, City of Los Angeles voters amended the City Charter to include the Budget Stabilization Fund as a charter-required fund.~~

~~A stabilization fund, is created with money set aside during periods of robust economic growth or when revenue projections are exceeded to help smooth out years when revenue is stagnant or is in decline. Furthermore, it provides the following protections and benefits to the City's financial health and stability:~~

- ~~Sets aside revenue during years of strong revenue growth and would prevent using above average revenue growth to finance ongoing expenses such as increased employee salaries and benefits, as well as new services and programs.~~
- ~~Enforces spending discipline by setting aside money collected from revenues received during good economic conditions for use during years with lower growth or declining revenue;~~
- ~~Protects against reducing services during a recession;~~
- ~~Addresses temporary cash flow shortages, revenue shortfalls or unpredictable one-time expenditures;~~
- ~~Mitigates long-term imbalances by curbing the use of unusual surpluses for ongoing expenditures;~~
- ~~May reduce City's borrowing costs due to stronger bond ratings; and,~~
- ~~Stabilizes finances during significant downturns.~~

~~Legal Basis of the Reserve Fund and Budget Stabilization Fund~~

[14] Los Angeles Administrative Code Section 5.120.4

~~City Charter~~

~~The City Charter established the Reserve Fund which holds unrestricted cash set aside outside the budget for unforeseen expenditures, emergencies or natural disasters. Charter Section 344 requires the Controller to transfer surplus general revenues and other unspent appropriations from the General Fund to the Reserve Fund at the end of the fiscal year. In March 2011, voters passed Charter Amendment P which codified the establishment of the Contingency Reserve Account and Emergency Account within the Reserve Fund. Charter Amendment P also established the BSF in the City Treasury and authorized the requirements for transfers or expenditures from the BSF to be established by ordinance.~~

B. Required Level

1. No Minimum Balance

~~Unlike the Reserve Fund, t~~The BSF does not have a minimum balance ~~threshold amount~~ that it must maintain. The deposit and withdrawal rules established herein will ultimately dictate the available balance in the BSF. When General Fund tax growth is projected to exceed average annual ongoing growth, a portion of that growth must be deposited into the BSF. If growth is projected to fall short of average annual ongoing growth, a portion of the BSF may be appropriated to the subsequent year's budget.

2. Establishment of the Average Annual Ongoing Growth Threshold

The Average Annual Ongoing Growth Threshold (Growth Threshold) shall be calculated by the Office of the City Administrative Officer and presented to the Mayor and City Council for approval following the release of the Controller's *Preliminary Financial Report* and prior to the release of the Mayor's Proposed Budget on an annual basis. If a Growth Threshold is not approved prior to the release of the Mayor's Proposed Budget, the prior year's Growth Threshold will be used. ~~the combined annual growth for the seven general fund tax revenue sources:~~

~~, specified herein as 3.4 [TBD] percent (3.4%), shall be recalculated and revised, by ordinance, every five years~~ The Growth Threshold shall be the percentage equal to the 20-year average of the actual annual growth of cumulative ongoing receipts from the following seven sources: ~~based on the actual revenue received during the previous five years using the average amount of revenue received during the prior five year calculation period as the base amount. The calculation shall~~

~~be made more often as necessary to reflect significant changes in any one of the seven specified general fund tax revenue sources, such as the repeal of, or any other action that reduces or increases the tax rates for, any of those taxes.~~[15]

1. Property Tax
2. Utility Users' Tax
3. Business Tax
4. Sales Tax
5. Transient Occupancy Tax
6. Documentary Transfer Tax
7. Parking Users' Tax

References to the General Fund taxes in the remainder of this Section shall refer to these seven sources.

~~In the event an affirmative action is taken by the City, voters, or another government entity that increases or decreases the tax rates of any of the seven revenue sources used to set the index for the deposit/withdrawal rules of the BSF, a recalculation of the index by the City Administrative Officer and Chief Legislative Analyst will be automatically triggered. Any changes to the index require an amendment to this policy and related ordinances.~~

C. Withdrawal Criteria

Savings in the BSF will primarily be used to mitigate revenue shortfalls due to economic ~~recessions~~ downturns and address the resulting short-term budgetary shortfall. ~~It~~ The BSF should not be used to pay for increased or enhanced services. While the BSF does not provide long-term relief from the implementation of structural reductions or solutions, it will provide a "soft landing" and transition for difficult and painful reductions to discretionary programs. ~~Withdrawals from the BSF must be made as follows:~~

~~The primary use of the BSF must be to mitigate revenue shortfalls due to economic recessions or revenue reductions and to address the resulting short-term budgetary shortfall. It shall not be used to provide increased or enhanced services or employee salaries and benefits.~~

During the development of the budget for the upcoming fiscal year, a transfer from the BSF to the General Fund may be incorporated as part of the adopted budget for that fiscal year when the anticipated ongoing combined growth (Anticipated Growth) of the ~~following seven~~ General ~~F~~fund taxes ~~revenue~~

[15] Los Angeles Administrative Code Section 5.120.4(a). [NOTE – LANGUAGE HERE DIFFERS FROM CODE AND THIS OFFICE RECOMMENDS THAT THE CODE BE AMDNEDED]

~~sources is anticipated to~~ falls short of the ~~3.4 percent~~ Growth Threshold ~~for the upcoming fiscal year~~. The Anticipated Ggrowth calculation will be based on the comparison between the ongoing General Fund tax receipts in the adopted budgets for the current fiscal year and the ensuing fiscal year ~~and the budget for the following fiscal year~~.

~~1. Property Tax~~
~~2. Utility Users' Tax~~
~~3. Business Tax~~
~~4. Sales Tax~~
~~5. Transient Occupancy Tax~~
~~6. Documentary Transfer Tax~~
~~7. Parking Users' Tax~~

For each one percent ~~The amount of the new budget appropriation to the BSF shall be the difference between~~ that the Aanticipated ~~combined revenue~~ Ggrowth ~~of the seven general fund tax revenue sources listed above~~ falls short of the Growth Threshold, the amount of the permitted transfer from the BSF shall be equal to five percent of ~~and~~ the ~~combined~~ value of the ~~these sources with an assumed 3.4 percent~~ anticipated shortfall. The maximum appropriation shall be equivalent to 25 percent of the value of the difference between the Anticipated Growth and the Growth Threshold, and may not exceed the available balance of the BSF.

The amount of the transfer from the BSF in any year may exceed the amount calculated pursuant to this methodology, subject to the availability of funds, if ~~shall be limited to 25 percent of the available balance in the BSF unless~~ the City Council and Mayor have declared a fiscal emergency for the City ~~has been declared~~ or have suspended ~~if~~ the BSF funding policy ~~is suspended by the City Council and Mayor~~ based on findings that it is in the best interest of the City to suspend the policy.

Any transfer authorized by this policy is permitted but not required.

~~The BSF does not have a maximum balance amount level.~~

[FOR REFERENCE, BELOW IS THE CURRENT AD CODE SECTION REGARDING THE TRANSFER AMOUNT, WHICH IS RECOMMENDED FOR AMENDMENT TO BE CONSISTENT WITH THE APPROACH PRESENTED IN THIS PROPOSED POLICY:

(b) In the event the combined growth rate for the seven General Fund tax revenue sources listed in subsection (a) herein, does not exceed 3.4%, or the recalculated rate, the amount that may be transferred from the Budget Stabilization Fund shall be the calculated amount of the

combined growth rate (3.4%, or the recalculated amount) less the anticipated combined growth rate, not to exceed the following limitations:

Projected Growth Rate	Maximum Transfer from the BSF
3.4% or higher	0% of BSF Balance
Greater than or equal to 3.3%, but less than 3.4%	5% of BSF Balance
Greater than or equal to 3.2%, but less than 3.3%	10% of BSF Balance
Greater than or equal to 3.1%, but less than 3.2%	15% of BSF Balance
Greater than or equal to 3.0%, but less than 3.1%	20% of BSF Balance
Less than 3%	25% of BSF Balance]

D. Deposit Criteria

~~Required Budget Appropriation to the Budget Stabilization Fund~~

~~In accordance with the budget development process established by the City Charter, beginning with the development of the 2014-15 budget, a new~~ A budget appropriation to the BSF shall be included as part of the adopted budget for the following fiscal year when the ~~combined growth percentage~~ Anticipated Growth ~~of the following seven general fund tax revenue sources is anticipated to~~ exceeds the Growth Threshold.~~3.4 percent. The growth calculation will be based on the comparison between the adopted budget for the current and year and the budget for the following fiscal year~~.

For each five-tenths of one percent ~~The amount of the new budget appropriation to the BSF shall be the difference between~~ that the ~~A~~anticipated ~~combined revenue~~ ~~G~~growth ~~of the seven general fund tax revenue sources listed above~~ exceeds the Growth Threshold, the amount of the required appropriation to the BSF shall be equal to five percent of ~~and~~ the ~~combined~~ value of the ~~these sources with an assumed 3.4 percent~~ anticipated excess growth. The maximum appropriation shall be equivalent to 25 percent of the value of the growth above the Growth Threshold.

~~The required annual appropriation to the Fund may be reduced only to maintain the Reserve Fund at five percent of the General Fund, to comply with the CIEP policy.~~

The required deposit to the BSF may be forgone in its entirety in the event that the City Council and Mayor declare a fiscal emergency ~~is declared by the City Council and Mayor,~~ or ~~if the~~ suspend the BSF funding policy ~~is suspended by the City Council and Mayor~~ based on findings that it is in the best interest of the City to suspend the policy.

Mid-year deposits to the BSF or deposits above the required amount may be authorized by the City Council, subject to the approval of the Mayor, at any time during the year from various General Fund sources. Consideration should be

given to depositing unanticipated and unbudgeted receipts that are not otherwise required to balance the current year budget. ~~including but not limited to:~~

- ~~One-time receipts from the sale or lease of the City's assets or securitization of future revenue streams.~~
- ~~Any unanticipated revenue recognized during the year that has not already been programed.~~
- ~~Funds made available from the release of prior year encumbrances.~~
- ~~Year-end surpluses.~~

E. Use of Excess

In the event that the Budget Stabilization Fund exceeds 2.75 percent of the adopted General Fund budget, the City Council and Mayor may consider appropriating the excess funds to other one-time funding priorities.

~~**Adjustments to the Required Budget Appropriation**~~

~~The required budget appropriation to the BSF may be adjusted up or down based on the following:~~

- ~~Upward adjustments may be made at the discretion of the City Council and Mayor (See other deposits to the BSF).~~

IV. Unappropriated Balance – Line Item for Reserve for Mid-Year Adjustments

A. Composition and Purpose

Each year, the City Council and Mayor shall appropriate funds to a line item in the Unappropriated Balance intended for use as a reserve for mid-year adjustments. The purpose of this line item shall be to address shortfalls that arise during the fiscal year that cannot be otherwise addressed through service adjustments or account transfers. This line item shall be used to address these shortfalls prior to the Reserve Fund.

B. Required Level

There shall be no required amount for the appropriation to the Unappropriated Balance line item for mid-year adjustments. The appropriation amount shall be determined by the Mayor and City Council through the annual budget development process. When determining the appropriation to this line item,

consideration shall be given to the nature of the risks to the subsequent year's budget and their likelihood and potential magnitude.

C. Uses

Transfers may be made from the Unappropriated Balance line item for mid-year adjustments during the fiscal year subject to the approval of the Mayor and City Council. Such transfers should be consistent with the purposes of this line item as determined by this Policy and that year's adopted budget.

D. Restoration

Transfers may be made to the Unappropriated Balance line item for mid-year adjustments during the fiscal year subject to the approval of the Mayor and City Council. Appropriate sources for such transfers include, but are not limited to, transfers of budgetary savings generated during the fiscal year in other General Fund accounts.

~~A. Liability Claims Fund~~

~~The Liability Claims Fund shall include funding for liability claims.~~

~~The Liability Claims Fund shall be budgeted in an amount reasonably expected to be expended on liability claims for the ensuing fiscal year. The City Attorney shall provide an estimate based on potential pending claims against the City. Any unspent funds at year-end would revert to the Reserve Fund.~~

~~The City Attorney will periodically recommend to the City Council that the City resolve or settle claims brought against the City. Upon review of the settlement terms, the City Council will then authorize payments from the Liability Claims Fund for these settlements.~~

~~Footnotes:~~

~~1. Allan, Ian J., GFOA Research Bulletin, Unreserved Fund Balance and Local Government Finance, November 1990.~~
~~2. Fitch Rating, Rating for General Obligation Bonds, July 2001.~~
~~3. Perspective on Municipal Issues, Key Factors in Moody's Credit Analysis of Tax Support Debt, April 15, 1993.~~
~~4. Standard & Poor's Creditwire, Los Angeles, California General Obligation Bond Rating, November 2000.~~

SECTION 5
GENERAL FUND ENCUMBRANCE POLICY

[NOTE: THE TEXT BELOW WAS ADOPTED BY THE CITY COUNCIL AND MAYOR IN FEBRUARY 2013. IT IS NOW RECOMMENDED FOR INCORPORATION INTO THE FINANCIAL POLICIES AS A NEW SECTION. THE PROPOSED REVISIONS BELOW REFLECT CHANGES FROM THE PREVIOUSLY APPROVED TEXT.]

~~**General Fund Encumbrance Policy**~~

OBJECTIVE

An ~~"~~encumbrance~~"~~ is a reservation of funds to cover purchase orders, contracts, or other goods and services that are chargeable to an appropriation. It records obligations before goods are received or services are rendered. Encumbrances are often recorded based on estimates of the cost of goods or services being purchased.

An employee or officer of the City may not obligate the City to make payment for goods, services, or any other purpose~~,~~ until ~~it~~ the employee has ~~been~~ determined that funds are actually available in the proper account for the specific purpose ~~(each department is responsible for determining the availability of funds)~~. The City's encumbrance accounting system controls spending based on the appropriations, allotments, expenditure budget, or a combination of them. ~~According to the Government Finance Officers Association, an encumbrance accounting system acts as an "early warning device," and by controlling expenditure commitments, a governmental entity "significantly reduces the opportunity to over-expend an appropriation." As such, an encumbrance must occur prior to disbursement of funds.~~ By requiring the government entity to commit to an expenditure through an encumbrance prior to the disbursement of funds, an encumbrance system provides a warning as the authorized expenditure level is approached and thus protects the entity from over-spending an appropriation.

While establishing encumbrances is an important accounting tool, retaining encumbrances past the point at which the associated expenditure is necessary restricts funds that could otherwise be used for pressing needs. Therefore, the objective of this policy is to establish the limitations on reprogramming prior-year encumbrances, and to ensure that the unnecessary encumbrances are released in a timely manner.

POLICY

I. Use of Current-Year Encumbered Funds

Once funds have been encumbered, they cannot be expended for anything other than what was authorized under the original encumbering authority, which could include a ~~e.g.,~~ p~~P~~urchase o~~O~~rder, c~~C~~ontracts, a~~A~~uthority for e~~E~~xpenditure, or

tTravel aAuthority~~, etc~~. City departments may disencumber and re-encumber funds within the same fiscal year.

II. Adjustments to Prior-Year Encumbrances

City departments may not increase a prior-year encumbrance, but they may disencumber one. ~~Prior-year encumbered funds may not be increased but may be disencumbered by a City department. Exceptions to this rule are continuing appropriations (~~Notwithstanding this Policy, prior-year encumbrances in ~~non-capital appropriations for certain~~ sSpecial funds ~~Revenue~~ and for cCapital pProjects ~~Funds,~~ may be increased. ~~which are carried forward to the next budget year) which may be increased or decreased.~~

Only the Mayor and City Council may reprogram pPrior-year disencumbered funds ~~may only be reprogrammed by the Mayor and Council~~. At the end of a fiscal year, all unencumbered funds will revert to their respective originating funding source or, if the originating source is the General Fund, to the Reserve Fund.

III. Release of Prior-Year Encumbrances

If ~~the~~ funds are not disencumbered~~,~~ they will continue to be regarded as obligated balances, thereby reducing the available unobligated account balances. Consequently, the timely disencumbrance of funds is necessary to reflect an accurate and updated status on the availability of funds.

As a rule, any ~~Financial Management System and Supply Management System~~ encumbered funds that remain unspent for a period longer than one fiscal year shall be reverted ~~subject~~. ~~to the following phase-in schedule~~: An exception to this policy applies to encumbrances for commodities procurements, which include supplies or equipment. These encumbered funds shall revert if they remain unspent for a period longer than three years.

~~Fiscal Year~~	~~Disencumbrance Date~~
~~2010-11 & older~~	~~February 2013~~
~~2011-12 & 2012-13~~	~~June 2014~~
~~2013-14~~	~~June 2015~~

The City Controller and the City Administrative Officer are authorized to implement this Policy and to ensure funds are disencumbered at the appropriate time.

IV. Consideration of Exceptions to the Policy

A. In extraordinary ~~and unusual~~ circumstances, departments may request a reappropriation of funds when it can be clearly demonstrated that it is in the

best interest of the City to do so. There must be a~~A~~t least one of the following conditions ~~must be satisfied~~ present before a request for reappropriation will be recommended for approval~~.~~:

1. A legal obligation~~/~~ or liability ~~exists~~. The goods or services must have been provided, but not yet paid.

2. A contingent liability ~~exists~~. Items that are likely to become liabilities as a result of conditions undetermined at a given date, such as guarantees, pending lawsuits, judgments under appeal, unsettled disputed claims, unfilled purchase orders, and uncompleted contracts.

3. A legislative appropriation for a specific project which cannot be completed within the allowable time frame. ~~However,~~ S~~s~~uch appropriations, however, cannot be carried on indefinitely and the ~~CAO~~ City Administrative Officer will reevaluate the continuation of the encumbrance ~~carry forward~~ if the project has not been completed.

B. This policy does not apply to prior-encumbrances for the Capital Improvement Expenditure Program (CIEP). These encumbrances are reviewed as part of the CIEP Year-end Reappropriations Report.

V. In the event that ~~the implementation of~~ this policy creates the need for Direct Expenditures ~~(DE)~~, departments must follow the applicable ~~DE~~ guidelines set forth in the Controller's manual.

FISCAL POLICIES – SUMMARY

Achieve structural balance:

- Back budget appropriations and expenditures with available current funding.
- Spend all one-time revenues for one-time purposes.
- Prepare annual forecasts of future revenue and expenditures.
- Consider future costs when initiating multi-year projects.
- Analyze and report on required financial support of grant programs.
- Use new revenues first to support continuing obligations.

Engage in performance budgeting to ensure that funding achieves its intended goals:

- Encourage departments to prepare strategic plans with measurable goals.
- Illustrate the resources used to achieve these goals in budget documents.
- Evaluate data that measures performance when making budget decisions.

Make responsible choices about employee-related costs:

- Evaluate thorough and accurate employee cost data when budgeting.
- Fund position authorities at the required levels.
- Designate the CAO as the City's representative with employee organizations.

Limit changes to the adopted budget:

- Initiate new programs through the budget process.
- Require Mayor and City Council approval for budget changes.

Protect unrestricted revenue sources:

- Seek new and diverse revenues.
- Only approve tax and revenue reductions with sunset clauses.
- Do not limit the use of unrestricted General Fund revenues to specific purposes.
- Do not reduce revenue during the year without corresponding expenditure cuts.

Assess fees that fully recover the reasonable cost of a service where appropriate:

- Evaluate fee levels annually.
- Report on fees that are set below reasonable costs.
- Use the General Fund to pay for waived fees.

Protect the integrity of special funds:

- Limit the use of special funds to their mandated purpose.
- Establish a goal that special funds pay all related costs.
- Encourage special fund administrators to establish reserves.
- Require special fund administrators to evaluate and manage fund balances.

Ensure transparency in financial decisions:

- Publish clear and accurate budget data.
- Include Fiscal Impact and Financial Policy Compliance statements in reports.
- Require the CAO to prepare periodic financial status reports.

Realize the value of assets:

- Sell surplus equipment and real property at market value.

Make adequate investment to maintain real property and equipment.

Set aside funding to pay for settlements and judgements and report on those payments.

PENSION AND RETIREMENT FUNDING POLICY – SUMMARY

Meet our commitment to retirees:

- Fully fund the retirement systems each year based on actuarial studies.
- Do not defer retirement payments to future years without consulting with experts.
- Consider using half of any true-up credit to pay down the unfunded portion of the systems.
- If the systems are overfunded, use savings for specific one-time purposes.

GENERAL FUND RESERVES POLICY –SUMMARY

Establish a goal that the cumulative General Fund reserve level (Reserve Fund, the Budget Stabilization Fund, and the Unappropriated Balance – Reserve for Mid-Year Adjustments) is at least ten percent of General Fund revenues:

- Reserves over 15 percent are available to pay for one-time priorities.
- Unused prior-year funds will revert to the Reserve Fund.
- Discourage the reappropriation of unused prior-year funds.

The Reserve Fund:

- Must be five percent of General Fund revenues.
- Use only to address contingencies and emergencies that arise during the year.
- Replenish the Reserve Fund if it drops below five percent.

The Budget Stabilization Fund:

- Contribute to the BSF when revenues exceed average growth.
- Use BSF funds if revenues fall below average growth.

The Unappropriated Balance – Reserve for Mid-Year Adjustments

- Use prior to the Reserve Fund to address shortfalls that arise during the year.
- Determine the appropriation to this account is through the budget process.

GENERAL FUND ENCUMBRANCE POLICY – SUMMARY

Release encumbrances when they are no longer needed:

- Release unspent General Fund encumbrances after one year.
- Release unspent General Fund encumbrances for commodities after three years.
- Limit exceptions to obligated funds, pending liabilities, and long-term projects.