



# **COMPREHENSIVE FINANCIAL MANAGEMENT POLICY**

**Adopted April 18, 2011**  
**Revised December 19, 2011**

**ORIGIN – The City’s 2030 Vision and Strategic Plan calls for the establishment of a Comprehensive Financial Management Policy in its Vision, as one of ten Vision Elements and as a Goal.**

**The Vision:** *“STRONG FINANCIAL MANAGEMENT - The people of Prior Lake have a powerful vision and great hopes for the community’s future. For the 2030 Vision to become a reality, the City must ensure that there is financial confidence in the City and that financial resources are available, in the amount and within appropriate time frames, to fund the operating and capital costs associated with implementing the Strategic Plan regardless of the pace of development. Financial strength includes always assuring that financial resources are used to achieve maximum value for the lowest reasonable expenditure needed to achieve the 2030 Vision” – 2030 Vision and Strategic Plan, adopted November 9, 2009*

**Vision Element:** *“Strong Financial Management,” one of the ten vision elements of the 2030 Vision and Strategic Plan (2030 VSP), represents an area of strategic importance that must be addressed to make the 2030 VSP a reality.*

**Goal:** *“Establish a comprehensive financial management policy which addresses the City’s approach to fund balances, revenues, expenditures and debt.”*

**PURPOSE**

The Comprehensive Financial Management Policy serves three main purposes:

- 1) To draw together in a single document the City’s major financial policies;
- 2) To establish principles to guide both staff and Council members to make consistent and informed financial decisions.
- 3) To inform the citizenry that the City is a prudent steward of their resources.

**POLICY AREAS**

The Comprehensive Financial Management Policy establishes City policy in the following areas:

- 1) Reserves
- 2) Revenues *(to be added in the future)*
- 3) Expenditures *(to be added in the future)*
- 4) Debt *(to be added in the future)*
- 5) *Financial Planning & Reporting (to be added in the future)*

**OBJECTIVES OF THIS POLICY**

- To provide both short-term and long-term financial stability to city government by ensuring adequate funding for providing services and protecting infrastructure needed by the community today and for years to come;
- To protect the City Council’s policy-making ability by ensuring that important policy decisions are not constrained by financial problems or local, state, regional or national emergencies;
- To provide sound financial principles to guide the decisions of the City Council and City management;

- To create a document that City management and City Council members can refer to when engaged in financial planning, day to day decision making, budget preparation and other financial management endeavors.

## **1. RESERVES**

The goal of the City Council in establishing a Reserve Policy is to ensure the long-term economic stability of the organization by providing sufficient funds for cash flow purposes, to accumulate savings for projects (one-time and grant-matching opportunities), and to have reserves for unexpected revenue shortfalls or emergencies, while providing a specific plan for increasing or decreasing the level of fund balance as appropriate. In creating this policy, the City Council expressly acknowledges that a key element in sound financial management is having a reserve at all times. This policy seeks to establish parameters for the reserves so it is neither larger than needed nor less than desirable and based upon financial and management analysis and principles. This policy also establishes the specific guidelines that will be used to classify fund balances into categories based primarily on the extent to which the City is bound to honor constraints on the specific purposes for which amounts in these funds can be spent.

### **A. CLASSIFICATION OF FUND BALANCE / PROCEDURES**

#### **1) Nonspendable**

This category includes fund balance that cannot be spent because it is either (i) not in spendable form or (ii) is legally or contractually required to be maintained intact. Examples include inventories and prepaid amounts.

#### **2) Restricted**

Fund balance should be reported as restricted when constraints placed on those resources are either (i) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or (ii) imposed by law through constitutional provisions or enabling legislation.

#### **3) Committed**

Fund balance that can only be used for specific purposes pursuant to constraints imposed by formal action of the government's highest level of decision-making authority. The committed amounts cannot be used for any other purpose unless the government removes or changes the specified use by taking the same type of action it employed to commit those amounts.

The City's highest level of decision making authority (City Council) will annually, or as deemed necessary, commit specific revenue sources for specified purposes by resolution. This formal action must occur prior to the end of the reporting period; however, the amount to be subject to the constraint may be determined in the subsequent period.

To remove the constraint on specified use of committed resources the City Council shall pass a resolution.

#### 4) Assigned

Amounts that are constrained by the government's intent to use for specified purposes, but are neither restricted nor committed. Assigned fund balance in the General Fund includes amounts that are intended to be used for specific purposes.

The City Council has delegated the authority to assign and remove assignments of fund balance amounts for specified purposes to the Finance Director.

#### 5) Unassigned

Unassigned fund balance represents the residual classification for the General Fund. It includes amounts that have not been assigned to other funds and that have not been restricted, committed, or assigned to specific purposes within the General Fund. The General Fund should be the only fund that reports a positive unassigned fund balance amount. This classification is also used to account for deficit fund balances in other governmental funds.

When both restricted and unrestricted resources are available for use, it is the City's policy to first use restricted resources and then use unrestricted resources as they are needed.

When committed, assigned or unassigned resources are available for use, it is the City's policy to use resources in the following order: 1) committed, 2) assigned and 3) unassigned.

### B. GENERAL FUND

The City will maintain a General Fund reserve balance at a level which takes into consideration the following:

- Cash Flow
  - Six months of projected operating expenditures recognizing that an increasingly larger share of the General Fund is dependent upon property taxes and that this trend is likely to continue;
  - Debt service for market referenda debt obligations;
- Contingency
  - Potentially volatile revenue sources recognizing that the City is dependent upon others in large funding categories of state aid, township fire agreements and SMSC contributions;
  - Unforeseen natural or man-made disasters and emergencies which will require advance payment by the City without any guarantee of repayment by the federal government or an insurer;
- Savings
  - Planned one-time expenditures and grant matching opportunities which become available but require immediate liquidity to take advantage of;
  - Initial establishment of a plan for long-term obligations;

- Other Factors
  - Impact on City's bond rating;
  - Status of public retirement systems and understanding that as an employer the City has a statutory obligation to fund unforeseen deficits.

#### Reserve Amount

Based on the above criteria, the goal would be to maintain a General Fund unrestricted fund balance (which includes Committed, Assigned and Unassigned classifications) of **45%** of projected expenditures for the subsequent year; however, this need could fluctuate with each year's budget objectives and appropriations such as large capital expenditures, and variations in the collections of revenues. This amount meets the financial needs of the City and is also consistent with the expertise and official opinion of the Minnesota State Auditor.

#### Reserve Expenditure Criteria

The City Council may consider the judicious use of reserve balances in the following situations:

- to fund an expenditure of significant long-term benefit or legacy to the community
- to fund a one-time (non-recurring) expenditure or grant matching opportunity
- to fund a one-time unplanned revenue shortfall
- to fund an unplanned expenditure due to an emergency or disaster
- to moderate property taxes
- to retire existing debt
- to fund policy shifts by other governmental entities having a negative impact on the City
- to provide catch-up funding for long-term obligations not previously recognized

*Reserve minimum: In no case will the reserve be allowed to fall below 40%.*

The City Council recognizes that any such funds may be appropriated for non-recurring expenditures as they represent prior year surpluses that may or may not materialize in subsequent fiscal years. This should only be considered after reviewing the long-term financial plan to ensure that short-term decisions are not compromising the long-term viability of the Fund.

The City Council also recognizes that the use of reserves to moderate property taxes is a temporary situation such that a future funding source will be needed to replace it; therefore, the City Council should evaluate the use of reserves for this purpose during the budget process and in conjunction with the long-term financial plan.

#### Replenishment of Reserve

In the event that the yearend reserve balance is projected to be less than the target level due to the use of reserve balances for purposes identified above, a plan must be presented at the time the reserve funds are appropriated that will reestablish the target level within 24 months.

Should the Fund Balance Reserve amount fall below the 45% targeted level, the City Council must approve and adopt a plan to restore this balance to the target level within 24 months.

If restoration of the reserve cannot be accomplished within such period without severe hardship to the City, then the City Council will establish a different time period.

A negative residual amount may not be reported for restricted, committed or assigned fund balances in the General Fund.

### **C. ENTERPRISE FUNDS**

The City will maintain reserves in Enterprise Funds at levels sufficient to provide adequate working capital for current expenditure needs, for the replacement of capital assets within the Fund over their estimated useful life and to pay for future capital projects. Future capital projects must be identified and quantified in a written finance plan for the fund which shall be included in the City's annual Capital Improvement Program.

The City will maintain a reserve balance at a level which that takes into consideration the following:

- Cash Flow
  - Three months of projected operating expenditures
  - Debt service obligations
- Contingency
  - Potentially volatile revenue sources
  - Unforeseen natural or man-made disasters and emergencies
- Savings
  - Planned one-time expenditures and grant matching opportunities
  - Impact of large capital projects identified in a long-term plan
- Other Factors
  - Impact on City's bond rating;
  - Requirements by external funding source

### **D. ECONOMIC DEVELOPMENT AUTHORITY FUND**

The City will strive to maintain a fund balance within the EDA Fund, a Special Revenue Fund, in order to meet both anticipated and unanticipated future economic development needs.

The City will maintain a reserve balance at a level which that takes into consideration the following:

- professional services;
- significant funding which may be required for acquisition of land for development opportunities;
- potential relocation costs or legal costs attributable to economic development actions;
- anticipated or unanticipated environmental concerns or impacts.

**E. OTHER SPECIAL REVENUE FUNDS**

The City will maintain reserves in the Special Revenue Funds at levels sufficient to provide working capital for current expenditure needs plus an amount that is estimated to be needed to meet legal restrictions, requirements by external funding sources and/or pay for future capital projects. Future capital projects must be identified and quantified in a written finance plan for the Fund, which shall be included in the City's annual Capital Improvement Program.

**F. DEBT SERVICE FUNDS**

The City will maintain reserves in the Debt Service Funds at levels sufficient to provide working capital for current expenditure needs plus an amount that is estimated to be needed to meet legal restrictions and requirements by external funding sources.

**G. CAPITAL PROJECT FUNDS**

The City will maintain reserves in the Capital Project Funds at levels sufficient to provide working capital for current expenditure needs plus an amount that is estimated to be needed to meet legal restrictions, requirements by external funding sources and/or pay for future capital projects. Future capital projects must be identified and quantified in a written finance plan for the Fund, which shall be included in the City's annual Capital Improvement Program.

**H. MONITORING AND REPORTING**

The City Manager and Finance Director shall annually prepare a report documenting the status of the fund balances with this policy and present it to the City Council in conjunction with the development of the annual budget and/or other long-term financial planning documents. Should the report disclose that there are unassigned funds available, a recommendation for use of said funds shall be presented to the City Council.

The City will annually review the adequacy of the reserve balances.

The City will periodically review updates to Rating Agency methodologies and medians to make sure that the reserve policy is consistent to ensure maintaining its existing rating or that it positions itself for an upgrade.