



WS#2

**DATE:** March 11, 2008  
**TO:** Mayor and City Council  
**FROM:** Director of Finance and Internal Services  
**SUBJECT:** Financial Policies and Possible New User Fees

### **RECOMMENDATION**

That the Council reads and comments on this report. These policies and detailed discussion related to user fees will be presented to the Council for adoption as a component of the budget process in June.

### **BACKGROUND**

The Governmental Finance Officers Association (GFOA) and the National Advisory Council on State and Local Budgeting (NACSLB) developed a comprehensive set of recommended budget practices. These practices and the associated framework outline a budget process that encompasses the broad scope of governmental planning and decision-making with regard to the use of resources. The framework is organized around the four principles of the budget process:

- Establish broad goals to guide government decision making,
- Develop approaches to achieve the adopted goals,
- Develop a budget to support the approaches for achieving the adopted goals, and
- Evaluate how well the goals were achieved and make adjustments.

As part of this approach, GFOA recommends that agencies adopt Financial Policies and recommends, at a minimum, that financial policies be developed in the following areas and formally adopted by the City Council.

- Financial Planning,
- Revenue Management, and
- Expenditure Control.

It is further recommended that these financial policies of the organization be reviewed during the budget process. Staff should review the policies to ensure continued relevance and to identify any gaps that should be addressed. The results of the review should be shared with the City Council during the review of the proposed budget, and the policies amended as needed to support the mission of the organization. These elements directly support Council's Fiscal Stability Initiative and recently adopted priorities.

## DISCUSSION

Based on the above recommendations, staff is developing the following financial policies:

- **Budget Practices**
  - The City of Hayward makes program and service decisions and allocates resources to programs and services through the budget process. As a result, the budget process is one of the most important activities undertaken by Hayward. The quality of decisions resulting from the budget process and the level of their acceptance depends on the budget process that is used.
  - The mission of the budget process is to help decision makers make informed choices about the provision of services and capital assets and to promote stakeholder participation in the process.
  - Key characteristics of the budget process include:
    - Incorporate a long-term perspective;
    - Establish linkages to broad organizational goals;
    - Focus budget decisions on results and outcomes;
    - Involve and promote effective communication with stakeholders;
    - Provide guidelines to Hayward's management and employees.
    - Brief analysis discussing the current financial status, the immediate future status, and long-term trends.
  
- **Balanced Budget**
  - The City is developing a policy that defines a balanced operating budget, encourages commitment to a balanced budget under normal circumstances, and provides for disclosure when a deviation from a balanced operating budget is planned or when it occurs.
  - A balanced budget is a basic budgetary constraint intended to ensure that the City does not spend beyond its means. At a minimum, balance should be defined to ensure that a government's use of resources for operating purposes does not exceed available resources over a defined budget period. A more stringent definition requires that a government maintain a balance between operating expenditures and operating revenues over the long term, not just during the current operating period. This latter definition of balance is referred to as structural balance.
  - The City will develop a policy that requires a balanced budget over a ten-year financial planning horizon, with the goal to eliminate the dependence on reserves to bridge a structural deficit by July 1, 2009.
  
- **Long Range Financial Forecasting in the Budget Preparation Process**
  - The City recognizes the importance of combining the forecasting of revenues and the forecasting of expenditures into a single financial forecast for the General Fund and all of the City's major Enterprise and Internal Service funds.
  - The City is developing ten-year financial plans that assess the long-term financial implications of current and proposed policies, programs, and. A key component in determining future options, potential problems, and opportunities is the

- accurate and thoughtful forecast of revenues and expenditures.
- Revenue and expenditure forecasting does the following: provides an understanding of available funding; evaluates financial risk; assesses the likelihood that services can be sustained; assesses the level at which capital investment can be made; identifies future commitments and resource demands; and identifies the key variables that cause change in the level of revenues. Most importantly, forecasting provides an early warning system for identifying future problems that might not be obvious when only looking at the short-term horizon, and allows the organization to adjust in a planned manner rather than as a reaction after the fact.
- **Internal Service Maintenance and Capital Replacement**
  - Capital assets comprise major government facilities, equipment, vehicles, computers, and data networks enabling the delivery of public sector services. The quality and continued utilization of these capital assets are essential to the health, safety, and quality of life of those utilizing such assets.
  - Budgetary pressures may impede capital program investments for maintenance and replacement purposes, making it increasingly difficult to sustain existing capital asset condition and avoid functional obsolescence. Yet deferring such essential reinvestments reduces vital public services and may even endanger public safety. The financial result is increased cost as the physical condition of these assets declines.
  - Hayward has therefore established capital planning, budgeting, and reporting practices to encourage adequate capital spending levels. Financial and capital improvement plans should address the continuing investment necessary to properly maintain its capital assets. Such practices should include proactive steps to promote adequate capital maintenance and reinvestment in existing public capital assets, as necessary.
  - The City has established internal service funds for Equipment/Vehicles, Facilities, and Technology. These funds will account for the operating and capital replacement needs of the City.
- **Multi-year Capital Improvement Plan (CIP)**
  - Buildings, infrastructure, and other major projects are the physical foundation for providing services to constituents. The procurement, construction, and maintenance of capital assets are critical activities of the City of Hayward, and therefore require careful planning.
  - Capital planning is critical to water, sewer, transportation, sanitation, and other essential public services. It is also an important component of a community's economic development program and strategic plan. And, it provides structure and support for the management and maintenance of capital facilities and infrastructure, which are important to the future health of the community. It is extremely difficult for governments to address the current and long-term needs of their constituents without a sound multi-year capital improvement plan that clearly identifies capital and major equipment needs, maintenance requirements,

and funding options, as well as their respective impacts on the related operating budgets.

- The City will develop a 10-year Capital Improvement Plan and identify alternative funding sources, use of grants or RDA funding where applicable.
- **Revenue Enhancements and Setting of Charges and Fees**
  - General government services are funded by general taxes, such as property tax and sales tax. The City will explore all possible/legal alternative funding sources.
  - Hayward intends to recover the full cost of providing goods and services. Circumstances where a charge or fee is set at less than 100 percent of full cost shall be identified. If the full cost of a good or service is not recovered, then an explanation of the City's rationale for this deviation should be provided. Some considerations that might influence Hayward's pricing practices are the need to regulate demand, the desire to subsidize certain services, administrative concerns such as the cost of collection, and the promotion of other goals.
  - Charges and fees should be reviewed and updated periodically based on factors such as the impact of inflation, other cost increases, the adequacy of the coverage of costs, and current competitive rates.
  - Information on charges and fees should be available to the public. This includes the City of Hayward policy regarding full cost recovery and information about the amounts of charges and fees, current and proposed, both before and after adoption.
  - Staff must constantly assess the cost and feasibility of collection and recovery. Although it may be determined that a high level of cost recovery may be appropriate for specific services, it may be impractical or too costly to establish a system to identify and charge the user. Accordingly, the feasibility of assessing and collecting charges should also be considered in developing user fees, especially if significant program costs are intended to be financed from that source.
- **Debt Issuance and Parameters**
  - A comprehensive debt policy sets forth the parameters for issuing debt and managing the debt portfolio and provides guidance to decision makers. These parameters recognize a long-term commitment to full and timely repayment of all debt as an intrinsic requirement for entry into the capital markets. Adherence to the parameters helps to ensure that Hayward maintains a sound debt position and that its credit quality is protected.
  - A policy regarding debt issuance and management parameters is beneficial because it enhances the quality of decisions, rationalizes the decision-making process, identifies objectives for staff to implement, demonstrates a commitment to long-term financial planning objectives, establishes healthy boundaries for the debt burden of the organization, and is viewed positively by the rating agencies.
- **Reserves**
  - Hayward should maintain a prudent level of financial resources to protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures. These resources also provide a

first defense against deficit spending and help maintain liquidity when budgeted draw downs are inevitable.

- Reserves may be used at the City Council's discretion to address temporary cash flow shortages, emergencies, unanticipated economic downturns, and one-time opportunities. These resources are intended to provide flexibility to respond to unexpected opportunities that may help the City of Hayward achieve its goals. The use of these funds may also be tied to an adverse change in economic indicators (such as declining staff levels or taxes) to ensure that the funds are not depleted before an emergency arises.
- A proposed policy for fund balance reserves in the General Fund and Internal Service Funds has been developed by staff. Please see attachment A for the details of this policy.

- **Internal Controls**

- The City of Hayward recognizes that Internal Controls are an integral part of any organization's financial and business policies and procedures and is committed to assuring that Internal Controls are an expected part of each employee's execution of their duties and responsibilities.
- Everyone within the organization has some role in internal controls, and that role varies depending upon the level of responsibility and the nature of involvement by the individual. The Mayor, Council, and senior executives establish the presence of integrity, ethics, competence, and a positive control environment. The department heads have oversight responsibility for internal controls within their units. Managers and supervisory personnel are responsible for executing control policies and procedures at the detail level within their specific unit. Each individual within a unit is to be cognizant of proper internal control procedures associated with their specific job responsibilities.
- Internal controls consists of all the measures taken by the organization for the purpose of; (1) protecting its resources against waste, fraud, and inefficiency; (2) ensuring accuracy and reliability in accounting and operating data; (3) securing compliance with the policies of the organization; and (4) evaluating the level of performance in all organizational units of the organization. Internal controls are simply good business practices.
- Internal control systems operate at different levels of effectiveness. Determining whether a particular internal control system is effective is a judgment resulting from an assessment of whether the five components - Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring - are present and functioning. Effective controls provide reasonable assurance regarding the accomplishment of established objectives, and are therefore central to effective service delivery.

#### Possible New User Fees

Based on some of the financial policies noted above and the Fiscal Stability Initiative previously presented by the City Manager, the City is engaged in a comprehensive user fee study. The objective of this study is to determine the true full cost of providing certain services, in order to charge customers the appropriate fees for the services provided. Staff has also compiled a list of

potential new user fees as a result of the budget process goals to enhance revenue by two percent. In most cases the proposed fees are an attempt to recover the cost of services already provided by the City, but not previously charged. Certain new fees are also being explored as a result of the fee study.

Staff would like to review some of these potential new fees with Council prior to recommending them for inclusion in the master fee schedule. Examples of these new fees include: establishing a fee for Planning Pre-application meetings, recapturing charges from collections agency on bad debts, creating a business license processing fee, exploring public safety related alcohol and tobacco permit fees, establishing a tow company license fee, and significantly expand fire inspection fees.

### **FISCAL IMPACT**

Adopting and implementing financial policies can impact the fiscal stability of the organization. Creating long range financial plans allows the City to see the long term effect of decision making. Presenting a balanced budget will require the City to obligate funds within its means. Creating internal service funds will assist the City in accumulating the appropriate reserves for replacement of capital assets. Adopting a full cost recovery policy for the services provide to the public will reduce the amount of general tax subsidies necessary to provide these discretionary services. Most importantly, enhancing our current General Fund reserve policies and establishing reserves policies in the Internal Service Funds will provide long-term financial stability to the City.

### **NEXT STEPS**

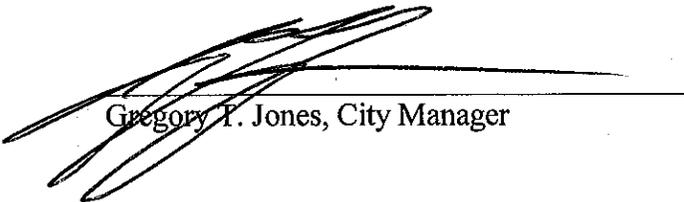
These financial policies and a complete update to the comprehensive user fee schedule will be presented as part of the budget process.

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Approved by:



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Attachments: Financial Policies-Reserves

## Reserves

*Hayward should maintain a prudent level of financial resources to protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures. These resources also provide a first defense against deficit spending and help maintain liquidity when budgeted draw downs are inevitable.*

### Policy

Reserves may be used at the City Council's discretion to address temporary cash flow shortages, emergencies, unanticipated economic downturns, and one-time opportunities. These resources are intended to provide flexibility to respond to unexpected opportunities that may help the City of Hayward achieve its goals. The use of these funds may also be tied to an adverse change in economic indicators (such as declining staff levels or taxes) to ensure that the funds are not depleted before an emergency arises. Reserve levels below or above targets are authorized, subject to approval. The minimum and maximum targets are based as follows:

Name	Minimum	Maximum	Basis
General Fund- Economic Uncertainty	\$5,000,000	10% of the annual general fund operating appropriations	Sales tax, real property transfer tax and development related fees are sensitive to general economic cycles. Since there are major revenue sources to the general fund it is necessary to create a reserve that will allow the City to continue providing necessary service levels during economic downturns.
General Fund-Liquidity	\$2,500,000	5% of the annual general fund operating appropriations	Certain major revenues of the general fund are passed through other government agencies, state and county. We cannot control the timing of when they make payments to the City. This reserve is to address short-term borrowing needs the City may encounter.
General Fund- Emergencies	\$10,000,00 (to be established over 10 year planning period)	3 months City payroll	To ensure that the City can provide essential services to the public during a disaster, a reserve for emergencies will be developed over the next 10 year planning period.

Equipment Management	Annual replacement requirements of existing assets	Long-term replacement requirements for existing and future assets	Accumulation of reserves will ensure timely replacement of city assets.
Facilities Replacement	Annual replacement requirements of existing assets	Long-term replacement requirements for existing and future assets	Accumulation of reserves will ensure timely replacement of city assets.
Technology Replacement	Annual replacement requirements of existing assets	Long-term replacement requirements for existing and future assets	Accumulation of reserves will ensure timely replacement of city assets.
Risk Management-General Liability	\$1,000,000	Amount recommended by City Attorney	The City is self insured and therefore it is prudent to set aside reserves for an unforeseen claim.
Retirement Benefit Liability	3% of annual payroll	Actuarial determined OPEB liability	Per GASB 45, City's must report the other Pension Employee Benefits (OPEB) Liability in financial statements. It is also recommended to set aside reserves for these obligations.

**References**

- *NACSLB's Framework for Improved State and Local Government Budgeting and Recommended Practices.*
- *Impact of Management Practices on Municipal Credit*, Fitch IBCA, May 4, 2000
- *Budgeting a General Fund Reserve*, CSMFO, February 18, 2000
- *City of Hayward City Council Resolution 89-180*, June 13, 1989