CITY OF NEWPORT BEACH
FINANCE COMMITTEE AGENDA

NEWPORT COAST CONFERENCE ROOM, BAY 2E
100 CIVIC CENTER DRIVE, NEWPORT BEACH
JULY 21, 2015, 4:00 P.M.

FINANCE COMMITTEE MEMBERS:

Keith Curry, Chair / Council Member
Diane Dixon, Mayor Pro Tem
Tony Petros, Council Member
Bill McCullough, Committee Member
Larry Tucker, Committee Member
John Warner, Committee Member
Vacant, Committee Member

STAFF MEMBERS:

Dave Kiff, City Manager
Dan Matusiewicz, Finance Director / Treasurer
Steve Montano, Deputy Director, Finance
Marlene Burns, Administrative Specialist to the Finance Director

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I. CALL MEETING TO ORDER

II. ROLL CALL

III. PUBLIC COMMENTS

Public comments are invited on agenda and non-agenda items generally considered to be within the subject matter jurisdiction of the Finance Committee. Speakers must limit comments to three (3) minutes. Before speaking, we invite, but do not require, you to state your name for the record. The Finance Committee has the discretion to extend or shorten the speakers' time limit on agenda or non-agenda items, provided the time limit adjustment is applied equally to all speakers. As a courtesy, please turn cell phones off or set them in the silent mode.

IV. APPROVAL OF MINUTES

A. Summary:
Approval of the June 11, 2015, Finance Committee Minutes.

Recommended Action:
Approve and file.

V. CURRENT BUSINESS

A. 2014-15 AUDIT PLANNING AND COMMUNICATION
Summary:
Receive and file a letter from the City's Independent Auditor communicating the scope and responsibilities associated with the 2014-15 Financial Statement audit. The letter also provides the auditor's contact information and invites those charged with governance to contact the

auditor should matters come to the Finance Committee's attention that would have material bearing on the financial statements taken as a whole including errors, fraudulent financial reporting, misappropriation of assets, or violations of laws by management or employees acting on behalf of the City.

Recommended Action:
Receive and file report and letter.

B. COUNCIL RESERVE POLICY F-2 REVIEW
Summary:
Council Reserve Policy F-2 provides guidance to City Staff regarding target reserve levels that are an integral part of prudent financial planning.

Recommended Action:
The Committee may review and comment on the current policy. Any changes to the policy recommended by the Finance Committee would be forwarded to the City Council for review and consideration.

C. QUESTION/ANSWERS PERTAINING TO FY 2015-16 ADOPTED BUDGET
Summary:
As a follow up to the previous Finance Committee meetings, the Committee is welcome to continue its questions and comments about the FY 2015-16 Adopted Budget. All questions and comments are still relevant even following Council adoption of the FY 2015-16 Budget as the input will help frame both budget adjustments and planning for the FY 2016-17 Budget, which begins relatively soon.

Recommended Action:
The Committee may ask questions specific to the Adopted FY 2015-16 Budget or any topics pertaining to City finance practices, policies, and procedures.

VI. ADJOURNMENT

CITY OF NEWPORT BEACH
FINANCE COMMITTEE
JUNE 11, 2015 MEETING MINUTES

I. CALL MEETING TO ORDER

The meeting was called to order at 4:00 p.m. in the Newport Coast Conference Room, Bay 2E, 100 Civic Center Drive, Newport Beach, California 92660.

II. ROLL CALL

PRESENT: Council Member Keith Curry (Chair); Mayor Pro Tem Diane Dixon; Committee Member Bill McCullough; Committee Member Larry Tucker; Committee Member John Warner (arrived at 4:06 p.m.); and Committee Member Jack Wu

ABSENT: Council Member Tony Petros (Excused)

STAFF PRESENT: City Manager, Dave Kiff; Finance Director, Dan Matusiewicz; Deputy Finance Director, Steve Montano; Administrative Specialist to the Finance Director, Marlene Burns; Senior Accountant, Theresa Schweitzer; Public Works Administrative Manager, Jamie Hook; Fire Administrative Manager, Angela Crespi; Deputy City Manager/HR Director, Terri Cassidy; Fire Chief, Scott Poster; Systems and Administrative Manager, Dan Campagnolo; Community Development Director, Kimberly Brandt; Revenue Manager, Evelyn Tseng; Accounting Manager, Rukshana Virany; Police Support Services Administrator; Jonathan Stafford; Budget Manager, Susan Giangrande; Senior Civil Engineer, David Keely; Harbor Resources Supervisor, Shannon Levin; Building Manager/Chief Building Official, Seimone Jurjis; License Supervisor, Monique Navarrete; and IT Manager, Rob Houston

MEMBER OF THE PUBLIC: Carl Cassidy

III. PUBLIC COMMENTS - None

IV. APPROVAL OF MINUTES

A. Summary:
Approval of the March 10, 2015, Joint City Council/Finance Committee Minutes and the May 11, 2015, Finance Committee Minutes.

Recommended Action:
Approve and file.

Mayor Pro Tem Dixon moved, and Committee Member Tucker seconded, to approve the March 10, 2015, Joint City Council/Finance Committee Minutes and the May 11, 2015, Finance Committee Minutes. The motion carried with 6 ayes and 1 absent (Council Member Petros).

V. CURRENT BUSINESS

A. MUNICIPAL FEE SCHEDULE

Summary:
Chapter 3.36 of the Newport Beach Municipal Code ("Municipal Code") requires that user fees for municipal services be recovered at 100%, unless otherwise provided for in Municipal

Code Section 3.36.030. After careful analysis and review by MGT of America, Inc. ("MGT"), staff developed and proposes updates to the fees for the Police, Fire, Public Works, and Community Development Departments.

Recommended Action:
Staff recommends that the Finance Committee direct staff to bring the attached changes for City Council approval.

Finance Director Dan Matusiewicz thanked Finance staff and participating Departments, introduced the item and deferred to staff for a report.

Deputy Finance Director Steve Montano provided a PowerPoint presentation. He acknowledged attendance of staff from various Departments as well as the consultant retained to help with this project. He addressed an overview of the presentation including a high-level summary of the proposed fee changes, the purpose of the fees and the authority for administering and updating the fees, the methodology on how the fees were calculated and each Department's proposed fees. He noted that 34% (100) of the fees are being decreased or eliminated. He addressed the phased approach, cost of services, and the reasons why some fees are being increased/decreased/eliminated, including recovering of costs for services.

Brief discussion followed regarding total revenue by Department related to fees.

Deputy Finance Director Montano addressed Police Department fees, variances in fees, Public Works fees and Transport fees.

Fire Chief Scott Poster addressed emergency medical transport fees. Discussion followed regarding County fees and services, potential revenue from the changes in fees, efforts to recover costs as much as possible, Medicare coverage, rate of recovery, situations where patients are treated but not transported and uncollectable charges.

City Manager Kiff responded to an inquiry from Mayor Pro Tem Dixon noting that staff would like input from the Committee regarding, policies, and uncollectable debt and on first responder non-transfer fees.

Mayor Pro Tem Dixon noted that taxpayers pay for the uncollectable debt.

Discussion followed regarding repetitive calls and it was noted that the Fire Department cannot discriminate and must respond to each call, without regard to the likelihood of collection.

Discussion followed regarding best practices by other cities, private ambulance services, issues with borrowing ambulances, and advance life support services.

Fire Chief Poster stated that the City of Costa Mesa is looking to implement the Newport Beach model and reported that many Fire Departments are getting into the transport business and suggested looking at neighboring cities. He addressed a jurisdictional comparison of fees and reported that Newport Beach calculated actual costs where other cities have not.

Discussion followed regarding efforts to collect and Chief Poster reported that the City contracts with outside agencies for billing and collection services.

Fire Administrative Manager Angela Crespi reported that bad debt average from 2014 is $578,000.

Fire Chief Poster added that about 34% of the calls for service in the City are for non-residents. Each jurisdiction decides how they want to set up their fee structure and what they want to bill.

Chair Curry noted that initially, when this was reviewed in the past, there was a differential charge for non-residents.

Fire Administrative Manager Crespi reported that the Department does not collect data on people that are not billed. She added 14% of transports are "private pay".

Finance Director Matusiewicz added that some of the fees offset the cost of the Fire Department's readiness to serve.

Fire Chief Poster noted there is some redundancy in terms of fire fighter paramedics and ALS calls and addressed the need to evaluate transport, financially.

In response to Mayor Pro Tem Dixon's question, Chief Poster commented that bad debt was not currently factored in.

Discussion followed regarding the expected revenue once the fee changes have been implemented and the percent of salaries and benefits derived from fees.

In reply to Committee Member Wu's question, Chief Poster noted that just a little less than 80% of all calls are EMS.

Discussion followed regarding the need for fire engines for certain calls. Chief Poster stated that when a call is received, the goal is to provide the closest resource to be able to respond as soon as possible.

Chair Curry redirected the discussion to the proposed fee changes.

Committee Member Tucker commented on increases in plan-check fees.

Chief Building Official Seimone Jurjis reported that plan-check fees are not charged on an hourly basis. He added that fees are based on the assessed value of the project, based on square footage. He indicated that staff is proposing a 21% increase in plan-check fees. Deputy Finance Director Montano added that fees have not been updated since 2008. Chair Curry commented on the cumulative impact of delayed action.

Discussion followed regarding appeals to City Council and the Planning Commission. Community Development Director Kimberly Brandt reported that a provision in the Municipal Code states that appeals are to be subsidized by 50%. She addressed the previous and current appeals process.

Chair Curry opened public comments. Chair Curry closed public comments.

Mayor Pro Tem Dixon moved, and Committee Member Tucker seconded, to approve recommend approval of the proposed changes in fees to City Council. The motion carried with 6 ayes and 1 absent (Council Member Petros).

Discussion followed regarding exploring how to recover "uncollectible costs", establishing a fee differential for residents and non-residents, considering a process to recover for high-volume users and incentivizing not to call and consider a policy change to recover non-resident non-transport services and bad debt. Chair Curry summarized direction to staff to return to the Finance Committee with recommendations on how to advance fee/cost recovery in the Fire Department.

B. BUSINESS LICENSE

Summary:

Pursuant to recent Council direction, staff will present an overview of the City's Business License Tax to the Finance Committee.

Recommended Action:

Receive and file.

Business License Supervisor Monique Navarrete provided an overview of the Business Tax Program. She addressed background, tax versus assessment fee, authority, raising revenue for public services, examples of services provided, business categories, and total current revenues. She added that the City receives very few complaints related to the Business Tax Program. She addressed the number of businesses licenses issued per year and costs to administer the program and noted that revenues go into the City's General Fund. She added that the program is not intended for regulation.

Business License Supervisor Navarrete addressed practices of surrounding cities.

Discussion followed regarding the Huntington Beach program, the number of businesses in Huntington Beach compared to Newport Beach, cities that base on a flat tax, charges per employee based on whether they collect sales tax or not, percentage of non-compliance, the tax collection process, enforcement and attempts at discovering non-compliant businesses.

Additionally, Business License Supervisor Navarrete reported on the number of California cities that require business licenses and those that do not. She presented changes that went into effect in 2014, and addressed what happens if the tax becomes a fee.

Finance Director Matusiewicz addressed the financial impact to the City by eliminating the program.

Discussion followed regarding practices in the City of Irvine. It was noted the Irvine has no marine services, no library and no lifeguards.

Ensuing discussion pertained to the criteria for requiring a business license and the process for taxing contractors.

Chair Curry opened public comments.

Carl Cassidy opined that the City does a good job in terms of business license taxes. He noted that using a P.O. Box for filing taxes is prohibited. Chair Curry closed public comments.

Committee Member Wu stated he would like to see what percentage of businesses in Huntington Beach, do not pay business license taxes.

Chair Curry suggested that staff research the matter and communicate the findings to the members of the Finance Committee.

Discussion followed regarding the possibility of getting a higher percentage of businesses participating if the tax is reduced.

Business License Supervisor Navarrete stated that most complaints received are not about the amount of the tax, but rather not knowing that a business license was needed or wanting to stay "under the radar" as long as possible.

Discussion followed regarding the number, categories, and sizes of businesses in the City and proprietors who do not have employees.

C. QUESTION/ANSWERS PERTAINING TO FY 2015/16 ADOPTED BUDGET

Summary:

As a follow up to the last Finance Committee, the Committee is welcome to continue its questions and comments about the FY 2015/16 Adopted Budget. All questions and comments are still relevant even following Council adoption of the FY 2015/16 budget, as the input will help frame both budget adjustments and planning for the FY 2016/17 budget, which begins relatively soon.

Recommended Action:

The Committee may ask questions specific to the Adopted FY 2015/16 Budget or any topics pertaining to City finance practices, policies, and procedure.

Chair Curry commented on the previous budget discussion and noted this item has been placed on the agenda to allow for further discussion if the Finance Committee desires it.

Discussion followed regarding providing an explanation of variances in budget presentations, going forward, changes in the budget, the performance plan and identifying what things the Finance Committee wants to review in order to make recommendations to the City Manager prior to starting the budget.

Committee Member Tucker commented on the importance of determining if the City has the right number of employees. He added that savings will result in more efficient use of employees.

Mayor Pro Tem Dixon noted that the number of employees are driven by the number and types of services provided.

Chair Curry commented on efforts made by the City to address costs associated with full-time employment, including outsourcing, the waste and street-sweeping contract, and other operational efficiencies. He added that the low-hanging fruit has been done and that the big labor costs are in Police and Fire services.

Committee Member Tucker commented on the possibility of additional efficiencies.

Mayor Pro Tem Dixon noted that the community is accustomed to a certain level of service and suggested that going forward, the Finance Committee should scrutinize principals to inform staff how to build their respective department budgets. She added that the budget includes $40 million of forced savings for future needs. Finance Director Matusiewicz addressed items that would go into the long-term need category, including the FFP, vehicle replacement plans, and transitions in the communications system, as well as others.

Committee Member Warner departed at 5:48 p.m.

Discussion followed regarding conducting efficiency studies, outsourcing park maintenance, and construction projects, the approval threshold for City contracts and the possibility of implementing a flat budget and its impact.

Finance Director Matusiewicz stated that many programs are near and dear to the community so that care must be taken before deciding to change or eliminate them.

Chair Curry suggested finding a function that would be a candidate for additional efficiencies and having the Finance Committee work with staff to identify a strategy and an estimate of the savings and develop recommendations for Council.

Mayor Pro Tem Dixon suggested reviewing the vehicle replacement policy in a future meeting.

Budget Manager Susan Giangrande noted that the vehicle replacement policy has not been reviewed in a long time.

Chair Curry opened public comments.

Carl Cassidy asked regarding the next Finance Committee meeting.

Chair Curry closed public comments.

Chair Curry announced that the next Finance Committee meeting will be on July 16, 2015, at 4:00 p.m.

D. FINANCE COMMITTEE SCHEDULE UPDATE

Summary: The Finance Committee work plan represents the planned topics of discussion; however, is subject to change based on the availability of information and the need to schedule other topics as they arise. This item proposes an update to previous work plan schedule.

Committee Member Tucker stated he would like to have a better understanding of the various City funds.

Chair Curry suggested that Member Tucker meet with Finance Director Matusiewicz to discuss the various City funds. He added that at the next Finance Committee meeting, there will be a discussion regarding reserves.

VI. ADJOURNMENT

The Finance Committee adjourned at 6:03 p.m. to the next regular meeting of the Finance Committee on July 16, 2015, at 4:00 p.m.

Filed with these minutes are copies of all materials distributed at the meeting.

The agenda for the Regular Meeting was posted on June 8, 2015, at 2:40 p.m., in the binder and on the City Hall Electronic Board located in the entrance of the Council Chambers at 100 Civic Center Drive.

Attest:

Keith Curry, Chair Finance Committee Chair	Date

July 21, 2015, Finance Committee Agenda Comments

These comments on items on the Newport Beach City Council Finance Committee agenda are submitted by: Jim Mosher (jimmosher@yahoo.com), 2210 Private Road, Newport Beach 92660 (949-548-6229)

Item IV.A. APPROVAL OF MINUTES

Approval of the June 11, 2015, Finance Committee Minutes

The following corrections are suggested:

Page 2, paragraph 8 from end: "*City Manager Kiff responded to an inquiry from Mayor Pro Tem Dixon noting that staff would like input from the Committee regarding, policies, and uncollectable debt and on first responder* ~~***non-transfer***~~ ***non-transport*** *fees*."

Page 2, paragraph 5 from end: "*Discussion followed regarding best practices by other cities, private ambulance services, issues with borrowing ambulances, and* ~~***advance***~~ ***advanced*** *life support services*."

Page 2, paragraph 2 from end: "*Fire Administrative Manager Angela Crespi reported* ~~***that***~~ ***the*** *bad debt average from 2014 is $578,000*."

Page 4, paragraph 5 from end: "*Committee Member Wu stated he would like to see what percentage of businesses in Huntington Beach*~~,~~ *do not pay business license taxes*." [delete extraneous comma]

Page 5, Item C discussion, paragraph 3: "*Committee Member Tucker commented on the importance of determining if the City has the right number of employees. He added that savings will result* ~~***in***~~ ***from*** *more efficient use of employees*." [?]

Page 5, paragraph 6 from end: "*Mayor Pro Tem Dixon noted that the community is accustomed to a certain level of service and suggested that going forward, the Finance Committee should scrutinize* ~~***principals***~~ ***principles*** *to inform staff how to build their respective department budgets.*"

CITY OF NEWPORT BEACH
FINANCE COMMITTEE
STAFF REPORT

Agenda Item No. 5A
July 21, 2015

TO: HONORABLE CHAIRMAN AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
Steve Montano, Deputy Finance Director
(949) 644-3240, smontano@newportbeachca.gov

SUBJECT: 2014-15 Audit Planning and Communication

DISCUSSION:

The City Charter and California state law require that the City of Newport Beach issue annually a complete set of financial statements and that an independent firm of certified public accountants audit the City's Comprehensive Annual Financial Report (CAFR) in conformance with generally accepted auditing standards. The City of Newport Beach's FY 2014-15 financial statements will be audited by White Nelson Diehl Evans LLP (Audit Team) with the goal of providing reasonable assurance that the financial statements are free of material misstatement.

In preparation for the start of field work pertaining to FY 2014-15 audit, staff met with the Audit Team on July 8, 2015, to review the current audit environment and discussed such topics as the addition of new funds, the significant financial events of year, management changes, and other topics relevant to the audit.

As part of the audit process, the Audit Team has submitted for the Finance Committee's review the attached "Communication with Those Charged with Governance" memorandum. Professional standards require the Audit Team to communicate matters related to the audit that are relevant to the Finance Committee's responsibilities in overseeing the financial reporting process.

The Finance Committee met with the Audit Team in February 2015 and will again around the same time in 2016 to discuss the audit findings for the fiscal year ending June 30, 2015. The Committee will have an opportunity to discuss any potential areas of concern and the auditors can discuss any changes in accounting standards or disclosures that were relevant for the audit year.

RECOMMENDED ACTION:

Receive and file.

Prepared and Submitted by:

/s/ Steve Montano

Steve Montano
Deputy Finance Director

Attachment:

A. "Communication with Those Charged with Governance" Memorandum from White Nelson Diehl Evans LLP

ATTACHMENT A

“Communication with Those Charged with Governance” Memorandum from White Nelson Diehl Evans LLP

WHITE NELSON DIEHL EVANS LLP
Certified Public Accountants & Consultants

June 24, 2015

Mr. Dan Matusiewicz
Finance Director/Treasurer
City of Newport Beach
100 Civic Center Drive
Newport Beach, CA 92660

Dear Mr. Matusiewicz:

Enclosed is the "Communication with Those Charged with Governance" letter issued during the planning phase of the audit. Please forward the letter to the Finance Committee.

If you have any questions, please feel free to call me.

Very truly yours,

Nitin P. Patel

Nitin P. Patel, CPA

2875 Michelle Drive, Suite 300, Irvine, CA 92606 • Tel: 714.978.1300 • Fax: 714.978.7893
Offices located in Orange and San Diego Counties

WHITE NELSON DIEHL EVANS LLP
Certified Public Accountants & Consultants

To the Honorable City Council
of the City of Newport Beach
Newport Beach, California

We are engaged to audit the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Newport Beach (the City) for the year ending June 30, 2015. Professional standards require that we provide you with the following information related to our audit.

Our Responsibilities under U.S. Generally Accepted Auditing Standards, *Government Auditing Standards* and OMB Circular A-133

As stated in our Amendment No. Two to Professional Services Agreement dated June 3, 2015, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

In planning and performing our audit, we will consider the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. We will also consider internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we will perform tests of its compliance with certain provisions of laws, regulations, contracts, and grants. However, providing an opinion on compliance with those provisions is not an objective of our audit. Also, in accordance with OMB Circular A-133, we will examine, on a test basis, evidence about the City's compliance with the types of compliance requirements described in the "U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement" applicable to each of its major federal programs for the purpose of expressing an opinion on the City's compliance with those requirements. While our audit will provide a reasonable basis for our opinion, it will not provide a legal determination on the City's compliance with those requirements.

We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

2875 Michelle Drive, Suite 300, Irvine, CA 92606 • Tel: 714.978.1300 • Fax: 714.978.7893
Offices located in Orange and San Diego Counties

Our Responsibilities under U.S. Generally Accepted Auditing Standards, *Government Auditing Standards* and OMB Circular A-133 (Continued)

Generally accepted accounting principles provide for certain required supplementary information (RSI) to supplement the basic financial statements. Our responsibility with respect to the management's discussion and analysis and the City's defined benefit plan schedules required by GASB Statement No. 68, Accounting and Financial Reporting for Pensions - An Amendment of GASB Statement No. 27, which supplement the basic financial statements, is to apply certain limited procedures in accordance with generally accepted auditing standards. However, the RSI will not be audited and, because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance, we will not express an opinion or provide any assurance on the RSI.

We have been engaged to report on the combining and individual fund financial statements and schedule of expenditures of federal awards, which accompany the financial statements but are not RSI. Our responsibility for this supplementary information, as described by professional standards is to evaluate the presentation of the supplementary information in relation to the financial statements as a whole and to report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

We have not been engaged to report on the introductory section or statistical section, which accompany the financial statements but are not RSI. Our responsibility with respect to this other information in documents containing the audited financial statements and auditors' report does not extend beyond the financial information identified in the report. We have no responsibility for determining whether this other information is properly stated. This other information will not be audited and we will not express an opinion or provide any assurance on it.

Planned Scope and Timing of the Audit

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested.

Our audit will include obtaining an understanding of the City and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing and extent of further audit procedures. Material misstatements may result from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the City or to acts by management or employees acting on behalf of the City. We will generally communicate our significant findings at the conclusion of the audit. However, some matters could be communicated sooner, particularly if significant difficulties are encountered during the audit where assistance is needed to overcome the difficulties or if the difficulties may lead to a modified opinion. We will also communicate any internal control related matters that are required to be communicated under professional standards. If a member of the Council is aware of matters that have a material bearing on the financial statements taken as a whole (such as those described above in items 1-4), please contact Nitin Patel at (714) 978-1300 or by email at npatel@wndecpa.com by September 30, 2015.

Planned Scope and Timing of the Audit (Continued)

We expect to begin the final fieldwork of our audit in October 2015 and issue our report by December 31, 2015.

This information is intended solely for the use of the City Council and management of the City and is not intended to be and should not be used by anyone other than these specified parties.

White Nelson Diehl Evans LLP

Irvine, California
June 24, 2015

July 21, 2015, Finance Committee Agenda Comments

These comments on items on the Newport Beach City Council Finance Committee agenda are submitted by: Jim Mosher (jimmosher@yahoo.com), 2210 Private Road, Newport Beach 92660 (949-548-6229)

Item V.A. 2014-15 AUDIT PLANNING AND COMMUNICATION

The Committee may wish to be aware of the following.

1. The voter-adopted Newport Beach City Charter (regarded by most as the supreme law of the City) includes a section that reads [emphasis added]:

   "Section 1116 Independent Audit.

   *The **City Council** shall employ **at the beginning** of each fiscal year*, a qualified certified public accountant who shall, at such time or times as may be specified by the City Council, and at such other times as he or she shall determine, examine the books, records, inventories and reports of all officers and employees who receive, handle or disburse public funds and of all such other officers, employees or departments as the City Council may direct. Within 270 days after the end of the fiscal year, a final audit and report shall be submitted by such accountant to the City Council, one copy thereof to be distributed to each member, one to the City Manager, Director of Finance, and City Attorney, respectively, and sufficient additional copies of the audit shall be placed on file in the office of the City Clerk where they shall be available for inspection by the general public, available on the City's website or electronic equivalent, and a summary of the financial statement as of the close of the fiscal year shall be published in a newspaper of general circulation within the City. (As amended effective January 20, 1959, April 28, 1966, and January 9, 2013)"

   Article IV requires the Council to take its actions publicly, at noticed meetings.

2. City Council Policy F-15 ("External Financial Reporting, Disclosure & Annual Audit") concludes [emphasis added]:

   "After soliciting and receiving written proposals** from qualified independent accounting firms, **the Finance Director shall submit a recommendation to the Finance Committee and City Council. Under the premise that multiyear audit agreements are more cost efficient, allow for greater continuity and reduce audit disruption, the City may engage auditors in multi-year contracts but the term of each contract shall not exceed five years. Generally, the City will request proposals for audit services every five years. However, the Finance Committee may make an exception to the competitive proposal requirement if extraordinary circumstances exist and a change in auditors may not be prudent. *If the City Council is satisfied with the performance of the auditors, the independent accountants may submit additional proposals **through a competitive selection process*** but it is the City's policy to require mandatory audit firm rotation after ten years of consecutive service.

> “After audit results have been communicated to the City, the Finance Department is then responsible for responding to all findings within six months to the Finance Committee and appropriate regulatory agencies, if applicable.”

3. The “PURPOSE & RESPONSIBILITIES” of the Finance Committee as established by the most recent enabling Resolution 2015-40 include [emphasis added]::

   > “J. Conduct audit conference meeting(s) with the auditors to *provide **independent review and oversight** of the City of Newport Beach's financial reporting processes*, framework of internal control, and to provide a forum in which auditors can candidly discuss concerns in the absence of staff;”

4. True to the Charter (which was originally approved by voters in 1954), it appears that at least through 1975 the City Council publicly considered and approved the audit proposal for the coming fiscal year through a series of annual resolutions (for example, City Council Resolutions 4842, 5044, … 8570) approving the contract.
5. Starting in about 1979 (Resolution 9538), the Council’s public approval of audit contracts included not only the current fiscal year, but one or more future years.
6. In keeping with Policy F-15, the current contract with White Nelson Diehl Evans, LLP (known at that time as “Diehl, Evans & Company, LLP”), City Contract 4776, was publicly awarded after a competitive process as Item 5 at the City Council’s May 10, 2011, meeting. It was presented as an integrated contract, expiring on March 31, 2012, but with options to extend for three additional one year terms, for a total of four years – ending, one assumes, no later than March 31, 2015.
7. On January 6, 2015, without any public consultation I am aware of with either the Finance Committee or the City Council, the City Manager signed an “Amendment One” to Contract 4776, retroactive to November 20, 2014, adding $42,203 and extending the term through March 31, 2016, to cover the additional services of “City’s Financial Audit” ($35,852) and “City’s Single Audit” ($6,351) for “FY2014-15”.
8. On June 2, 2015, again without any public consultation I am aware of with either the Finance Committee or the City Council, the City’s Finance Director signed an “Amendment One” to Contract 4776, effective June 3, 2015, adding nine pages of “Scope of Services” and a one page “peer review report” supplied by White Nelson Diehl Evans, LLP.
9. Prior to the selection of Diehl Evans & Company in 2011, due to changes in personnel, Civic Center financing and various other issues, City staff twice recommended temporary one-year extensions to the contract with the previous auditor, Mayer Hoffman McCann PC, but in both cases the matter was referred to the City Council (and at least the second time to the Finance Committee) for their decision at a public meeting (see Item 8 at the May 12, 2009, and April 13, 2010, City Council meetings).

Given its oversight function, I would think the Finance Committee might wish to review and be aware of the scope of services of the current audit contract.

CITY OF NEWPORT BEACH
FINANCE COMMITTEE
STAFF REPORT

Agenda Item No. 5B
July 21, 2015

TO: HONORABLE CHAIRMAN AND MEMBERS OF THE COMMITTEE

FROM: Dan Matusiewicz, Finance Director
(949) 644-3123 or danm@newportbeachca.gov

SUBJECT: Council Reserve Policy F-2 Review

ABSTRACT:
Prudent financial management requires that some portion of available funds be reserved for future use. Council Reserve Policy F-2 establishes reserve requirements for the City and reiterates funding policies associated with pension and other post-employment benefits (OPEB). Staff has prepared a summary of Council Reserve Policy F-2 for discussion purposes. For a more in depth look at each reserve policy, please refer to Reserve Policy F-2 included as Attachment A.

RECOMMENDATION:
Staff welcomes input and recommendations on Council Reserve Policy F-2. Finance staff will bring Committee recommendation, if any, to the City Council for consideration.

DISCUSSION:

Background
Prudent long-term financial management compels the City to strategically reserve resources. Reserve accounts provide a mechanism for saving current resources for future use. City Council has full discretion on appropriating funds from reserve accounts and these funds may only be used for the specific purpose for which the reserve account was established, unless alternate uses are specified in the annual budget or action is taken by Council. Council Reserve Policy F-2 establishes the requirements and guidelines for the administration of such reserves.

Fund Categories
Council Reserve Policy F-2 references two categories of funds in which the City's reserves reside. It is essential to understand the differences between the two categories of funds in order to understand the nature of the reserves.

Governmental Funds
The first fund category is Governmental Funds. Funds that fall into this category have a short-term measurement focus and basis of accounting that *exclude* long-term assets and long-term liabilities. The majority of the City's funds, including the General Fund, fall into this category. Fund balance is the term used to describe the total assets that accumulate in Governmental Funds net of related liabilities.

Proprietary Funds
The other fund category is Proprietary Funds which differ from Governmental Funds in that they have a long-term measurement focus and basis of accounting that *includes* long-term assets and long-term liabilities. This basis of accounting is more similar to private sector accounting. Examples of proprietary funds are the City's Water Enterprise Fund and Wastewater Enterprise Fund, and Internal Service Funds, such as the Equipment Fund and Insurance Reserve Fund. Net Assets, or equity, in a proprietary fund include long-term assets such as property, plant and equipment net of related long-term liabilities as they do in private sector accounting. Net Assets, therefore, is not a good measure of liquid resources available to satisfy near-term obligations and should not be compared to fund balance in governmental funds. Net Working Capital, is the difference between current (liquid) assets and current (near-term) liabilities and represents a closer approximation of fund balance in a governmental fund.

Below is a table outlining the major differences between Governmental Funds and Proprietary Funds.

	GOVERNMENTAL FUNDS	**PROPRIETARY FUNDS**
Fund Examples	General Fund, Special Revenue Funds, Capital Projects Funds, Debt Service Funds	Water Enterprise Fund, Sewer Enterprise Fund, Equipment Fund, Insurance Reserve Fund
Measurement Focus	Short-Term, excludes long-term assets and long-term liabilities.	Long-Term, includes long-term assets and long-term liabilities.
Measurement of resources for comparative purposes	Fund Balance	Net Working Capital

GOVERNMENTAL FUND RESERVES (FUND BALANCE)

Governmental Funds make five further distinctions of fund balance that identify the levels of restrictions, if any, on fund balance. The five classifications of fund balance/reserves in order from most restricted to least restricted are listed below:

CLASSIFICATIONS	NATURE OF RESTRICTION	RESERVE EXAMPLES
Non-spendable	Cannot be readily converted to cash	Inventories, Prepaid Assets, Permanent Endowment
Restricted	Externally imposed restrictions	Debt Service, Affordable Housing, Park In Lieu, Oceanfront Encroachment
Committed	City Council imposed commitment	Facilities Financial Planning, Parking, Cable Franchise
Assigned	City Manager assigned purpose/intent	None at this time
Unassigned	Residual balance not otherwise restricted	Contingency, Residual Fund Balance

Not all governmental fund reserves are listed in the above table.

Internally, the City has divided the five categories into two distinct categories: non-discretionary and discretionary. The reserves classified as non-spendable or restricted, are typically described by the City as non-discretionary reserves since these resources are not readily convertible to cash and/or may be subject to externally imposed restrictions. Reserves classified as committed, assigned, or unassigned are included as discretionary reserves since City Council can remove any restrictions imposed on this group. Therefore, these resources are more readily available to Council in the event of an emergency.

Externally, creditors and rating agencies often take a more conservative approach simply categorizing fund balance as “Reserved” or “Unreserved Fund Balance.” Unassigned fund balance is deemed to be unrestricted while all other categories are deemed to be “Reserved” in some fashion and therefore, potentially not available to management to pay creditors. For this reason, we have classified our contingency reserve as “Unassigned.”

The following excerpt from a Fitch Rating Agency article on "Twelve Habits of Highly Successful Finance Officers" demonstrates the importance of maintaining a contingency reserve or "Rainy day reserve":

> Fund Balance Reserve Policy/Working Capital Reserves
> Maintaining an operating reserve or rainy day fund is perhaps the most effective practice an issuer can use to enhance its credit rating. It is also the most frequently implemented practice, adopted by both large and small local government issuers. A financial reserve may be used to address unanticipated revenue shortfalls or unforeseen expenditures. This provides a first defense against deficit spending and helps maintain liquidity when budgeted drawdowns become inevitable. The appropriate size of such a reserve depends on the potential variability of the entity's revenues and expenses, as well as its working cash needs to handle seasonality of revenues or expenditures. Governments can issue cash flow notes — tax anticipation notes or revenue anticipation notes — when revenue receipts and/or expenditure disbursements are uneven throughout the fiscal year or mismatched with one another. In such cases, short-term borrowings can be an effective means to even out lumpy or unbalanced cash flows. However, in several instances, governments have issued sizeable amounts of cash flow notes to compensate for unanticipated year-end cash and fund balance deficits. A need for notes in situations of fiscal stress may indicate weakened credit quality and is a leading cause of downgrades. Issuers that can meet their seasonal cash flow needs from working cash on hand can avoid all the potential problems that issuing notes in finance shortfalls might create.

As a matter of practice, the City does not issue short-term obligations, as mentioned in the Fitch article, to bridge the gap between revenue cash flow and expenditures. The City's liquidity is most challenged during the latter half of August through October when property tax installments stop coming in. The City has been able to manage cash flows by matching security maturities with cash flow needs and use of the Local Agency Investment Fund (LAIF).

Best Practice: Government Finance Officers' Association (GFOA)

How large is the average General Fund reserve in other cities? The *Government Finance Review* published a study in 1994 called "GFOA's Financial Indicators Database: Benchmarking and Other Uses." This article looked at 209 U.S. cities with population ranging between 10,000 and 25,000 persons and found that the median General Fund reserve was approximately fifteen (15%) percent of expenditures.

The adequacy of unreserved fund balance in the general fund should be assessed based upon a government's own specific circumstances. Nevertheless, GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unreserved fund balance in their general fund of no less than five (5%) percent to fifteen (15%) percent of regular general fund operating revenues, or of no less than one to two months of regular general fund operating expenditures.

General Fund Contingency (Rainy Day) Reserve

The General Fund Contingency Reserve, which is classified as unassigned, is viewed as the most important reserve of the City especially to creditors. The basic purpose of the contingency reserve (a.k.a rainy day reserve) is to protect the budget from unexpected or unforeseen fiscal disruptions such as catastrophic loss of critical infrastructure, unanticipated revenue shortfalls, and actions by another government that eliminates or shifts revenues from the City.

Currently, the General Fund Contingency Reserve has a target balance of twenty-five (25%) percent of General Fund “Operating Budget” as originally adopted. Operating budget includes current expenditure appropriations and excludes capital improvement projects and transfers out. Appropriations and access to these funds are reserved for emergency situations only, but may be accessed by Council by simple budget appropriation. If any portion of the Contingency Reserve is used, a plan to replenish the reserve within five years will be presented to Council. The estimated contingency reserve balance for Fiscal Year 2015 is approximately $42.2 million.

Facilities Financial Planning (FFP) Reserve

The FFP Reserve is also an important reserve. This reserve is used to earmark funds for the replacement or upgrade of critical City facilities in conjunction with the Facilities Financial Plan. The FFP Reserve is funded by an annual contribution from the General Fund, which is approved as part of the budget adoption process, and developer contributions. The funds accumulated in the FFP Reserve can only be used for specific purposes declared by the City Council. The minimum target balance of the FFP Reserve is equal to the maximum annual debt service payment for existing obligations (Currently $8.2 million). Target fund balance is determined based on cash flow projections of prioritized facility replacement projects (Currently $37.8 million).

Harbor Capital Reserve (HCR) Fund

Since previous plans to accumulate resources to fund harbor improvements have been unsuccessful, the City should consider the creation of a sinking fund to accumulate resources based on long-term, Harbor Master Plan. The current Tidelands Capital Plan is too narrowly focused on near-term projects to be useful for a long-range financial planning. Staff recommends that the Tidelands Committee develop a master plan that prioritizes and quantifies critical harbor maintenance and improvements at least 30 years out. This plan will better inform the City Council and the Finance staff of the financial requirements necessary to maintain our harbor at an acceptable level for the community. Funding and reserve requirements can be developed based on this plan.

PROPRIETARY FUND RESERVES (NET WORKING CAPITAL)

As previously mentioned, the most comparable measure of liquid financial resources in proprietary funds is net working capital. From this point forward, when referring to reserves, net working capital is the intended meaning (the net difference between liquid assets and near term liabilities).

Water and Wastewater Enterprise Fund Reserves

The Water Fund and Wastewater Fund operations are very similar in that they are both used to account for operations of a self-supporting activity that is entirely financed through user charges. As such, they both have two similar reserves.

First, each fund has a Stabilization and Contingency Reserve that is used as a safeguard against seasonal variations in cash flows and short-lived cost increases that create annual rate volatility. In extreme conditions, having such a reserve allows the City to maintain operations for a reasonable period before instituting a rate increase to offset cost increases. This reserve provides a reorganization period of six (6) months with zero income or twenty-four (24) months at a twenty-five (25%) percent loss rate. The target funding level of this reserve is fifty (50%) percent of the annual operating budget. The City Council must approve any use of these funds.

The Water Operating Reserve is currently $4.7 million over its reserve target of $9.6 million. The Wastewater system is currently $300 thousand below its reserve target of $1.4 million and is expected to worsen rapidly. Council should consider rate or operational adjustments to Wastewater Enterprise in the very near future.

Effective water operations and wastewater operations require the use of an operable infrastructure system. Therefore, each service also has an Infrastructure Replacement Funding Reserve that is used as a temporary repository for cash flows associated with the funding of infrastructure improvement projects as outlined in the Water Master Plan and Wastewater Master Plan. The funding of this reserve is based on an annual contribution rate that when combined with prior or future year contributions would allow for updates to infrastructure as scheduled in their respective master plans. There are no minimum or maximum funding levels, but the contribution level should be reviewed periodically to ensure that major infrastructure updates as outlined in the master plans can occur as planned. The balance of the Water and Wastewater infrastructure replacement reserves are estimated to be $5.4 million and $740 thousand respectively.

The following table shows the Fiscal Year 2014 Net book value of Water and Wastewater infrastructure. It is intended to illustrate the ***historical*** cost of our Water and Sewer infrastructure system and provides a little insight of the future improvement needs and the magnitude of loss that might occur in the event of a major earthquake.

Fiscal Year 14 Infrastructure Values		
	Water	Wastewater
Book Value	$ 122,600,952	$ 45,298,815
Accumulated Depreciation	(44,699,240)	(15,794,565)
Net Book Value	77,901,712	29,504,250

Internal Service Fund (Strategic) Reserves

Internal Service Funds (ISF) Reserve is used to manage and account for specific program activity in a centralized cost center while acting as a strategic savings plan for long-term assets and liabilities. The revenue comes from internal charges to departmental operating budgets rather than external revenue sources. Setting aside resources in these funds lessens the burden placed on the budget when liabilities become payable. The net working capital of these funds is represent a strategic savings plan to replace aging assets or prefund expected liabilities.

We group our Internal Service Funds into the following four categories: Equipment, Insurance (Risk Management), Compensated Absences and Post Retirement (Retiree Insurance). The target balance and cash flow patterns are unique to each category and are described below.

<u>Equipment</u>
The main purpose of the Equipment ISF is to accumulate funds for the maintenance and regular replacement of vehicles and other major pieces of equipment. This fund receives operating money from each Department by way of charges determined by equipment usage and a replacement charge based on an annual assessment of the equipment’s age, condition, and anticipated future replacement date and cost. Any rate adjustments are included in the budget preparation process. The target funding level is determined by the Finance Director based on anticipated cash flow needs. If the target funding level is excessive or insufficient, rates are adjusted as part of the next budget cycle. Below is a table outlining the estimated Fiscal Year 2015 Funding Status.

Equipment Replacement Funding Status	2015 Est.
Reserve	$ 10,264,785
Accumulated Vehicle Depreciation	$ 16,924,902
Percentage of Depreciation Funded	61%

Insurance Reserve (Risk Management)

The Insurance ISF is used to account for the activities of general liability and workers' compensation claims. The City employs an actuary to estimate the liabilities associated with each program. The costs associated with each program are typically claims administration, legal defense, insurance premiums, self-insured retention, and the establishment of appropriate loss reserves including "incurred-but-not reported" (IBNR) claims. Both programs are funded by the operating budget of each department. Each department is charged a rate equal to its proportionate share of the total "revenue" required to fund each program at its target funding level.

The City relies on the actuarial valuations to estimate the long-term liability and an appropriate funding level. Deviation from the actuary's expected estimate can be significant. Therefore, the target funding level is typically greater than the actuary's "Expected Level" but not more than a "Target Funding Level" to achieve seventy-five (75%) percent confidence level. Another way to think of a seventy-five (75%) percent level of confidence is that there is a seventy-five (75%) percent chance there will be sufficient resources to pay the full amount of existing claims without future contributions. The following table outlines the estimated Fiscal Year 2015 Funding Status of each program in the Insurance ISF.

	2015 Est.	
Insurance (Risk Management) Funding Status	General Liability	Workers' Compensation
Cash Reserve	7,772,649	15,985,759
Actuarial Expected Level (50%-65% Confidence Level)	9,622,383	14,345,000
Maximum Target Funding Level (75% Confidence Level)	10,496,383	16,167,000
Percentage of Actuarial Target Funded	74%	99%

The table above demonstrates that the General Liability programs are twenty-six (26%) percent below the target funding level and Workers Compensation is one (1%) percent below the target funding level.

Compensated Absences

The Compensated Absences ISF is used as a budget smoothing technique for cash-out payments to employees for flex leave, vacation leave, and sick leave upon separation from the City. Each department makes contributions to this fund based on a specified percentage of salary. The minimum target balance of this fund is three (3) year average of previous cash flows. The Finance Director recommends any funding adjustments to the annual budget development process or during the mid-year budget adjustments. The maximum reserve balance is set at fifty (50%) percent of the projected liability. The table below illustrates that the projected balance is eighty-six (86%) percent of the maximum reserve level.

Compensated Absences Funding Status	**2015 Est.**
Cash Reserve	$ 4,054,984
Maximum Target Funding Level (50% of Liabilities)	$ 4,717,746
Percentage of Actuarial Target Funded	86%

Pension and OPEB Funding Policies

Assets set-aside to prefund pension and retiree benefits are held in employee benefit trusts managed by CalPERS.

Pension
The City's principal Defined Benefit Pension program is provided through California Public Employees Retirement System (CalPERS). The City's contribution to the plan is based on an actuarially determined contribution that includes the normal cost of providing the contracted benefits plus or minus an amortization of plan changes and net actuarial gains and losses since the last valuation. It has been the City's policy and practice to pay one-hundred percent of the annual actuarially required contribution (ARC). Any new unfunded actuarial liability (UAL) is amortized over a twenty (20) to thirty (30) year period. Changes in actuarial assumptions are typically amortized over a twenty (20) year period while experience gains and losses are amortized over a thirty (30) year period.

It is the goal of the City to maintain the UAL within a range that is acceptable to actuarial standards, approximately eighty (80%) percent funded. The City Council shall consider increasing annual contributions to the plan as deemed necessary. Currently, the City's CalPERS pension plans are approximately sixty-six (66%) percent funded with a UAL estimated at $273 million at June 30, 2015, rolled forward from the June 30, 2013, valuation. The City has taken many actions to improve the funded status and long-term viability of the plans and is currently scheduled to pay off the UAL in eighteen (18) years. The City will receive its June 30, 2014, valuation in October and the Committee will have the opportunity to consider further funding alternatives for the 2016-17 Fiscal Year Budget.

Other Post Employment (OPEB) Benefits

OPEB benefits refer to post-employment medical benefits to retirees. The City's funding obligations consists of two (2) retiree medical plans.

1) New Plan – The New Plan became effective January 2006. It applies to all employees hired after that date, and those employees who elected to fully convert to a defined contribution plan. Both the employee and the City make contributions while the employee is active. Once the contributions have been made, a substantial portion of the funding risk has been transferred to the employee. This plan is one hundred (100%) percent funded on an ongoing basis and is part of the annual budget process. Funds to cover this expenditure are contained in each department's annual operating budget.

2) Old Plan – Applies to employees who retired prior to January 2006 and certain active employees that were eligible to continue to receive a defined benefit plan. Previously this program was funded on a pay-as-you-go basis so there was a significant unfunded liability. The City's intention is to amortize the remaining unfunded liability over twenty (20) years. The City relies on a biennial actuarial review to determine the amount of the contribution. It is the goal of the City to maintain a funded status within a range that is acceptable to actuarial standards. The City Council shall consider increasing the annual contributions to the plan if the funded status falls below acceptable actuarial standards.

The current UAL associated with the Retiree Insurance Plan is approximately $25 million as of the June 30, 2013, valuation is being amortized over thirteen (13) remaining years.

Portions of the September, October, and November Finance Committee meetings will be dedicated to a detailed review of the most current Pension and OPEB information.

/s/ Dan Matusiewicz

Dan Matusiewicz
Finance Director

Attachment:

A. Council Reserve Policy F-2

ATTACHMENT A

Council Reserve Policy F-2

RESERVE POLICY

PURPOSE

To establish City Council policy for the administration of Reserves defined as fund balances in governmental funds and net working capital in proprietary funds.

BACKGROUND

Prudent financial management dictates that some portion of the funds available to the City be reserved for future use.

As a general budget principle concerning the use of reserves, the City Council decides whether to appropriate funds from Reserve accounts. Even though a project or other expenditure qualifies as a proper use of Reserves, the Council may decide that it is more beneficial to use current year operating revenues or bond proceeds instead, thereby retaining the Reserve funds for future use. Reserve funds will not be spent for any function other than the specific purpose of the Reserve account from which they are drawn without specific direction in the annual budget; or by a separate City Council action. Information regarding Annual Budget Adoption and Administration is contained in City Council Policy F-3.

GOVERNMENTAL FUNDS AND FUND BALANCE DEFINED

Governmental Funds including the General Fund, Special Revenue Funds, Capital Projects Funds, Debt Service Funds and Permanent Funds have a short-term or current flow of financial resources, measurement focus and basis of accounting and therefore, exclude long-term assets and long-term liabilities. The term Fund Balance, used to describe the resources that accumulate in these funds, is the difference between the fund assets and fund liabilities of these funds. Fund Balance is similar to the measure of net working capital that is used in private sector accounting. By definition, both Fund Balance and Net Working Capital exclude long-term assets and long-term liabilities.

PROPRIETARY FUNDS AND NET WORKING CAPITAL DEFINED

Proprietary Funds including Enterprise Funds and Internal Service Funds have a long-term or economic resources measurement focus and basis of accounting and therefore, include long-term assets and liabilities. This basis of accounting is very similar to that used in private sector. However, instead of Retained Earnings, the term Net Assets is used to describe the difference between fund assets and fund liabilities. Since Net

Assets include both long-term assets and liabilities, the most comparable measure of proprietary fund financial resources to governmental Fund Balance is Net Working Capital, which is the difference between current assets and current liabilities. Net Working Capital, like Fund Balance, excludes long-term assets and long-term liabilities.

GOVERNMENTAL FUND RESERVES (FUND BALANCE)

For Governmental Funds, the Governmental Accounting Standards Board ("GASB") Statement No. 54 defines five specific classifications of fund balance. The five classifications are intended to identify whether the specific components of fund balance are available for appropriation and are therefore "Spendable." The classifications also are intended to identify the extent to which fund balance is constrained by special restrictions, if any. Applicable only to governmental funds, the five classifications of fund balance are as follows:

CLASSIFICATIONS	NATURE OF RESTRICTION
Non-spendable	Cannot be readily converted to cash
Restricted	Externally imposed restrictions
Committed	City Council imposed commitment
Assigned	City Manager assigned purpose/intent
Unassigned	Residual balance not otherwise restricted

A. Non-spendable fund balance: That portion of fund balance that includes amounts that are either (a) not in a spendable form, or (b) legally or contractually required to be maintained intact. Examples of Non-spendable fund balance include:

1. Reserve for Inventories: The value of inventories purchased by the City but not yet issued to the operating Departments is reflected in this account.

2. Reserve for Long Term Receivables and Advances: This Reserve is used to identify and segregate that portion of the City's financial assets which are not due to be received for an extended period, so are not available for appropriation during the budget year.

3. Reserve for Prepaid Assets: This reserve represents resources that have been paid to another entity in advance of the accounting period in which the resource is deducted from fund balance. A common example is an insurance premium, which is typically payable in advance of the coverage period.

Although prepaid assets have yet to be deducted from fund balance, they are no longer available for appropriation.

4. Reserve for Permanent Endowment - Bay Dredging: The endowment specifies that the principal amount will not be depleted and represents the asset amounts to be held in the Bay Dredging Fund.

5. Reserve for Permanent Endowment - Ackerman Fund: The endowment specifies that the principal amount will not be depleted and represents the asset amount to be held in the Ackerman Fund.

B. Restricted fund balance: The portion of fund balance that reflects constraints placed on the use of resources (other than non-spendable items) that are either (a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments; or (b) imposed by law through constitutional provisions or enabling legislation. Examples of restricted fund balance are:

1. Reserve for Debt Service: Funds are placed in this Reserve at the time debt is issued. The provisions governing the Reserve, if established, are in the Bond Indenture and the Reserve itself is typically controlled by the Trustee.

2. Affordable Housing: A principal provision of the Newport Beach Housing Element requires developers to provide housing units for lower income households, the number of which is to be negotiated for each development project. In lieu of constructing affordable housing, developers have paid into this reserve which is used at the City Council's discretion to provide alternate methods for the delivery of affordable housing for lower income households.

3. Park In Lieu: Per NBMC 19.52 and California Government Code Section 664777 (The 1975 "Quimby Act"), a dedication of land or payment of fees for park or recreational purposes in conjunction with residential development is required. The fees collected can only be used for specific park or recreation purposes as outlined in NBMC 19.52.030 and 19.52.070.

4. Upper Newport Bay Restoration Reserve: This reserve is the repository for funds mandated by SB573, as well as special fees charged to permit holders as an alternative to meeting certain specified mitigation criteria. In addition to the mitigation fees, ten percent (10%) of Beacon Bay lease revenue is placed in this Reserve. Funds in the Reserve are restricted for Upper Newport Bay restoration projects.

5. Permanent Endowment for Bay Dredging: The endowment also specifies that the interest earnings on the principal amount can only be used for dredging projects in the Newport Bay.

6. Permanent Endowment for Ackerman Fund: The endowment also specifies that the interest earnings on the principal amount can only be used for scholarships provided by the City.

7. Oceanfront Encroachment Reserve: In the early 1990's, it was discovered by survey that improvements to several ocean front parcels were encroaching onto the public beach. The encroachment was relatively minor. The negotiated solution was for the property owners to pay a permit fee each year to the City. Revenue thus generated may only be used for ocean front restoration projects and incidental costs of improvements and maintenance to enhance public access and use of ocean beaches as approved by the City Council. This Reserve is the repository for those funds. City Council Policy L-12 contains additional background and details about the encroachment issue The external restriction on this balance is imposed by the Local Coastal Plan (LCP).

C. Committed fund balance: That portion of a fund balance that includes amounts that can only be used for specific purposes pursuant to constraints imposed by formal action by the government's highest level of decision making authority, and remain binding unless removed in the same manner. The City considers a resolution to constitute a formal action for the purposes of establishing committed fund balance. The action to constrain resources must occur within the fiscal reporting period; however the amount can be determined subsequently. City Council imposed Commitments are as follows:

1. Facilities Financial Planning (FFP) Fund: In conjunction with the City's Facilities Financial Plan, a sinking fund has been established to amortize the cost of critical City facilities such as, but not limited to, the Civic Center, Police Department buildings, Fire Stations, Library Branches and other Facility Improvement Projects.

   The Facilities Financial Planning Program establishes a level charge to the General Fund that will perpetually replenish the cash flows necessary to finance the construction of critical City facilities. This plan will be updated annually as part of the budget process, or as conditions change. The City shall strive to maintain fund balance in the Facilities Financial Planning Reserve at a level equal to or greater than the maximum annual debt service on existing obligations.

The eligible uses of this reserve include the cash funding of public facility improvements or the servicing of related debt.

2. Off Street Parking: Per NBMC 12.44.025 fifty percent (50%) of parking meter revenue collected in designated areas is set aside for acquisition, development and improvement of off street parking facilities within those areas.

3. In Lieu Parking: Per NBMC 12.44.125 the City requires commercial businesses to provide adequate off-street parking or where this is not possible, businesses are afforded the opportunity to pay an annual fee and use parking spaces in a municipal lot, providing such a lot is located within specified proximity to the business. These funds can only be used to provide additional parking.

4. Neighborhood Enhancement - A: NBMC 12.44.027 directs revenues from parking meters in Zone 9 shall be apportioned to this Neighborhood Enhancement A. Funds accumulated will only be used for the purpose of enhancing and supplementing services to the West Newport area. Both the nature of the supplemental services and the definition of the area served are set forth in the Code Section above.

5. Neighborhood Enhancement - B: NBMC 12.44.027 directs that fifty percent (50%) of revenues from parking meters in the Balboa Peninsula be apportioned to this Neighborhood Enhancement B. Funds accumulated will only be used for the purpose of enhancing and supplementing services in the Balboa Peninsula. Specific details are contained in the Code Section.

6. Cable Franchise: Pursuant to the provisions of the Newport Beach Municipal Code, Title 5, Business Licenses & Regulations, Chapter 5.44, in return for the use of the City's streets and public ways for the purpose of installing, operating, maintaining, or reconstructing a cable system to provide cable service, fees are collected by the City from cable providers. Those fees are to be used by the City for support of Public, Education, and Government access programming only.

7. Oil and Gas Reserve: The annual $40,000 which is being set aside from the oil and gas field production revenues is to be used to fund abandoned wells and facilities as they go out of service.

8. Capital Reappropriation: This reserve represents an administrative procedure that recognizes a portion of fund balance is not readily available to fund new

endeavors because it has been reappropriated through the budget adoption process or amendment process.

D. Assigned fund balance: That portion of a fund balance that includes amounts that are constrained by the City's intent to be used for specific purposes but that are not restricted or committed. This policy hereby delegates the authority to the City Manager or designee to modify or create new assignments of fund balance. Constraints imposed on the use of assigned amounts may be changed by the City Manager or his designee. Appropriations of balances are subject to Council Policy F-3 concerning budget adoption and administration.

E. Unassigned fund balance:

1. Contingency Reserve: The Contingency Reserve shall have a target balance of twenty five percent (25%) of General Fund "Operating Budget" as originally adopted. Operating Budget for this purpose shall include current expenditure appropriations and shall exclude Capital Improvement Projects and Transfers Out. Appropriation and/or access to these funds are generally reserved for emergency or unforeseen situations but may be accessed by Council by simple budget appropriation. Examples may include but are not limited to the following:

    a. A catastrophic loss of critical infrastructure.

    b. A State or Federally declared state of emergency.

    c. Any settlement arising from a claim or judgment.

    d. Deviation from budgeted revenue projections.

    e. Any action by another government that eliminates or shifts revenues from the City.

    f. Inability of the City to meet its debt service obligations in any given year.

    g. Other circumstances deemed necessary by City Council to meet the claims and obligations of the City.

Should the Contingency Reserve be used, the City Manager shall present a plan to City Council to replenish the reserve within five years.

2. Residual Fund Balance: The residual portion of available fund balance that is not otherwise restricted, committed or assigned and is above and beyond the Contingency Reserve target reserve balance.

PROPRIETARY FUND RESERVES (NET WORKING CAPITAL)

In the case of Proprietary Funds (Enterprise and Internal Service Funds), Generally Accepted Accounting Principles ("GAAP") does not permit the reporting of reserves on the face of City financial statements. However, this does not preclude the City from setting policies to accumulate financial resources for prudent financial management of its proprietary fund operations. Since proprietary funds may include both long-term capital assets and long-term liabilities, the most comparable measure of liquid financial resources that is similar to fund balance in proprietary funds is net working capital which is the difference between current assets and current liabilities. For all further references to reserves in Proprietary Funds, Net Working Capital is the intended meaning.

A. Water Enterprise Fund

1. Stabilization and Contingency Reserve: This Reserve is used to provide sufficient funds to support seasonal variations in cash flows and in more extreme conditions, to maintain operations for a reasonable period of time so the City may reorganize in an orderly manner or effectuate a rate increase to offset sustained cost increases. The intent of the Reserve is to provide funds to offset cost increases that are projected to be short-lived, thereby partially eliminating the volatility in annual rate adjustments. It is not intended to offset ongoing, long-term pricing structure changes. The target level of this reserve is fifty percent (50%) of the annual operating budget. This reserve level is intended to provide a reorganization period of 6 months with zero income or 24 months at a twenty-five percent (25%) loss rate. The City Council must approve the use of these funds, based on City Manager recommendation. Funds collected in excess of the Stabilization reserve target would be available to offset future rate adjustments, while extended reserve shortfalls would be recovered from future rate increases. Should catastrophic losses to the infrastructure system occur, the Stabilization and Contingency Reserve may be called upon to avoid disruption to water distribution.

2. Infrastructure Replacement Funding Policy: This funding policy is intended to be a temporary repository for cash flows associated with the funding of infrastructure replacement projects provided by the Water Master Plan. The contribution rate is intended to level-amortize the cost of infrastructure replacement projects over a long period. The annual funding rate of the Water

Master Plan is targeted at an amount that, when combined with prior or future year contributions, is sufficient to provide for the eventual replacement of assets as scheduled in the plan. This contribution policy is based on the funding requirements of the most current Water Master Plan. There are no minimum or maximum balances contemplated by this funding policy. However, the contributions level should be reviewed periodically or as major updates to the Water Master Plan occur. Annual funding is contingent on many factors and may ultimately involve a combined strategy of cash funding and debt issuance with the intent to normalize the burden on Water customer rates.

B. Wastewater Enterprise Fund

1. Stabilization and Contingency Reserve: This Reserve is used to provide sufficient funds to support seasonal variations in cash flows and in more extreme conditions, to maintain operations for a reasonable period of time so the City may reorganize in an orderly manner or effectuate a rate increase to offset sustained cost increases. The intent of the Reserve is to provide funds to offset cost increases that are projected to be short-lived, thereby partially eliminating the volatility in annual rate adjustments. It is not intended to offset ongoing, long-term pricing structure changes. The target level of this reserve is fifty percent (50%) of the annual operating budget. This reserve level is intended to provide a reorganization period of 6 months with zero income or 24 months at a twenty-five percent (25%) loss rate. The City Council must approve use of these funds, based on City Manager recommendation. Funds collected in excess of the Stabilization reserve target would be available to offset future rate adjustments, while extended reserve shortfalls would be recovered from future rate increases. Should catastrophic losses to the infrastructure system occur, the Stabilization and Contingency Reserve may be called upon to avoid disruption to wastewater service.

2. Infrastructure Replacement Funding Policy: This funding policy is intended to be a temporary repository for cash flows associated with the funding of infrastructure replacement projects provided by the Wastewater Master Plan. The contribution rate is intended to level-amortize the cost of infrastructure replacement projects over a long period of time. The annual funding rate of the Wastewater Master Plan is targeted at an amount that, when combined with prior or future year contributions, is sufficient to provide for the eventual replacement of assets as scheduled in the plan. This contribution policy should be updated periodically based on the most current Wastewater Master Plan. There are no minimum or maximum balances contemplated by this funding policy. However, the contributions level should be reviewed periodically or as major updates to the Wastewater Master Plan occur. Annual funding is

contingent on many factors and may ultimately involve a combined strategy of cash funding and debt issuance with the intent to normalize the burden on Wastewater customer rates.

C. Internal Service Funds

Background.

Internal Service Funds are used to centrally manage and account for specific program activity in a centralized cost center. Their revenue generally comes from internal charges to departmental operating budgets rather than direct appropriations. They have several functions.

--They work well in normalizing departmental budgeting for programs that have life-cycles greater than one year; thereby facilitating level budgeting for expenditures that will, by their nature, be erratic from year to year. This also facilitates easier identification of long term trends.

--They act as a strategic savings plan for long-term assets and liabilities.

--From an analytical standpoint, they enable appropriate distribution of city-wide costs to individual departments, thereby more readily establishing true costs of various operations.

Since departmental charges to the internal service fund duplicate the ultimate expenditure from the internal service fund, they are eliminated when consolidating entity-wide totals.

The measurement criteria, cash flow patterns, funding horizon and acceptable funding levels are unique to each program being funded. Policy regarding target balance and/or contribution policy, gain/loss amortization assumption, source data, and governance for each of the City’s Internal Service Funds is set forth as follows:

1. For all Internal Service Funds: The Finance Director may transfer part or all of any unencumbered fund balance between the Internal Service Funds provided that the withdrawal of funds from the transferred fund would not cause insufficient reserve levels or insufficient resources to carry out its intended purpose. This action is appropriate when the decline in cash balance in any fund is precipitated by an off-trend non-recurring event. The Finance Director will make such recommendations as part of the annual budget adoption or through separate Council action.

2. Equipment Maintenance Fund and Equipment Replacement Fund: The Equipment Maintenance and Replacement Funds receive operating money from the Departments to provide equipment maintenance and to fund the regular replacement of major pieces of equipment (mostly vehicles) at their economic obsolescence.

   a. Equipment Maintenance Fund: The Equipment Maintenance Fund acts solely as a cost allocation center (vs. a pre-funding center) and is funded on a pay-as-you-go basis by departmental maintenance charges by vehicle type and usage requirement. Because of this limited function, the target year-end balance is zero.

      Contribution rates (departmental charges) are set to include the direct costs associated with maintaining the City vehicle fleet, including fleet maintenance employee salary and benefits, operating expenses and maintenance related capital outlay. Administrative overhead and maintenance facility improvements and replacement costs are to be provided outside of this cost unit.
      Governance is achieved through annual management adjustment of contribution rates on the basis of maintenance cost by vehicle and distribution of costs based on fleet use by department.

   b. Equipment Replacement Fund: Operating Departments are charged annual amounts sufficient to accumulate funds for the replacement of vehicles, communications equipment, parking equipment and other equipment replacement determined appropriate by the Finance Director. The City Manager recommends annual rate adjustments as part of the budget preparation process. These adjustments are based on pricing, future replacement schedules and other variables.

      The age and needs of the equipment inventory vary from year to year. Therefore the year-end fund balance will fluctuate in direct correlation to accumulated depreciation. In general, it will increase in the years preceding the scheduled replacement of relatively large percentage of the equipment, on a dollar value basis. However, rising equipment costs, dissimilar future needs, replacing equipment faster than their expected life or maintaining equipment longer than their expected life all contribute to variation from the projected schedule.

      Target funding levels shall be determined by the Finance Director after considering the age, expected life and cash flow anticipated by the replacement equipment being funded. If departmental replacement charges for equipment prove to be excessive or insufficient with regard to this target funding level, new rates established during the next budget cycle will be adjusted with a view toward bringing the balance back to the target level over a three-year period.

3. Insurance Reserve Funds: The Insurance Reserve funds account for the activities of general liability and workers' compensation claims.

   Background.

   The City employs an actuary to estimate the liabilities associated with the general liability and workers compensation activities. The costs typically associated with these programs include: claims administration, legal defense, insurance premiums, self insured retention and the establishment of appropriate loss reserves including "incurred-but-not reported" (IBNR) claims. In a prescribed measurement methodology, the Actuary estimates the liabilities in conformity with Generally Accepted Accounting Principles (GAAP).

   The Actuary refers to this measurement level in his report as the "Expected Level." However, because actuarial estimates are subject to significant uncertainties, actuaries typically recommend that a target funding level be set at an amount in excess of expected liability as a margin to cover contingencies. A typical target funding level would be set to obtain a specified confidence level (the percent chance that resources set-aside will be sufficient to cover existing claims).

   Full funding of the Actuary's "Target Funding Level" establishes a seventy-five percent (75%) confidence there will be sufficient resources (including projected interest) to pay the full amount of existing claims without future contributions. Funding at the "Expected Level" produces a confidence level of only fifty percent to sixty-five percent (50%-65%). Therefore, the target funding of insurance reserves should exceed the "Expected Level" to account for adverse estimate deviation.

   Policy & Practice.

   The City should target funding of its risk management obligations at not less than the Expected Level, described above; and not more than an amount sufficient to establish a seventy-five percent (75%) Confidence Level. Actuarial losses should be recovered over a rolling 3-year basis while actuarial gains should be amortized over a rolling 5-year basis. As part of the operating budget, each department will be charged a rate equal to its proportionate share of the total "revenue" required to fund the Insurance Reserve Fund at this level.

To lessen the impact of short-term annual rate change fluctuation, City management may implement one-time fund transfers (rather than department rate increases) when funding shortfalls appear to be due to unusually sharp and non-recurring factors. Excess reserves in other areas may be transferred to the internal service fund in these instances but such transfers should not exceed the funding necessary to reach a seventy-five (75%) confidence level interval.

4. Compensated Absences Fund:

Background.

The primary purpose of flex leave, vacation leave and sick leave is to provide compensated time off as appropriate and approved. However, under certain circumstances, typically at separation from service, some employees have the option of receiving cash-out payments for some accumulated leave balances. The Compensated Absences Fund is utilized primarily as a budget smoothing technique for any such leave bank liquidations. The primary purpose of the Compensated Absences Fund is to maintain a balance sufficient to facilitate this smoothing.

Policy and Practice.

The contribution rate will be set to cover estimated annual cash flows based on a three-year trailing average.

The minimum cash reserve should not fall below that three-year average. The maximum cash reserve should not exceed fifty percent (50%) of the long term liability. The target cash reserve shall be the median difference between the minimum and maximum figures.

Each department will make contributions to the Compensated Absences Fund through its operating budget as a specified percentage of salary. The Finance Director will review and recommend adjustments to the percentage of salary required during the annual budget development process. This percentage will be set so as to maintain the reserve within the parameters established above.

5. Post Retirement Funding Policies:

a. Pension Funding:

(i) California Public Employees Retirement System (CalPERS): The City's principal Defined Benefit Pension program is provided through contract with CalPERS. The City's contributions to the plan include an actuarially determined employer contribution that fluctuates each year based on an annual actuarial plan valuation. This variable rate employer contribution includes the normal cost of providing the contracted benefits plus or minus an amortization of plan changes and net actuarial gains and losses since the last valuation period.

It is the City's policy to make contributions to the plan equaling at least one hundred percent (100%) of the actuarially required contribution (annual pension cost). Because the City pays the entire actuarially required contribution each year, by definition, its net pension obligation at the end of each year is $0. Any unfunded actuarial liability (UAL) is amortized and paid in accordance with the actuary's funding recommendations. The City will strive to maintain its UAL within a range that is considered acceptable to actuarial standards. The City Council shall consider increasing the annual CalPERS contribution should the UAL status fall below acceptable actuarial standards.

(ii) Laborer's International Union of North America (LIUNA): The City provides funds to support a supplemental pension plan for some employee associations through contract with LIUNA. This is funded at a fixed percentage of total compensation on a pay-as-you-go basis. The City is not contractually required to guarantee the level of the ultimate LIUNA benefit to retirees, nor does it do so. Therefore the City's liability for this program is full funded each year.

b. Other Post Employment Benefits (OPEB Funding):

Background.

The City's OPEB funding obligations consists of two retiree medical plans.

New Plan. Effective January 2006, the City and its employee associations agreed to major changes to the Post Employment Healthcare Plan. New employees and all current employees participate in a program that requires certain defined employee and employer contributions while the employee is in active service. However, once the contributions have been made to the employee's account, the City has transferred a substantial portion of the funding risk to the employee.

Old Plan. Eligible employees who retired prior to the "New Plan" and certain active employees were eligible to continue to receive post-retirement medical benefits (a defined benefit plan). The cost was divided among the City, current employees and retirees. In the past, this program was largely funded on a pay-as-you-go basis, so there was a significant unfunded liability. Recognizing this problem, the City began contributing to this obligation in 2001. In 2008, these assets were placed in a pre-funding trust. The City's intention is to amortize the remaining unfunded liability within 20 years.

Policy & Practice.

New Plan. Consistent with agreements between the City and Employee Associations, the new defined contribution plan will be one hundred percent (100%) funded, on an ongoing basis, as part of the annual budget process. Funds to cover this expenditure will be contained within the salary section of each department's annual operating budget.

Old Plan. The City's policy is to pre fund the explicit (cash subsidy) portion of the Actuarial Accrued Liability (AAL) of the remnants of the old plan over a 20-year amortization period, or less. This amount will be based on the Annual Required Contribution (ARC) determined by a biennial actuarial review; subject to review and analysis by the City. The City will strive to maintain a funded status that will be within a range that is considered acceptable to actuarial standards. The City Council shall consider increasing the annual OPEB contribution should the funded status fall below acceptable actuarial standards.

Adopted - January 24, 1994
Amended - April 10, 1995
Amended - April 27, 1998
Amended - March 14, 2000
Amended – May 8, 2001
Amended – April 23, 2002
Amended – April 13, 2004
Amended – September 15, 2008
Amended – November 12, 2008
Amended – May 24, 2011
Amended – September 27, 2011
Amended – May 14, 2013
Amended – June 10, 2014

RESERVE POLICY

PURPOSE

To establish City Council policy for the administration of Reserves defined as fund balances in governmental funds and net working capital in proprietary funds.

BACKGROUND

Prudent financial management dictates that some portion of the funds available to the City be reserved for future use.

As a general budget principle concerning the use of reserves, the City Council decides whether to appropriate funds from Reserve accounts. Even though a project or other expenditure qualifies as a proper use of Reserves, the Council may decide that it is more beneficial to use current year operating revenues or bond proceeds instead, thereby retaining the Reserve funds for future use. Reserve funds will not be spent for any function other than the specific purpose of the Reserve account from which they are drawn without specific direction in the annual budget; or by a separate City Council action. Information regarding Annual Budget Adoption and Administration is contained in City Council Policy F-3.

GOVERNMENTAL FUNDS AND FUND BALANCE DEFINED

Governmental Funds including the General Fund, Special Revenue Funds, Capital Projects Funds, Debt Service Funds and Permanent Funds have a short-term or current flow of financial resources, measurement focus and basis of accounting and therefore, exclude long-term assets and long-term liabilities. The term Fund Balance, used to describe the resources that accumulate in these funds, is the difference between the fund assets and fund liabilities of these funds. Fund Balance is similar to the measure of net working capital that is used in private sector accounting. By definition, both Fund Balance and Net Working Capital exclude long-term assets and long-term liabilities.

PROPRIETARY FUNDS AND NET WORKING CAPITAL DEFINED

Proprietary Funds including Enterprise Funds and Internal Service Funds have a long-term or economic resources measurement focus and basis of accounting and therefore, include long-term assets and liabilities. This basis of accounting is very similar to that used in private sector. However, instead of Retained Earnings, the term Net Assets is used to describe the difference between fund assets and fund liabilities. Since Net

Assets include both long-term assets and liabilities, the most comparable measure of proprietary fund financial resources to governmental Fund Balance is Net Working Capital, which is the difference between current assets and current liabilities. Net Working Capital, like Fund Balance, excludes long-term assets and long-term liabilities.

GOVERNMENTAL FUND RESERVES (FUND BALANCE)

For Governmental Funds, the Governmental Accounting Standards Board ("GASB") Statement No. 54 defines five specific classifications of fund balance. The five classifications are intended to identify whether the specific components of fund balance are available for appropriation and are therefore "Spendable." The classifications also are intended to identify the extent to which fund balance is constrained by special restrictions, if any. Applicable only to governmental funds, the five classifications of fund balance are as follows:

CLASSIFICATIONS	NATURE OF RESTRICTION
Non-spendable	Cannot be readily converted to cash
Restricted	Externally imposed restrictions
Committed	City Council imposed commitment
Assigned	City Manager assigned purpose/intent
Unassigned	Residual balance not otherwise restricted

A. Non-spendable fund balance: That portion of fund balance that includes amounts that are either (a) not in a spendable form, or (b) legally or contractually required to be maintained intact. Examples of Non-spendable fund balance include:

   1. Reserve for Inventories: The value of inventories purchased by the City but not yet issued to the operating Departments is reflected in this account.

   2. Reserve for Long Term Receivables and Advances: This Reserve is used to identify and segregate that portion of the City's financial assets which are not due to be received for an extended period, so are not available for appropriation during the budget year.

   3. Reserve for Prepaid Assets: This reserve represents resources that have been paid to another entity in advance of the accounting period in which the resource is deducted from fund balance. A common example is an insurance premium, which is typically payable in advance of the coverage period.

Although prepaid assets have yet to be deducted from fund balance, they are no longer available for appropriation.

4. Reserve for Permanent Endowment - Bay Dredging: The endowment specifies that the principal amount will not be depleted and represents the asset amounts to be held in the Bay Dredging Fund.

5. Reserve for Permanent Endowment - Ackerman Fund: The endowment specifies that the principal amount will not be depleted and represents the asset amount to be held in the Ackerman Fund.

B. Restricted fund balance: The portion of fund balance that reflects constraints placed on the use of resources (other than non-spendable items) that are either (a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments; or (b) imposed by law through constitutional provisions or enabling legislation. Examples of restricted fund balance are:

1. Reserve for Debt Service: Funds are placed in this Reserve at the time debt is issued. The provisions governing the Reserve, if established, are in the Bond Indenture and the Reserve itself is typically controlled by the Trustee.

2. Affordable Housing: A principal provision of the Newport Beach Housing Element requires developers to provide housing units for lower income households, the number of which is to be negotiated for each development project. In lieu of constructing affordable housing, developers have paid into this reserve which is used at the City Council's discretion to provide alternate methods for the delivery of affordable housing for lower income households.

3. Park In Lieu: Per NBMC 19.52 and California Government Code Section 664777 (The 1975 "Quimby Act"), a dedication of land or payment of fees for park or recreational purposes in conjunction with residential development is required. The fees collected can only be used for specific park or recreation purposes as outlined in NBMC 19.52.030 and 19.52.070.

4. Upper Newport Bay Restoration Reserve: This reserve is the repository for funds mandated by SB573, as well as special fees charged to permit holders as an alternative to meeting certain specified mitigation criteria. In addition to the mitigation fees, ten percent (10%) of Beacon Bay lease revenue is placed in this Reserve. Funds in the Reserve are restricted for Upper Newport Bay restoration projects.

5. Permanent Endowment for Bay Dredging: The endowment also specifies that the interest earnings on the principal amount can only be used for dredging projects in the Newport Bay.

6. Permanent Endowment for Ackerman Fund: The endowment also specifies that the interest earnings on the principal amount can only be used for scholarships provided by the City and high-tech library equipment.

7. Oceanfront Encroachment Reserve: In the early 1990's, it was discovered by survey that improvements to several ocean front parcels were encroaching onto the public beach. The encroachment was relatively minor. The negotiated solution was for the property owners to pay a permit fee each year to the City. Revenue thus generated may only be used for ocean front restoration projects and incidental costs of improvements and maintenance to enhance public access and use of ocean beaches as approved by the City Council. This Reserve is the repository for those funds. City Council Policy L-12 contains additional background and details about the encroachment issue The external restriction on this balance is imposed by the Local Coastal Plan (LCP).

C. Committed fund balance: That portion of a fund balance that includes amounts that can only be used for specific purposes pursuant to constraints imposed by formal action by the government's highest level of decision making authority, and remain binding unless removed in the same manner. The City considers a resolution to constitute a formal action for the purposes of establishing committed fund balance. The action to constrain resources must occur within the fiscal reporting period; however the amount can be determined subsequently. City Council imposed Commitments are as follows:

1. Facilities Financial Planning (FFP) Fund: In conjunction with the City's Facilities Financial Plan, a sinking fund has been established to amortize the cost of critical City facilities such as, but not limited to, the Civic Center, Police Department buildings, Fire Stations, Library Branches and other Facility Improvement Projects.

   The Facilities Financial Planning Program establishes a level charge to the General Fund that will perpetually replenish the cash flows necessary to finance the construction of critical City facilities. This plan will be updated annually as part of the budget process, or as conditions change. The City shall strive to maintain fund balance in the Facilities Financial Planning Reserve at a level equal to or greater than the maximum annual debt service on existing obligations.

The eligible uses of this reserve include the cash funding of public facility improvements or the servicing of related debt.

2. Off Street Parking: Per NBMC 12.44.025 ~~fifty percent (50%) of parking meter revenue collected in designated areas is set~~the City Council may direct revenues into the off-street parking facilities fund~~ aside~~ for purposes of the acquisition, development and improvement of off street parking facilities, and for any expenditures necessary or convenient to accomplish such purposes.
~~2. within those areas.~~

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3. In Lieu Parking: Per NBMC 12.44.125 the City requires commercial businesses to provide adequate off-street parking or where this is not possible, businesses are afforded the opportunity to pay an annual fee and use parking spaces in a municipal lot, providing such a lot is located within specified proximity to the business. These funds can only be used to provide additional parking.
~~3.~~

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4. Neighborhood Enhancement - A: Funds previously accumulated to Neighborhood Enhancement Area "A" pursuant to a prior version of NBMC 12.44.027 shall continue to be ~~directs revenues from parking meters in Zone 9 shall be apportioned to this Neighborhood Enhancement A. Funds accumulated will only be~~ used only for the purpose of enhancing and supplementing services to the West Newport area. Both the nature of the supplemental services and the definition of the area served are set forth in NBMC 12.44.027~~the Code Section above~~.

5. Neighborhood Enhancement - B: Funds previously accumulated to Neighborhood Enhancement Area "B" pursuant to a prior version of NBMC 12.44.027 shall continue to be ~~NBMC 12.44.027 directs that fifty percent (50%) of revenues from parking meters in the Balboa Peninsula be apportioned to this Neighborhood Enhancement B. Funds accumulated will only be~~ used only for the purpose of enhancing and supplementing services in the Balboa Peninsula. ~~Specific details are contained in the Code Section.~~Both the nature of the supplemental services and the definition of the area served are set forth in NBMC 12.44.027.
~~5.~~

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6. Cable Franchise: Pursuant to the provisions of the Newport Beach Municipal Code, Title 5, Business Licenses & Regulations, Chapter 5.44, in return for the use of the City's streets and public ways for the purpose of installing, operating, maintaining, or reconstructing a cable system to provide cable

service, fees are collected by the City from cable providers. Those fees are to be used by the City for support of Public, Education, and Government access programming only.

7. Oil and Gas Reserve: The annual $40,000 which is being set aside from the oil and gas field production revenues is to be used to fund abandoned wells and facilities as they go out of service.

8. Capital Reappropriation: This reserve represents an administrative procedure that recognizes a portion of fund balance is not readily available to fund new endeavors because it has been reappropriated through the budget adoption process or amendment process.

D. Assigned fund balance: That portion of a fund balance that includes amounts that are constrained by the City's intent to be used for specific purposes but that are not restricted or committed. This policy hereby delegates the authority to the City Manager or designee to modify or create new assignments of fund balance. Constraints imposed on the use of assigned amounts may be changed by the City Manager or his designee. Appropriations of balances are subject to Council Policy F-3 concerning budget adoption and administration.

E. Unassigned fund balance:

1. Contingency Reserve: The Contingency Reserve shall have a target balance of twenty five percent (25%) of General Fund "Operating Budget" as originally adopted. Operating Budget for this purpose shall include current expenditure appropriations and shall exclude Capital Improvement Projects and Transfers Out. Appropriation and/or access to these funds are generally reserved for emergency or unforeseen situations but may be accessed by Council by simple budget appropriation. Examples may include but are not limited to the following:

   a. A catastrophic loss of critical infrastructure.

   b. A State or Federally declared state of emergency.

   c. Any settlement arising from a claim or judgment.

   d. Deviation from budgeted revenue projections.

   e. Any action by another government that eliminates or shifts revenues from the City.

f. Inability of the City to meet its debt service obligations in any given year.

g. Other circumstances deemed necessary by City Council to meet the claims and obligations of the City.

Should the Contingency Reserve be used, the City Manager shall present a plan to City Council to replenish the reserve within five years.

2. Residual Fund Balance: The residual portion of available fund balance that is not otherwise restricted, committed or assigned and is above and beyond the Contingency Reserve target reserve balance.

PROPRIETARY FUND RESERVES (NET WORKING CAPITAL)

In the case of Proprietary Funds (Enterprise and Internal Service Funds), Generally Accepted Accounting Principles ("GAAP") does not permit the reporting of reserves on the face of City financial statements. However, this does not preclude the City from setting policies to accumulate financial resources for prudent financial management of its proprietary fund operations. Since proprietary funds may include both long-term capital assets and long-term liabilities, the most comparable measure of liquid financial resources that is similar to fund balance in proprietary funds is net working capital which is the difference between current assets and current liabilities. For all further references to reserves in Proprietary Funds, Net Working Capital is the intended meaning.

A. Water Enterprise Fund

1. Stabilization and Contingency Reserve: This Reserve is used to provide sufficient funds to support seasonal variations in cash flows and in more extreme conditions, to maintain operations for a reasonable period of time so the City may reorganize in an orderly manner or effectuate a rate increase to offset sustained cost increases. The intent of the Reserve is to provide funds to offset cost increases that are projected to be short-lived, thereby partially eliminating the volatility in annual rate adjustments. It is not intended to offset ongoing, long-term pricing structure changes. The target level of this reserve is fifty percent (50%) of the annual operating budget. This reserve level is intended to provide a reorganization period of 6 months with zero income or 24 months at a twenty-five percent (25%) loss rate. The City Council must approve the use of these funds, based on City Manager recommendation. Funds collected in excess of the Stabilization reserve target would be available to offset future rate adjustments, while extended reserve shortfalls would be recovered from future

rate increases. Should catastrophic losses to the infrastructure system occur, the Stabilization and Contingency Reserve may be called upon to avoid disruption to water distribution.

2. Infrastructure Replacement Funding Policy: This funding policy is intended to be a temporary repository for cash flows associated with the funding of infrastructure replacement projects provided by the Water Master Plan. The contribution rate is intended to level-amortize the cost of infrastructure replacement projects over a long period. The annual funding rate of the Water Master Plan is targeted at an amount that, when combined with prior or future year contributions, is sufficient to provide for the eventual replacement of assets as scheduled in the plan. This contribution policy is based on the funding requirements of the most current Water Master Plan. There are no minimum or maximum balances contemplated by this funding policy. However, the contributions level should be reviewed periodically or as major updates to the Water Master Plan occur. Annual funding is contingent on many factors and may ultimately involve a combined strategy of cash funding and debt issuance with the intent to normalize the burden on Water customer rates.

B. Wastewater Enterprise Fund

1. Stabilization and Contingency Reserve: This Reserve is used to provide sufficient funds to support seasonal variations in cash flows and in more extreme conditions, to maintain operations for a reasonable period of time so the City may reorganize in an orderly manner or effectuate a rate increase to offset sustained cost increases. The intent of the Reserve is to provide funds to offset cost increases that are projected to be short-lived, thereby partially eliminating the volatility in annual rate adjustments. It is not intended to offset ongoing, long-term pricing structure changes. The target level of this reserve is fifty percent (50%) of the annual operating budget. This reserve level is intended to provide a reorganization period of 6 months with zero income or 24 months at a twenty-five percent (25%) loss rate. The City Council must approve use of these funds, based on City Manager recommendation. Funds collected in excess of the Stabilization reserve target would be available to offset future rate adjustments, while extended reserve shortfalls would be recovered from future rate increases. Should catastrophic losses to the infrastructure system occur, the Stabilization and Contingency Reserve may be called upon to avoid disruption to wastewater service.

2. Infrastructure Replacement Funding Policy: This funding policy is intended to be a temporary repository for cash flows associated with the funding of infrastructure replacement projects provided by the Wastewater Master Plan.

The contribution rate is intended to level-amortize the cost of infrastructure replacement projects over a long period of time. The annual funding rate of the Wastewater Master Plan is targeted at an amount that, when combined with prior or future year contributions, is sufficient to provide for the eventual replacement of assets as scheduled in the plan. This contribution policy should be updated periodically based on the most current Wastewater Master Plan. There are no minimum or maximum balances contemplated by this funding policy. However, the contributions level should be reviewed periodically or as major updates to the Wastewater Master Plan occur. Annual funding is contingent on many factors and may ultimately involve a combined strategy of cash funding and debt issuance with the intent to normalize the burden on Wastewater customer rates.

C. Internal Service Funds

Background.

Internal Service Funds are used to centrally manage and account for specific program activity in a centralized cost center. Their revenue generally comes from internal charges to departmental operating budgets rather than ~~direct appropriations~~external revenue sources. They have several functions.

--They work well in normalizing departmental budgeting for programs that have life-cycles greater than one year; thereby facilitating level budgeting for expenditures that will, by their nature, be erratic from year to year. This also facilitates easier identification of long term trends.

--They act as a strategic savings plan for long-term assets and liabilities.

--From an analytical standpoint, they enable appropriate distribution of city-wide costs to individual departments, thereby more readily establishing true costs of various operations.

Since departmental charges to the internal service fund duplicate the ultimate expenditure from the internal service fund, they are eliminated when consolidating entity-wide totals.

The measurement criteria, cash flow patterns, funding horizon and acceptable funding levels are unique to each program being funded. Policy regarding target balance and/or contribution policy, gain/loss amortization assumption, source data, and governance for each of the City's Internal Service Funds is set forth as follows:

1. For all Internal Service Funds: The Finance Director may transfer part or all of any unencumbered fund balance between the Internal Service Funds provided that the withdrawal of funds from the transferred fund would not cause insufficient reserve levels or insufficient resources to carry out its intended purpose. This action is appropriate when the decline in cash balance in any fund is precipitated by an off-trend non-recurring event. The Finance Director will make such recommendations as part of the annual budget adoption or through separate Council action.

2. Equipment Maintenance Fund and Equipment Replacement Fund: The Equipment Maintenance and Replacement Funds receive operating money from the Departments to provide equipment maintenance and to fund the regular replacement of major pieces of equipment (mostly vehicles) at their economic obsolescence.

   a. Equipment Maintenance Fund: The Equipment Maintenance Fund acts solely as a cost allocation center (vs. a pre-funding center) and is funded on a pay-as-you-go basis by departmental maintenance charges by vehicle type and usage requirement. Because of this limited function, the target year-end balance is zero.

      Contribution rates (departmental charges) are set to include the direct costs associated with maintaining the City vehicle fleet, including fleet maintenance employee salary and benefits, operating expenses and maintenance related capital outlay. Administrative overhead and maintenance facility improvements and replacement costs are to be provided outside of this cost unit.
      Governance is achieved through annual management adjustment of contribution rates on the basis of maintenance cost by vehicle and distribution of costs based on fleet use by department.

   b. Equipment Replacement Fund: Operating Departments are charged annual amounts sufficient to accumulate funds for the replacement of vehicles, communications equipment, parking equipment and other equipment replacement determined appropriate by the Finance Director. The City Manager recommends annual rate adjustments as part of the budget preparation process. These adjustments are based on pricing, future replacement schedules and other variables.

      The age and needs of the equipment inventory vary from year to year. Therefore the year-end fund balance will fluctuate in direct correlation to accumulated depreciation. In general, it will increase in the years preceding the scheduled replacement of relatively large percentage of the equipment, on a dollar value basis. However, rising equipment costs, dissimilar future needs, replacing equipment faster than their expected life or maintaining equipment longer than their expected life all contribute to variation from the projected schedule.

Target funding levels shall be determined by the Finance Director after considering the age, expected life and cash flow anticipated by the replacement equipment being funded. If departmental replacement charges for equipment prove to be excessive or insufficient with regard to this target funding level, new rates established during the next budget cycle will be adjusted with a view toward bringing the balance back to the target level over a three-year period.

3. Insurance Reserve Funds: The Insurance Reserve funds account for the activities of general liability and workers' compensation claims.

Background.

The City employs an actuary to estimate the liabilities associated with the general liability and workers compensation activities. The costs typically associated with these programs include: claims administration, legal defense, insurance premiums, self insured retention and the establishment of appropriate loss reserves including "incurred-but-not reported" (IBNR) claims. In a prescribed measurement methodology, the Actuary estimates the liabilities in conformity with Generally Accepted Accounting Principles (GAAP).

The Actuary refers to this measurement level in his report as the "Expected Level." However, because actuarial estimates are subject to significant uncertainties, actuaries typically recommend that a target funding level be set at an amount in excess of expected liability as a margin to cover contingencies. A typical target funding level would be set to obtain a specified confidence level (the percent chance that resources set-aside will be sufficient to cover existing claims).

Full funding of the Actuary's "Target Funding Level" establishes a seventy-five percent (75%) confidence there will be sufficient resources (including projected interest) to pay the full amount of existing claims without future contributions. Funding at the "Expected Level" produces a confidence level of only fifty percent to sixty-five percent (50%-65%). Therefore, the target funding of insurance reserves should exceed the "Expected Level" to account for adverse estimate deviation.

Policy & Practice.

The City should target funding of its risk management obligations at not less than the Expected Level, described above; and not more than an amount sufficient to establish a seventy-five percent (75%) Confidence Level. Actuarial losses should be recovered over a rolling 3-year basis while actuarial gains should be amortized over a rolling 5-year basis. As part of the operating budget, each department will be charged a rate equal to its proportionate share of the total "revenue" required to fund the Insurance Reserve Fund at this level.

To lessen the impact of short-term annual rate change fluctuation, City management may implement one-time fund transfers (rather than department rate increases) when funding shortfalls appear to be due to unusually sharp and non-recurring factors. Excess reserves in other areas may be transferred to the internal service fund in these instances but such transfers should not exceed the funding necessary to reach a seventy-five (75%) confidence level interval.

4. Compensated Absences Fund:

Background.

The primary purpose of flex leave, vacation leave and sick leave is to provide compensated time off as appropriate and approved. However, under certain circumstances, typically at separation from service, some employees have the option of receiving cash-out payments for some accumulated leave balances. The Compensated Absences Fund is utilized primarily as a budget smoothing technique for any such leave bank liquidations. The primary purpose of the Compensated Absences Fund is to maintain a balance sufficient to facilitate this smoothing.

Policy and Practice.

The contribution rate will be set to cover estimated annual cash flows based on a three-year trailing average.

The minimum cash reserve should not fall below that three-year average. The maximum cash reserve should not exceed fifty percent (50%) of the long term liability. The target cash reserve shall be the median difference between the minimum and maximum figures.

Each department will make contributions to the Compensated Absences Fund through its operating budget as a specified percentage of salary. The Finance Director will review and recommend adjustments to the percentage of salary required during the annual budget development process. This percentage will be set so as to maintain the reserve within the parameters established above.

5. Post Retirement Funding Policies:

a. Pension Funding:

(i) California Public Employees Retirement System (CalPERS): The City's principal Defined Benefit Pension program is provided through contract with CalPERS. The City's contributions to the plan include an actuarially determined employer contribution that fluctuates each year based on an annual actuarial plan valuation. This variable rate employer contribution includes the normal cost of providing the contracted benefits plus or minus an amortization of plan changes and net actuarial gains and losses since the last valuation period.

It is the City's policy to make contributions to the plan equaling at least one hundred percent (100%) of the actuarially required contribution (annual pension cost). Because the City pays the entire actuarially required contribution each year, by definition, its net pension obligation at the end of each year is $0. Any unfunded actuarial liability (UAL) is amortized and paid in accordance with the actuary's funding recommendations. The City will strive to maintain its UAL within a range that is considered acceptable to actuarial standards. The City Council shall consider increasing the annual CalPERS contribution should the UAL status fall below acceptable actuarial standards.

(ii) Laborer's International Union of North America (LIUNA): The City provides funds to support a supplemental pension plan for some employee associations through contract with LIUNA. This is funded at a fixed percentage of total compensation on a pay-as-you-go basis. The City is not contractually required to guarantee the level of the ultimate LIUNA benefit to retirees, nor does it do so. Therefore the City's liability for this program is full funded each year.

b. Other Post Employment Benefits (OPEB Funding):

Background.

The City's OPEB funding obligations consists of two retiree medical plans.

New Plan. Effective January 2006, the City and its employee associations agreed to major changes to the Post Employment Healthcare Plan. New employees and all current employees participate in a program that requires certain defined employee and employer contributions while the employee is in active service. However, once the contributions have been made to the employee's account, the City has transferred a substantial portion of the funding risk to the employee.

Old Plan. Eligible employees who retired prior to the "New Plan" and certain active employees were eligible to continue to receive post-retirement medical benefits (a defined benefit plan). The cost was divided among the City, current employees and retirees. In the past, this program was largely funded on a pay-as-you-go basis, so there was a significant unfunded liability. Recognizing this problem, the City began contributing to this obligation in 2001. In 2008, these assets were placed in a pre-funding trust. The City's intention is to amortize the remaining unfunded liability within 20 years.

Policy & Practice.

New Plan. Consistent with agreements between the City and Employee Associations, the new defined contribution plan will be one hundred percent (100%) funded, on an ongoing basis, as part of the annual budget process. Funds to cover this expenditure will be contained within the salary section of each department's annual operating budget.

Old Plan. The City's policy is to pre fund the explicit (cash subsidy) portion of the Actuarial Accrued Liability (AAL) of the remnants of the old plan over a 20-year amortization period, or less. This amount will be based on the Annual Required Contribution (ARC) determined by a biennial actuarial review; subject to review and analysis by the City. The City will strive to maintain a funded status that will be within a range that is considered acceptable to actuarial standards. The City Council shall consider increasing the annual OPEB contribution should the funded status fall below acceptable actuarial standards.

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