



ATTACHMENT 2



CITY COUNCIL POLICY: FINANCIAL MANAGEMENT AND BUDGETARY POLICY

Adopted Revised: ~~October 20, 2020~~ January 3, 2023

1 Purpose.

Provide the framework and direction for financial planning and decision making by the City Council and City staff. These policies are designed to ensure the City's financial integrity and provision of services that address the priorities of Lake Forest's constituents.

This policy establishes financial parameters that will guide the budget development and deliberation process, safeguard financial assets, and maintain the City's strong financial condition.

The desired policy outcome is that the long-term implications of financial decisions are fully understood and considered in the decision-making process. The City Council will review this policy during each budget development process and consider any recommended revisions with the adoption of the budget.

2 Long-Range Financial Planning and Budget.

- a) The budget is a resource allocation document and serves as the financial plan for the City. It will serve as the policy document of the City Council and will provide policy direction to the City **Manger-Manager** in the areas of desired service levels and funding priorities.
- b) The City Manager shall present a proposed budget to the City Council on a biennial basis to be adopted no later than June 30 in odd numbered years preceding the commencement of the two-year budget cycle. The budget will be prepared, presented, and administered by the City Manager and Director of Finance/City Treasurer.
- c) The City will maintain a long-range fiscal perspective by preparing a two-year operating budget, seven-year Capital Improvement Plan, and seven-year Financial Forecast. The Budget will be developed and adopted with a sharp focus on long-term financial solvency and compliance with provisions of this policy.
- d) The City Council values public input in the budgeting process and will provide opportunities for public input.

- e) The budget document will be prepared in a manner which facilitates public study and effectively communicates key economic issues and fiscal policies. The budget will document and explain assumptions for underlying revenue sources and expenditure estimates.
- f) The City Council may authorize the use of reserves and/or non-recurring revenues to balance the budget when unforeseen events occur that reduce the City's recurring revenues, and to direct the City Manager to make budgetary recommendations that will re-balance the budget within a specified timeframe.
- g) All budgetary procedures will conform to state regulations and Generally Accepted Accounting Principles (GAAP) for governmental agencies.
- h) The City's budget will be presented by function Program Area of government with a logical breakdown of programs. The budget format will clearly outline the major service areas and associated expenditures.
- i) The budgeting process will include reports to the City Council and will include budgetary status and compliance. The City Manager will notify the City Council whenever changing operations or economic developments require corrective budgetary modifications. The City Manager shall also inform the City Council if operating revenues are projected to decrease by more than 10% from the adopted budget.
- j) Non-personnel appropriations in the Operating Budget may be carried over from the first year to the second year of the two-year budget period with the approval of the City Manager with notification to the City Council Audit Committee.
- j)k) Non-personnel appropriations in the Operating Budget may be carried over from on two-tear budget cycle to another when an agreement is in effect prior to the commencement of the new two-year budget with the approval of the City Manager with notification to the City Council Audit Committee.
- k) Departmental bBudget control shall be the responsibility of the Department Head. Department Heads shall, with the concurrence of the Director of Finance/City Treasurer, have the authority to move appropriations between programs line items within- under their responsibility within the same Program Area.their departmental budgets. At the discretion of the City Manager, appropriations may be transferred from one department Program Area to another, or between funds within the Operating Budget with notification to the City Council Audit Committee.
- h)m) At the City Manager's discretion, appropriations may be moved from

one capital improvement project to another existing project within the adopted Capital Improvement Program with notification to the City Council Audit Committee.

m)n) During the budget cycle, special circumstances may require an adjustment in the appropriations established in the adopted budget and would require a budget amendment. These may include:

- i. Changes to spending priorities
- ii. Increase in operating or capital expenditures
- iii. Decrease in operating revenues

n)o) City Council approval is required to increase the total sum of the appropriations made for the Operating Budget or the Capital Improvement Plan from the adopted Budget Resolution. City Council approval is also required to move appropriations between the Operating Budget and the Capital Improvement Program.

e)p) The goal of the City's long-range financial planning is to pay for capital projects and large, one-time expenditures from existing sources (savings or reserve funds) and not be dependent on borrowing or new revenues.

3 Capital Planning.

- a) The purpose of the Capital Improvement Program is to systematically plan, schedule and finance capital projects as approved and prioritized by the City Council. The Capital Improvement Program will be a seven-year plan and will include major rehabilitation costs to existing infrastructure and facilities, as well as the cost of new facilities or capital improvements. Staff will inventory and assess the condition of all major capital assets every two years and make recommendations to the City Council regarding any modification of the Capital improvement Program as part of the budget development process.
- b) Proposed capital projects will include projected changes in operating and maintenance costs, work force requirements, productivity, and risk management considerations.
- c) A capital improvement project shall be established for all projects greater than \$100,000 with an expected useful life of at least 3 years that also meet the definition of a public project per State Public Contracts Code Section 22002. These include projects involving construction, reconstruction, alteration, renovation, improvement, demolition or major repair work. This

excludes routine, recurring and usual work for the preservation, protection, or maintenance of publicly owned land, improvements and equipment.

- d) For purposes of this policy, the scope of a proposed capital improvement project may be defined as the work to be undertaken at a single location. However, if work at a specific location would not otherwise meet the cost threshold for establishing a separate capital improvement project and similar work is to take place at another location(s) during the same fiscal year, then all such similar work shall be defined as one capital improvement project.
- e) A capital project may originate from a variety of input, including but not limited to public feedback, City Council and Commission ideas, the Biennial Residential and Business Satisfaction Study (i.e., survey), grant requirements or staff analysis. As part of the budget process, staff uses this input to submit Capital Improvement Program requests providing a detailed description of the proposed project or purchase. All requests will be reviewed by the City Manager using the formal evaluation process described below or some other alternative process identified by the City Manager. One evaluation consists of several ranking criteria, which are assigned relative weights as follows:

<i>Criteria</i>	<i>Weight</i>
<i>Project's impact on health and safety</i>	10
<i>Project improves, upgrades, or rehabilitates an existing facility</i>	9
<i>Project's impact on City operating budget</i>	8
<i>Project remedies a service deficiency</i>	8
<i>Percent of project costs to be funded by (non-City) resources and/or funding to be lost if project not done</i>	7
<i>Priority assigned by requesting Department</i>	6
<i>Other considerations, such as aesthetics, feasibility, special populations serviced, conformance to plans (including the General Plan), interjurisdictional effects and community economic effects</i>	6

Once evaluation scores as assigned, project priorities will be determined and presented to the City Council for further review. After completing its review, the City Council will appropriate funding for the first two years of the Seven Year Capital Improvement Program as part of the two-year budget cycle.

- f) Unexpended project appropriations will be automatically carried forward as continuing appropriations to future fiscal years as required to complete the intent of the original budget with notification to the City Council Audit Committee.

- g) The City will actively pursue grant and other outside funding sources for all capital improvement projects. Staff will be cognizant that the grant amount should justify the staff time and other resources needed for its administration.

4 Risk Based Reserves.

This section is designed to develop standards for setting reserve levels for various significant City funds. Adequate reserve levels are a necessary component of the City’s overall financial management strategy and a key factor in external agencies’ measurement of the City’s financial strength.

- a) The City shall maintain reserves at a prudent level and shall use reserves appropriately with a focus on contributing to the reserves in good times and drawing on reserves in times of severe economic downturns, unforeseen major expenses, and/or sudden revenue losses to maintain a consistent level of service and quality operations.
- b) The City shall establish certain financial reserves to protect the City against unexpected interruptions in revenues, vulnerability of State actions, adverse economic conditions, unpredictable one-time costs, and exposure to natural disasters and emergencies.
- c) Established reserves will be based on an analysis of the risks that influence the needs for reserves as a hedge against uncertainty and loss. A risk is defined as probability and magnitude of a loss, disaster, or other undesirable event. The Risk Analysis will review the following risk factors and the City’s level of exposure to each risk factor impacting the City’s General Fund.

OPERATING RISK FACTORS
Revenue Source Stability

Vulnerability to Extreme Events
Expenditure Volatility
Leverage
Liquidity
Other Fund Dependency
Growth

CAPITAL RISK FACTORS
Capital Projects Infrastructure

and Asset Replacement
Capital Asset Replacement

- d) The Risk Analysis will identify the reserve level for each risk factor, the recommended Target General Fund Reserves based on all risk factors.
- e) The Risk Analysis will be performed biennially in coordination with the development of the operating budget.
- f) The Total Minimum Reserve shall be established 5% below the Target General Fund Reserve Level.
- g) The Target General Fund Reserves and Total Minimum Reserve will be established and updated by resolution based on each biennial analysis.
- h) Spending beyond the Total Minimum Reserve shall require a four-fifths vote of the City Council.
- i) Gas Tax HUTA Fund – A minimum reserve level of \$400,000 will be set aside as a reserve for street repair emergencies and other unanticipated traffic safety projects. The City Manager shall provide a plan including timeline to replenish the reserves within 180 days of City Council authorization to use the reserves. This reserve is intended to protect the City against unexpected interruptions in revenues, vulnerability of State actions, adverse economic conditions related to this revenue source.
- j) Measure M Local Fair Share Fund – A minimum reserve level of \$250,000 will be set aside as a reserve for street repair emergencies and other unanticipated traffic safety projects. The City Manager shall provide a plan including timeline to replenish the reserves within 180 days of City Council authorization to use the reserves. This reserve is intended to protect the City against unexpected interruptions in revenues, vulnerability of State actions, adverse economic conditions related to this revenue source.
- k) The City shall maintain a Pension Employer Contribution Stabilization Trust Fund to reduce volatility in the employer contribution rates set by CalPERS. The City shall target a 95% funding status for the pension plan and a required pension liability payment of less than 10% of the annual pension contribution within the seven-year financial forecast. Funding status will be based on the most recent actuarial valuation of the pension plan. The operating budget presented by the City Manager will provide an update on the balance of the available resources and any recommendations for the budget period.

- I) The City Shall maintain an Other Post-Employment Benefits Trust (“OPEB”) Fund to fund the required health care costs to retirees. The City shall target a 100% funding status based on the most recent actuarial valuation of the OPEB Plan. The City shall make annual required contributions based on the most recent actuarial valuation of the OPEB Plan. The operating budget presented by the City Manager will provide an update on the balance of the available resources and any recommendations for the budget period.

5 Fund Balance Management.

- a) The Fund Balance Policy establishes guidelines and procedures for allocating and reporting fund balance in the financial statements in accordance with Governmental Accounting Standard Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and as committed by City Council.
- b) Fund balance is defined as the difference between the assets and liabilities reported in a governmental fund.
- c) GASB Statement No. 54 defines five separate components of fund balance, each of which identifies the extent to which the City is bound to honor constraints on the specific purposes for which amounts can be spent.
- d) The following components defined by GASB Statement No. 54 shall constitute the City’s Fund Balance for financial reporting purposes:
 - i. *Nonspendable Fund Balance* (inherently nonspendable) – Assets that cannot be converted to cash(e.g., prepaid items and inventories of supplies) and assets that will not be converted to cash soon enough to affect the current period.
 - ii. *Restricted Fund Balance* (externally enforceable limitations on use) – Limitations imposed by creditors, grantors, contributors, or laws and regulations of other governments and limitations imposed by law through constitutional provisions or enabling legislation.
 - iii. *Committed Fund Balance* (self-imposed limitations on use set in place prior to the end of the fiscal year) – Limitation

imposed at the highest level of decision making that requires formal action at the same level to remove (Ordinance).

- iv. *Assigned Fund Balance* (limitation resulting from intended use) – Intended use established by highest level of decision making, by a body designated for that purpose, or by an official designated for that purpose, (delegated by the City Council to the City Manager).
 - v. *Unassigned Fund Balance* (residual net resources) – Excess of nonspendable, restricted, committed, and assigned total fund balance.
- e) For the General Fund, unless the fund balances are non-spendable or restricted, fund balances are “spendable” and available for use at the discretion of the City Council.
- f) For all other Special Revenue, Capital Projects and Debt Serve Funds, these resources are limited as to use by external enforceable limitations (e.g., enabling legislation) therefore fund balances in these funds will be categorized as restricted.
- ## 6 Revenues and Expenditures.
- a) The City will maintain a level of expenditures which will provide for the health, safety and welfare of the residents of the community.
 - b) The City will endeavor to maintain a diversified and stable revenue base to minimize the effects of fluctuations in any single revenue source. Efforts will be directed to optimize existing revenue sources while periodically reviewing potential new revenue sources.
 - c) The City will estimate revenue using an objective, analytical process; in the case of assumption uncertainty, conservative projects will be utilized.
 - d) The City will fund all current expenditures from current revenues, avoiding procedures that balance current budgets by postponing needed expenditures, accruing future revenues or rolling over short-term debt.
 - e) Development processing costs and related administrative expenses shall be totally offset by development fees.
 - f) Gas tax revenues will be annually set aside to offset all costs in connection with the City’s street maintenance program. The City will strive to maintain this

program in such a manner that will not require the infusion of available General Fund revenues/resources.

7 User Fees.

- a) The purpose of this User Fee Policy is to provide a consistent framework for the analysis and evaluation of user fees imposed by the City of Lake Forest. Topics include: Services for which user fees are appropriately considered, basis for maximum fee amounts, amount of costs to be recovered from fees, and procedures for updating fees.
- b) User fees are applied to recover all or a portion of the City's costs for providing service of individual benefit or cause. "Providing service means activities at the option of the individual, such as requests for service, or City response to the decisions or action of the individual, such as regulation. The wide-ranging application of user fees for services of individual benefit or cause enables the general revenue sources of the City to be directed more fully to other services yielding broader community benefit.
- c) User fees are managed by nearly every operating function within the City. Areas where user fees will be commonly applied include:
 - a. Regulatory activities, such as review and inspection of land development, construction/building, and improvements to infrastructure, and other areas of code review, compliance, and enforcement.
 - b. Permitting, such as special events and use of public facilities, infrastructure, and services.
 - c. Facility rentals and use of public spaces, such as community centers, recreational sites, parks, and athletic field use.
 - d. Program participation.
 - e. Municipal operations providing service of individual benefit/request.
 - f. Municipal operations responding to individual action.
 - g. Licensing, billing, records management, and administration services.
 - h. Direct-billing of City staff time.
- d) Refer to the City's Comprehensive Master Fee Schedule for a complete list of current services for which a user fee is imposed.
- e) The City will identify basic tax-provided services and will establish user fees

and charges for services provided in excess of basis services and/or non-taxpaying users.

- f) User fees are set at the discretion of the City Council, so long as the fees conform to the requirements of Article 13C of the California Constitution, which requires a “cost of services” basis for setting fee amounts.
- g) The City’s User fees will be set according to the estimates reasonable cost of service. Furthermore, user fees will bear a fair and reasonable relationship to the payer’s burdens on or benefits received from the activities and/or services provided by the City.
- h) When evaluating user fees, the City will calculate the “full cost of service,” for each activity, which is the maximum fee amount allowed. The full cost of service will include components for:
 - i) The direct cost of service:
 - a. Labor associated with performance of service from all personnel involved in the activity.
 - b. Services, supplies, and/or materials required to complete the activity.
 - j) A reasonable share of the indirect costs of service:
 - a. The services, supplies, and materials which support the personnel involved in the activity.
 - b. The indirect management, administration, and support services associated with the City functions involved in the activity.
 - c. The central services, City management and administration, and governmental oversight associated with the functions involved in the activity.
- k) Once the full cost of service is established for each activity, the City will apply a consistent set of guidelines for determining the amount of cost to be recovered in the final fee amount. A cost recovery percentage will be applied to the full cost of service to calculate the fee.
- l) Figure 1 below explains the City’s guidelines for setting a cost recovery threshold for each activity where user fees are applied. The cost recovery threshold assigned to each fee-related service will be identified in the periodic

analysis and documentation supporting the calculation of the City’s user fees.

FIGURE 1: COST RECOVERY GUIDELINES

COST RECOVERY THRESHOLD	CHARACTERISTIC OF THE SERVICE / ACTION
<p>“NONE” No Recovery of the Costs of Service</p>	<ul style="list-style-type: none"> • Acute interest in protecting: <ul style="list-style-type: none"> – Public safety – Integrity of City infrastructure, assets, and operations – Vulnerable populations • Collection of fees is not feasible or cost-effective
<p>“LOW” Up to 50% of the Full Cost of Service</p>	<ul style="list-style-type: none"> • The broader public benefits greatly from the individual service provided • Larger fee amounts may discourage compliance with City requirements • Market sensitivities may negatively impact demand for services deemed important to the character of the community • City policy directs an influence on fee amounts for: <ul style="list-style-type: none"> – Concern for low-income participation – Concern for specific sectors, such as owner-occupied residences or small business – Priority for resident participation, versus non-resident
<p>“MODERATE” Greater than 50% of the Full Cost of Service</p>	<ul style="list-style-type: none"> • While the individual benefits greatly from service provided, public benefit or public interest in compliance/participation is present • Factors described in lower thresholds retain some influence • Though service benefits the individual to a high degree, fee levels should be sensitive to the encouragement of current City initiatives
<p>“FULL” 100% of the Full Cost of Service</p>	<ul style="list-style-type: none"> • Service benefits the individual to a great degree • Service is highly regulatory • Fee amounts do not materially impact compliance or demand • Fee amounts for comparable service are in line with other regional communities • The City discourages the activity
<p>“PENALTY” Greater than Full Cost</p>	<ul style="list-style-type: none"> • Must be a fine/penalty for non-compliance with City code

m) The City shall recalculate the full cost of activities supported by user fees to take into account inflation and other related matters. The following cost index will be used as the basis for calculating annual changes to the fee amounts: Consumer Price Index (CPI) for the Los Angeles-Long Beach-Anaheim Metropolitan Statistical Area. The escalation amount will be the published annual percentage change calculation. The City’s Master Fee Schedule shall be approved and updated by resolution in connection with the adoption of the operating budget.

- n) The City will complete a thorough user fee study periodically, at least every five years, to determine the full cost of service of each activity included in the Comprehensive Master Fee Schedule. The user fee study will:
- Analyze the direct and indirect costs associated of existing and new fee-related service provided City-wide.
 - Revisit cost recovery thresholds applied to fee related services.
 - Determine updated fee amounts consistent with the cost of service basis and the City's cost recovery at that time.

8 Accounting, Auditing, and Financial Reporting

- The City's accounting and financial reporting systems shall be maintained in accordance with generally accepted accounting principles (GAAP) and other standards promulgated by the GASB.
- The City shall prepare an annual report, in a **an Annual** Comprehensive **Annual** Financial Report (**CAFR ACFR**) format, which shall conform to the reporting standards established by the Governmental Accounting, Auditing and Financial reporting (GAFR).
- The annual financial report will be audited each year by an independent auditor. A new independent auditor shall be selected competitively, through a formal public request for proposal process, at least every six years pursuant to State law.
- An Audit Committee shall be formed consisting of two City Council Members and the City Manager, or designee, to provide a direct line of communication between the auditor and the City Council. The City Attorney shall be available to advise the Audit Committee.
- The City Manager will provide quarterly reports to the Audit Committee that compares year-to-date actuals with revenue and expenditure projections.
- The City Manager will notify the City Council whenever changing operations or economic developments require corrective budgetary measures.

9 Cash Management, Investments and Banking Relations.

- ~~Investments and cash management will be the responsibility of the Director of Finance/City Treasurer under the direction of the City Manager. **The City may engage one or more external investments advisers that may be granted discretionary authority to purchase and sell investment securities in accordance with the City's Statement of Investment Policy.**~~

- a)
- b) In accordance with Government Code Section 53646, the City Council will review and update annually a specific statement of investment and portfolio policy. The primary purpose of this policy is to set forth the City's investment philosophy and objectives. The City's investment objectives overriding objectives of the program are to preserve principal, provide sufficient liquidity, and manage investment risks, while seeking a market-rate of return. are safety, liquidity, and yield. The policy also specifically outlines authorized investments, the acceptable percentages and maximum maturities allowed for each investment instrument and the criteria used to determine qualified depositories/dealers.
- c) In the selection of banking services, a competitive public request for proposal process will be used at least every five-ten years.

Policy History

1. Adopted October 20, 2020
2. Revised March 2, 2021
3. Revised January 18, 2022
4. Revised January 3, 2023