Board of Supervisors Memorandum

October 4, 2022

Fund Balance Policy for the General Fund

Background

As stated in my Fiscal Year 2023/2024 Budget Process Memorandum dated September 20, 2022, recommendations were made to improve the budget process for Fiscal Year 2023/2024. Included in those recommendations was the creation of a Fund Balance Policy for the General Fund.

Fund Balance Calculation Used in the Prior Year's Budget Process

As part of each year's annual budget process, the General Fund's unrestricted ending fund balance is estimated using the amount carried forward from the prior year, plus actual revenues and expenditures through February of the current fiscal year, plus departmental revenue and expenditure projections for the remainder of the current fiscal year. This calculation does not include the $25 million Pension Fund Reserve amount established under Board of Supervisors Policy D 22.11 for the Public Safety Personnel Retirement System and Correctional Officers Retirement Plan.

Historically, the County has ensured that the budgeted ending fund balance for the General Fund was at least five percent of the General Fund revenues and operating transfers-in. Revenues were used in this calculation because there was little variability or unpredictability in forecasting these revenues prior to the pandemic. The budgeted fund balance calculation has been between $40 and $50 million. Over the past two years, the County has also included a $10 million Emergency Reserve within its Adopted Budget.

In addition to these reserves, the County's budget also included conservative estimates for general government revenues and an assumption that all vacant positions were filled for the entire fiscal year. Since the pandemic, the general government revenues have come in higher than initially anticipated, and departments have experienced difficulties retaining and hiring employees. For the past two fiscal years, the County has had, on average, 800 to 1,300 unfilled positions, of which 500 to 750 of those unfilled positions reside within the General Fund. The increased revenue and the savings from these vacant positions have contributed to the increase in the General Fund's ending fund balance.

Included within the Fiscal Year 2022/2023 Adopted Budget, the Fiscal Year 2021/2022 ending fund balance was estimated to be roughly $138 million. Currently, the actual unaudited ending fund balance is estimated to be $173 million, which is $35 million over the original projection. This increase is due to a number of factors, including conservative estimates for revenues, favorable forecasting of expenditures through the end of this fiscal year, some General Fund expenditures being covered by grants, and realized vacancy savings.

Fund Balance Calculation Used for Ratings

The General Fund's ending fund balance is also used for pricing our debt. Fund Balance is one of the many variables the private, independent rating agencies utilize when they evaluate the County's financial situation and determine the County's debt rating. The County's debt rating determines the rate at which the County can borrow money and whether additional Certificates of Participation debt can be issued. Additional Certificates of Participation debt can only be issued if the issuance does not cause the then-assigned rating to be reduced or withdrawn. As stated in my County's Credit Ratings Memorandum dated September 27, 2022, our current rating(s) for Certificates of Participation of AA- (Standard & Poor's) and AA (Fitch Ratings) were recently reaffirmed by the rating agencies.

Although the size of the fund balance in the General Fund is a key factor in securing and maintaining investment grade credit ratings, it is not the only factor considered. Other important factors are the reliability of the County's revenue sources, economic conditions, community wealth factors, cash position, debt ratios, management performance, changes in fund balance between fiscal years, and fiscal decisions made by the County.

A common metric used by the Governmental Finance Officers Association (GFOA) and the rating agencies is the General Fund's Ending Fund Balance over the General Fund's Total Operating Expenditures per the Audited Financial Statements. GFOA and the rating agencies recommend a ratio of at least two months (or approximately 17 percent) of operating expenditures to be held in a Fund Balance Reserve. Therefore, County Administration and Finance and Risk Management recommend a 17 percent reserve of operating expenditures. The attached proposed Fund Balance Policy for the General Fund is provided for your consideration.

New Fund Balance Calculation per Proposed Policy

Both processes discussed above use the same data points to achieve two different results. Since the County does not have a formal Board of Supervisor's Policy on this topic, research was conducted using various other municipalities, the GFOA, and our Financial Advisor.

Since the General Fund's ending fund balance for the Fiscal Year 2021/2022 is greater than initially projected, this amount is now included in the projected Fiscal Year 2022/23 beginning fund balance. County Administration and Finance and Risk Management recommend utilizing these additional funds to fund the target level recommended in the attached proposed Fund Balance Policy.

As you can see in the table below, over the past five years, the County has ended each year with a healthy Fund Balance primarily due to the County not having to utilize the budgeted reserves, conservative revenue and expenditure estimates, and realized vacancy savings.

	Fiscal Year				
	Audited Financial Statements				Unaudited
Actuals	2017/18	2018/19	2019/20	2020/21	2021/22
Unrestricted Fund Balance*	108,926,345	102,109,649	98,107,183	148,191,927	173,206,858
Operating Expenditures*	501,673,777	517,016,973	517,731,914	543,285,794	547,489,515
Fund Balance/Operating Expenditure %	21.7%	19.7%	18.9%	27.3%	31.6%

* Excludes PSPRS/CORP Debt Related Expenses and Fund Balance in Fiscal Years 2020/21 and 2021/22.

As shown above, the Fiscal Year 2021/2022 Unaudited Financial Statements meet the 17 percent recommendation within the proposed policy. Typically, final audited financial statements are available in December 2022. Once the audit is completed, Finance and Risk Management will present the final audited fund balance and provide an analysis of the current year forecast to determine if there are any excess funds available. If additional funds are available, they could be used for various items such as offsetting future medical and dental rate increases, class and compensation study salary adjustments, employee raises, new initiatives, expanded programs, etc. Should the Board adopt this new methodology for calculating the Unrestricted General Fund Balance, this would require departments to be right-sized by eliminating a percentage of the funded, vacant positions.

<u>Vacant Positions</u>

Over the past two years, the County has recognized between $13 and $16 million in net vacancy savings in the General Fund. The average vacancy rate has been as high as 15 percent for the past two years. Since Pima County budgeted to fund all positions, any savings attributed to these vacancies are included in the General Fund Balance calculation.

Given our historical trends, accurate expenditure forecasts are more important than ever. Since salaries comprise the largest portion of the expenditure budget, we recommend the following actions to provide a more accurate picture of where salary expenditures are headed:

1. Any position that has been vacant for 180 days or more and is not currently being recruited will be eliminated from the department's budgets effective November 1, 2022. Eliminating these positions will apply to all departments, regardless of the fund. There are currently over 150 positions that have been vacant for 180 days or more and are not being recruited.

    a. The dollars associated with the General Fund Departments will be placed into a new PCN Reserve. This PCN Reserve will be used to fund new position requests from General Fund departments that do not have any vacant positions and have demonstrated a need for additional staffing. This PCN Reserve will be initially funded with approximately $3.5 million from the eliminated positions identified above. A simple process will be created for departments to request additional positions.

b. The dollars associated with non-General Fund Departments will remain within those departments' fund balances. However, these non-General Fund departments will be required to use their vacant positions prior to requesting additional positions through the same process identified above.

2. All grant-funded positions must live within the grant funds. Therefore, these grant-funded positions are not included in this analysis as they are a function of the grant award and must be monitored and managed as part of the grant.

3. For Budget Fiscal Year 2023/2024, new base budgets will be created for all departments to reflect the elimination of positions discussed above.

4. No new positions will be authorized until the existing vacant positions are filled or reallocated.

5. Any salary increases, outside of Board action, must be absorbed by the department by eliminating vacant positions.

6. Finance and Risk Management will include a report on vacant positions as part of its monthly financial report to the Board.

Recommendation:

To ensure that we maintain an adequate fund balance, I am recommending the Board of Supervisors approve a target level for the unrestricted fund balance within the General Fund to be 17 percent of the previous year's General Fund audited operating expenditures. To achieve this goal, I recommend that the Board of Supervisors implement the vacant position strategy outlined above. The funds realized from this decision, should the Board of Supervisors approve, will be segregated into the "committed" fund balance.

Sincerely,

Jan Lesher
County Administrator

JKL/dym – September 28, 2022

Attachment

c: Carmine DeBonis, Jr., Deputy County Administrator
Francisco Garcia, MD, MPH, Deputy County Administrator & Chief Medical Officer
Steve Holmes, Deputy County Administrator
Ellen Moulton, Director, Finance and Risk Management
Michelle Campagne, Senior Advisor, County Administration

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PURPOSE

To establish a Pima County policy for setting fund balance guidelines for the County's General Fund. This policy shall also establish a process for reaching and maintaining the targeted level of unrestricted fund balance within the General Fund and the uses of amounts in excess of the target.

BACKGROUND

The policy is being established to ensure that the County maintains an adequate fund balance in order to:

- Secure and maintain the County's credit ratings,
- Provide sufficient working capital to meet cash flow needs throughout the year,
- Ensure a stable tax rate by offsetting significant economic downturns or revenue shortfalls, and
- Provide one-time funds for unforeseen expenditures related to emergencies.

The Fund Balance is a key element in the determination of the County's credit rating. This allows the County to obtain the lowest interest rate debt possible to fund critical infrastructure, such as the Pavement Preservation program, Facilities Management projects, and other Pay-As-You-Go (PAYGO) Capital Improvement Projects.

DEFINITIONS

Fund Balance – The General Fund's balance is the difference between its assets and liabilities.

Fund Balance Components – For financial reporting purposes, and in accordance with Generally Accepted Accounting Principles (GAAP) and Governmental Accounting Standards Board Statement No. 54, the fund balance will be reported within the General Fund under the following categories:

Nonspendable – Amounts cannot be spent because they are not in spendable form or because they are legally or contractually required to remain intact.

Restricted – Amounts restricted for specific purposes due to externally enforceable limitations placed on the use of these resources by either (a) creditors (such as debt covenants), grantors, contributors, or laws or regulations of other governments; or (b) imposition by law through constitutional provisions or enabling legislation.

Committed – Amounts constrained by limitations set by formal action by the Board of Supervisors that requires formal action to remove said limitations.

Assigned – Amounts constrained by the intent to be used for a specific purpose, but the Board of Supervisors has taken no formal action to limit the use of these resources.

Unassigned – Residual amount not allocated to any other category in the General Fund.

Unrestricted Fund Balance – Unrestricted fund balance includes committed, assigned, and unassigned fund balance categories. For this policy, the unrestricted fund balance does not include the $25 million Pension Fund Reserve amount established under Board of Supervisors Policy D 22.11 for the Public Safety Personnel Retirement System and Correctional Officers Retirement Plan.

POLICY

A. Maintaining an Unrestricted Fund Balance

In order to ensure the County maintains an adequate unrestricted fund balance within the General Fund to meet the objectives discussed above, the following guidelines shall be adhered to:

1. Maintain an unrestricted fund balance in the General Fund of 17% of the previous year's General Fund audited operating expenditures. This amount is in addition to the $25 million Pension Fund Reserve established under Board of Supervisors Policy D 22.11.

2. In the event that the unrestricted fund balance in the General Fund drops below 17% at the end of any fiscal year, County Administration will develop a plan to bring the balance to the target level over a period of no more than two years. This plan will be submitted to the Board of Supervisors for approval to be implemented during the current fiscal year or through the annual budgetary process.

3. In the event that the unrestricted fund balance in the General Fund is greater than 17% at the end of any fiscal year and the current year's monthly forecast, the excess amounts should be used to address unexpected, nonrecurring costs. County Administration will develop and submit a recommendation to the Board of Supervisors for approval to use the excess in one or in a combination of the following ways:

    a. Transfer excess amounts to support future capital improvement programs or repair and maintenance projects.

    b. Transfer excess amounts to reduce the unfunded pension liabilities further.

    c. Reduce the tax rate in the subsequent year, provided this won't create a significant fluctuation in the tax rate in future years.

    d. Retire outstanding long and/or short-term debt.

e. Fund operating emergencies, unanticipated budgetary shortfalls, and unanticipated shortfalls in the General Fund.

4. By vote, the Board of Supervisors can also use the unrestricted fund balance in the General Fund for operating emergencies, unanticipated budgetary shortfalls, and unanticipated shortfalls within the General Fund or any other Funds. Any such action must also provide a plan to restore the unrestricted fund balance to the minimum required balance within two years.

5. To ensure continued compliance, the Department of Finance and Risk Management shall report the General Fund's unrestricted fund balance to the Board of Supervisors on a monthly basis.

Adopted: 10/04/2022
Revised:
Effective: