Memorandum

CITY OF DALLAS

DATE September 15, 2011

TO Honorable Members of the Budget, Finance & Audit Committee: Jerry R. Allen (Chair), Tennell Atkins (Vice Chair), Monica R. Alonzo, Scott Griggs, Ann Margolin

SUBJECT Financial Management Performance Criteria Changes Briefing

On Tuesday, September 20, 2011, you will be briefed on the Financial Management Performance Criteria Changes. The material is attached for your review.

If you have questions or need additional information, please let me know.

Jeanne Chipperfield

Jeanne Chipperfield
Chief Financial Officer

Attachment

cc: Honorable Mayor and Members of the City Council
Mary K. Suhm, City Manager
Rosa A. Rios, Acting City Secretary
Thomas P. Perkins, Jr., City Attorney
Craig D. Kinton, City Auditor
C. Victor Lander, Administrative Judge
A.C. Gonzalez, First Assistant City Manager
Ryan S. Evans, Assistant City Manager
Jill A. Jordan, P.E., Assistant City Manager
Forest E. Turner, Assistant City Manager
Joey Zapata, Interim Assistant City Manager
Helena Stevens-Thompson, Assistant to the City Manager
Jack Ireland, Director, Office of Financial Services
Edward Scott, City Controller

Financial Management Performance Criteria Changes

Budget, Finance & Audit Committee
September 20, 2011

Key Focus Area
E3
Efficient, Effective, Economical Government

Purpose

- The purpose of the briefing is to propose changes to the City’s Financial Management Performance Criteria
- Seek recommendation for approval of these changes

Summary of Changes

- Revise fund balance classifications to be in accordance with new accounting standards
- Other revisions are proposed due to changes to requirements or to clarify the criteria

Fund Balance Classifications

- Fund balance is the difference between a fund's assets and liabilities; the fund balance is adjusted annually by the difference between revenues and expenditures
- The Governmental Accounting Standards Board (GASB) adopted new terminology in GASB Statement Number 54 for classifications of fund balance
- The revised statement on fund balance reporting is effective for the City's fiscal year end 2011 financial statements
- Fund balance classifications previously emphasized the amount available for appropriation
- The objectives of this new statement are to:
  - Show constraints on spending and the sources of those constraints, rather than the availability of appropriation
  - Enhance the usefulness of fund balance information; and
  - Establish a hierarchy based on the extent to which a government is bound to observe constraints imposed upon the use of resources.

Classifications Prior to GASB Statement 54

- **<u>Reserved</u>**: The portion of fund balance which is not available for appropriation
  - Examples: Inventories, Encumbrances and Debt Service
- **<u>Designated</u>**: Self-imposed limitations reflecting actual plans approved by the government's senior management on the use of otherwise available fund balance
  - Examples: Emergency Reserve and Contingency Reserve
- **<u>Unreserved/Undesignated</u>**: Residual classification available for appropriation

Revised Classifications in GASB Statement 54

- **Nonspendable**: Amounts that cannot be spent because they are either not in spendable form or legally or contractually required to be maintained intact
  - Example: Inventories
- **Restricted**: Amounts subject to constraints which are externally imposed by creditors, grantors, contributors, laws or regulations
  - Example: Debt Service
- **Committed**: Amounts subject to self-imposed constraints through formal action of the city council
  - Example: Risk Reserve
- **Assigned**: Amounts constrained by the City's intent to be used for specific purposes
  - Example: Encumbrances
- **Unassigned**: Residual classification

Other GASB Statement 54 Changes

- Contingency and Emergency Reserves
  - The new guidance requires the City to classify these reserves as Unassigned Fund Balance.
  - For budgeting purposes, the City will continue to set aside amounts for these purposes.

Comparison of Classifications Pre- and Post-GASB 54 As of September 30, 2010

Pre - GASB 54 Presentation

	General Fund *	
Fund balances		
Reserved for:		
Encumbrances	$	18,230
Inventories		9,034
Unreserved, designated for:		
9-1-1 Program		2,599
Cultural Programs		738
Risk reserve		1,250
Future expenditures		971
Emergencies		17,563
Contingencies		1,367
Unreserved, undesignated		40,220
Total fund balance	$	91,972

GASB 54 Presentation

	General Fund *	
Fund balances		
Nonspendable	$	9,034
Restricted		2,599
Committed		1,988
Assigned		19,201
Unassigned		
Contingencies		1,367
Emergencies		17,563
Residual unassigned		40,220
Total fund balance	$	91,972

*Multiple funds are summarized with the General Fund for financial reporting but presented separately for budgetary purposes.
Example: 9-1-1 Fund

FMPC Recommended Revisions

- Operating Program
  - FMPC #9
    - Current FMPC: “The combined levels of the Emergency Reserve and the Contingency Reserve shall be maintained at a level which, when added to the end of year unreserved, undesignated fund balance of the General Fund, is at a level not less than 5% of the General Fund operating expenditures less debt service.”
    - Recommendation: Replace reference to unreserved fund balance to unassigned fund balance and include the amounts set aside for emergency and contingency reserves in the unassigned fund balance of the General fund
    - Reason: To comply with reclassifications from GASB 54
    - Revised FMPC: “The unassigned fund balance of the General Fund, which includes the Emergency and Contingency Reserves, shall be maintained at a level not less than 5% of the General Fund operating expenditures less debt service. (The Risk Reserve is not included in this calculation).”

FMPC Recommended Revisions, Continued

- Operating Program
  - FMPC #6
    - Current FMPC: "Each enterprise fund of the City will maintain revenues which support the full (direct and indirect) cost of the utility."
    - Recommendation: Replace "utility" with "fund"
    - Reason: Not all enterprise funds are utilities
    - Revised FMPC: "Each enterprise fund of the City will maintain revenues which support the full (direct and indirect) cost of the fund."
- Capital and Debt Management
  - FMPC #19
    - Current FMPC: "Interest expense and other capital related expenses incurred prior to actual operation will be capitalized only for facilities of enterprise activities"
    - Recommendation: Delete reference to capitalization of other capital expenses
    - Reason: Generally Accepted Accounting Principles only restrict capitalization of interest expense to enterprise funds. Other capital expenditures may be incurred in non-enterprise funds
    - Revised FMPC: "Interest expense incurred prior to actual operation will be capitalized only for facilities of enterprise activities"

FMPC Recommended Revisions, Continued

- Dallas Water Utilities
  - DWU FMPC #12
    - Current FMPC: "Wholesale treated water rates for customer cities and other governmental entities will be determined on the basis of the inter-city agreement of 1979."
    - Recommendation: Change the reference from the 1979 inter-city agreement to the agreement currently in effect.
    - Reason: Changes to the agreement were approved by Council May 12, 2010
    - Revised FMPC: "Wholesale treated water rates for customer cities and other governmental entities will be determined on the basis of the inter-city agreement currently in effect."

Recommendation

- A recommendation for approval of changes to the FMPC, as detailed in the attached appendix, on the September 28 agenda.

Appendix

FINANCIAL MANAGEMENT PERFORMANCE CRITERIA

Operating Program

1. The City shall operate on a current funding basis. Expenditures shall be budgeted and controlled so as not to exceed current revenues plus the planned use of unassigned ~~undesignated~~ fund balance accumulated through prior year surplus. Nonrecurring or one-time revenues should, to the extent possible, only be used for one-time expenditures (expenditures not expected to reoccur and requiring future appropriations) to avoid future shortfalls.

2. The year-to-year increase of actual revenue from the levy of the ad valorem tax will generally not exceed 8%:

   - Excluding taxable value gained through annexation or consolidation;
   - Excluding the value gained through new construction;
   - Excluding expenditure increases mandated by the voters or another governmental entity; and
   - Not excluding the valuation gained through revaluation or equalization programs.

3. Debt will not be used to fund current operating expenditures.

4. All retirement systems will be financed in a manner to systematically fund liabilities. The City will assure sufficient funds are provided to pay current service plus interest on unfunded liabilities plus amortization of the unfunded liabilities over a programmed period. No less than annual reviews will be provided to Council by the pension funds.

5. Actuarial analysis will be performed annually on all retirement systems. Adjustments in benefits and contributions will be authorized only after meeting the test of actuarial soundness. All health plans should have actuarial reviews performed bi-annually to determine the required levels of funding necessary. These health plans shall be financed in a manner to ensure sufficient funds are available to fund current liabilities and provide some reserve levels for extraordinary claims.

6. Each enterprise fund of the City will maintain revenues which support the full (direct and indirect) cost of the ~~utility~~ fund. In addition, each Enterprise Fund and Internal Service Fund should maintain at least 30 days of budgeted operations and maintenance expense in net working capital, and avoid cash deficits.

Operating Program (Continued)

7. The Emergency Reserve, a component of unassigned fund balance, shall be used to provide for temporary financing of unanticipated or unforeseen extraordinary needs of an emergency nature; for example, costs related to a natural disaster or calamity, a 5% decline in property values, or an unexpected liability created by Federal or State legislative action. Funds shall be allocated from the Emergency Reserve only after an analysis has been prepared by the City Manager and presented to City Council. The analysis shall provide sufficient evidence to establish that the remaining balance is adequate to offset potential downturns in revenue sources. The analysis shall address the nature of the adopted expenditure and the revenue requirement in subsequent budget years. Prior to allocating funds from the Emergency Reserve, the City Council shall find that an emergency or extraordinary need exists to justify the use of these funds. Funds shall be allocated each year in the budget process to replace any use of the Emergency Reserve funds during the preceding fiscal year to maintain the balance of the Emergency Reserve levels.

8. The Contingency Reserve, a component of unassigned fund balance, shall be used to provide for unanticipated needs that arise during the year: for example, expenses associated with new service needs that have been identified after the budget process, new public safety or health needs, revenue shortfalls, service enhancements, or opportunities to achieve cost savings. Funds shall be allocated from the Contingency Reserve only after an analysis has been prepared by the City Manager and presented to the City Council outlining the initial and recurring costs associated with the adopted expenditure. Additionally, these funds would be used prior to use of the Emergency Reserve funds. Funds shall be allocated each year in the budget process to replace any use of the Contingency Reserve funds during the preceding fiscal year and to maintain the balance of the Contingency Reserve at a level ranging from ½% to 1% of budgeted departmental expenditures.

9. ~~The combined levels of the Emergency Reserve and the Contingency Reserve shall be maintained at a level which, when added to the end-of-year unreserved, undesignated fund balance~~ The unassigned fund balance of the General Fund, which includes the Emergency and Contingency Reserves, shall be maintained ~~is~~ at a level not less than 5% of the General Fund operating expenditures less debt service. (The Risk Reserve is not included in this calculation.)

10. A Risk Reserve shall be maintained at a level which, together with purchased insurance policies, adequately protects the City's assets against loss. An analysis shall be conducted every three years or when the deductible level of the City's property insurance is modified (whichever is earlier), to determine the appropriate level of this reserve.

11. A General Fund liability fund shall be budgeted annually to provide for outstanding and anticipated claims expense and resulting liabilities during the budget year. An individual judgment settlement cap is set at $5,000,000. The Emergency Reserve will be accessed should the cap be exceeded. An analysis shall be conducted every two years to determine the appropriate level of this fund.

12. Consider the establishment of a Landfill Closure / Post-Closure Reserve to provide for any future potential liabilities. Analysis will be performed periodically to determine appropriate timing and amount of funding needs. Funds could be allocated from an increase in user fees.

FINANCIAL MANAGEMENT PERFORMANCE CRITERIA

Operating Program (Continued)

13. Operating expenditures will be programmed to include current costs of fully maintaining City facilities, including parks, streets, levees, vehicles, buildings, and equipment. A cost benefit analysis will be performed on replacement cost versus projected required maintenance costs to determine the level at which City facilities should be maintained. The analysis will also determine the long-term cost of any potential deferred maintenance cost. Normal maintenance will be funded through the operating budget.

14. An annual assessment and five year projection for all equipment and maintenance needs should be performed, and a maintenance and replacement schedule developed based on the projection.

15. An annual review of selected fees and charges will be conducted to determine the extent to which the full cost of associated services is being recovered by revenues. All fees and charges will be reviewed at least once every four years.

Capital and Debt Management

16. Any capital projects financed through the issuance of bonds shall be financed for a period not to exceed the expected useful life of the project. (Bonds issued for street resurfacing shall be financed for a period not to exceed 10 years.)

17. The net (non self-supporting) General Obligation (G.O.) Debt of Dallas will not exceed 4% of the true market valuation of the taxable property of Dallas.

18. Total direct plus overlapping debt shall be managed so as to not exceed 8% of market valuation of taxable property of Dallas. All debt, which causes total direct plus overlapping debt to exceed 6% of market valuation, shall be carefully planned and coordinated with all overlapping jurisdictions.

19. Interest expense~~s and other capital related expenses~~ incurred prior to actual operation will be capitalized only for facilities of enterprise activities.

20. Average (weighted) General Obligation bond maturities (exclusive of Pension Obligation Bonds) shall be kept at or below 10 years.

21. Annual General Obligation debt service (contribution) including certificates of obligation debt for risk management funding shall not exceed 20% of the total governmental fund expenditures (comprised of general fund, special funds, debt service funds and capital project funds).

FINANCIAL MANAGEMENT PERFORMANCE CRITERIA

Capital and Debt Management (Continued)

22. Per Capita General Obligation Debt including Certificates of Obligation (C.O.'s), Equipment Acquisition Notes and General Obligation Bonds will be managed to not exceed 10% of the latest authoritative computation of Dallas' per capita annual personal income.

23. Debt may be used to finance betterments intended to extend service life of original permanent capital improvements under the following conditions:

    - the original improvement is at or near the end of its expected service life;

    - the betterment extends the life of the original improvement by at least one third of the original service life;

    - the life of the financing is less than the life of the betterment;

    - the betterment is financed through either C.O.'s or G.O.'s.

24. Interest earnings from G.O. Bonds shall be used solely to fund capital expenditures, debt service, or used to fund a reserve for capital contingencies.

25. Certificates of Obligation should be used only to fund tax-supported projects previously approved by the voters; or for risk management funding as authorized by the City Council; or non-tax revenue-supported projects approved by City Council.

26. Certificates of Obligation (C.O.) Debt including that for risk management funding supported by an ad valorem tax pledge should not exceed 15% of total authorized and issued General Obligation (G.O.) Debt.

    - All C.O.'s issued in lieu of revenue bonds should not exceed 10% of outstanding G.O. Debt.

27. Certificates of Obligation will be limited to projects consistent with Financial Management Performance Criteria for debt issuance.

28. Certificates of Obligation for an enterprise system will be limited to only those projects, which can demonstrate the capability to support the certificate debt either through its own revenues, or another pledged source other than ad valorem taxes.

29. Certificates of Obligation authorization will remain in effect for no more than five years from the date of approval by the City Council.

FINANCIAL MANAGEMENT PERFORMANCE CRITERIA

Capital and Debt Management (Continued)

30. Certificates of Obligation authorized for risk management funding shall be issued for a term not to exceed 20 years.

31. Tax Increment Financing zones should be established where revenues will recover 1.25 times the public cost of debt in order to provide an adequate safety margin.

32. A Tax Increment Financing Reinvestment Zone may not be created if more than 10 percent of the property in the adopted zone, excluding property dedicated for public use, is used for residential purposes. "Residential purposes" includes property occupied by a house, which is less than five living units.

33. Pursuant to the provisions of the Texas Tax Code, the City creates reinvestment zones both for tax increment financing ("TIF RZ") and for the tax abatement ("TA RZ"). TA RZs are created for the purpose of granting tax abatement on real or business personal property or both located in the TA RZ. For the FMPC, TIF RZs and TA RZs shall be referred to as Reinvestment Zones ("RZ").

    No RZ can be created if the total property tax base of certain TIF RZs plus the total real property and business personal property tax base (if there is business personal property tax being abated) of TA RZs exceeds 10% of the total tax base (all real and business personal property) of the City. Reinvestment zones that are no longer collecting tax increment or abating taxes (i.e. now contributing 100% to the City of Dallas property tax revenues) will be excluded from the calculation.

34. All PID and TIF proposals, even "pay-as-you-go" projects, will be evaluated for service impact. A five-year fiscal note must accompany any request to establish a PID or TIF including repayment terms of any inter-fund borrowing.

FINANCIAL MANAGEMENT PERFORMANCE CRITERIA

Capital and Debt Management (Continued)

35. All adopted PID or TIF debt issuances supported by a district's revenues, are subject to the following criteria:

    - Coverage Tests - The project should provide for revenues, net of overlapping taxes, of 1.25 times maximum annual debt service requirement. The issuance of TIF bonds may be considered prior to achieving coverage ratio of 1.25 if:

        - a developer or property owner provides a credit enhancement such as a letter of credit or bond insurance from an AAA-rated financial institution for the entire amount of the debt issue; and

        - in the event that there is insufficient TIF increment revenues to retire TIF bonds, which event consequently requires that the credit enhancement mechanism be called upon to service the TIF bonded indebtedness, contingent liability to reimburse a credit-enhancer would be the sole liability of the developer or its affiliates; and

        - in the event that there are changes in the rating of the financial institution providing credit enhancement, then that institution shall be replaced with an AAA-rated financial institution within 90 days; and

        - in the event that no replacement of an AAA-rated institution is provided, no further TIF bonds in advance of the 1.25 coverage ratio will be provided for any additional TIF projects undertaken by the developer or its affiliates.

    - Additional Bonds Test - the project should include an additional bonds test parallel to the coverage test.

    - Reserve Fund - the project should include a debt service reserve fund equal to the maximum annual debt service requirements.

    - Limitations on Amount of PID/TIF Bonds – t he total amount of PID/TIF indebtedness will be included and managed as part of the City's overlapping debt, and

    - The total amount of PID/TIF debt outstanding should generally not exceed 20% of the City's outstanding general obligation indebtedness.

    - PID/TIF bonds should be limited to projects consistent with the City's previously adopted Financial Management Performance Criteria for debt issuance.

    - PID bonds should be limited to those projects, which can demonstrate the ability to support the debt either through its own revenues or another pledge source other than ad valorem taxes.PID/TIF bond authorizations should remain in effect for no more than five years from the date of City Council approval.

36. All adopted PID or TIF debt issuances must mature on or before the termination date of the respective PID or TIF district and, further, all bonds must also conform to the district's Financial Plan by maturing on or before the plan's projected date by which all district expenses would be paid, repayment of bonds.

FINANCIAL MANAGEMENT PERFORMANCE CRITERIA

Capital and Debt Management (Continued)

37. The City will not propose the issuance of any unrated, high yield PID/TIF bond which could be labeled a "high risk bond" except for small (less than $5 million) private placements coordinated with the City's Financial Advisor.

    - All projects must be carefully evaluated for credit-worthiness and meet the criteria above whether or not a credit rating is obtained.

38. The City should use PID/TIF bonds only when other options have been considered.

39. Advance refundings and forward delivery refunding transactions should be considered when the net present value savings as a percentage of the par amount of refunded bonds is at least 4%.

    Current refunding transactions should be considered when the net present value savings as a percentage of the par amount of refunded bonds is at least 4%.

40. Each Enterprise Fund (where applicable) will maintain fully funded debt service reserves. A surety bond (or other type of credit facility such as a letter of credit) may be used in lieu of funding the reserve if the former is economically advantageous.

Accounting, Auditing, and Financial Planning

41. The City will establish and maintain a high degree of accounting practices; accounting practices will conform to generally accepted accounting principles as set forth by the authoritative standard setting body for units of local government.

42. An annual audit will be performed by an independent public accounting firm, with the subsequent issue of an official Comprehensive Annual Financial Report (CAFR) within 120 days of the City's fiscal year end.

43. Full disclosure will be provided in the annual financial statements and bond representations.

Budget

44. Revenues and expenditures will be projected annually for at least three years beyond the current budget projections.

45. Financial systems will be maintained to monitor expenditures, revenues and performance of all municipal programs on an ongoing basis.

46. Operating expenditures will be programmed to include the cost of implementing service of the capital improvements, and future revenues necessary for these expenditures will be estimated and provided for prior to undertaking the capital improvement.

47. A report reflecting end of fiscal year status of performance against these criteria will be prepared within 60 days after official presentation of the Comprehensive Annual Financial Report to the City Council. A pro forma report reflecting Proposed Budget status will be submitted with the City Manager's Proposed Budget each year.

FINANCIAL MANAGEMENT PERFORMANCE CRITERIA

Cash Management

48. Investments will be made in conformance with the City's investment policy, with the primary objectives of preservation of capital, maintenance of sufficient liquidity and maximization of return on the portfolio.

49. The accounting system and cash forecasting system will provide regular information concerning cash position and investment.

50. Internal Service Funds and Enterprise Funds will maintain positive cash balances.

Grants and Trusts

51. All grants will be managed to comply with the laws, regulations and guidance of the grantor; and all gifts and donations will be managed and expended according to the wishes and instructions of the donor.

52. Prior to acceptance of proposed gifts and donations and governmental grants a fiscal review will be conducted. The review should consider matching requirements, impacts on both revenues and expenditures for the next five years, whether the objectives of the gifts, donation or grants meet the strategic goals of the City, and any potential impact of loss of funds.

Dallas Water Utilities

1. Current revenues will be sufficient to support current expenses including debt service and other obligations of the system.

2. Long-term debt will be used only for capital expansion, replacement and improvement of plant, not for current expenses.

3. Short-term debt, including tax-exempt commercial paper, will be used as authorized for interim financing of projects which result in capital improvements. The authorization of tax-exempt commercial paper will be limited to 20% of the 10-year capital improvement program in effect at the time of the commercial paper authorization. No commercial paper program will be authorized for more than ten years. Outstanding tax-exempt commercial paper will never exceed the amount authorized by Council.

4. Contingency reserves will be appropriated at a level sufficient to provide for unanticipated, nonrecurring expenditures.

5. Debt financing for capital projects will not exceed the useful life of the asset, and in no case shall the term exceed 30 years.

FINANCIAL MANAGEMENT PERFORMANCE CRITERIA

Dallas Water Utilities (Continued)

6. An unrestricted cash balance will be maintained such that it provides a minimum quick ratio of 1.50 and at least 30 days of budgeted expenditures for operations and maintenance in net working capital.

7. Net revenues available for debt service should be at least 1.5 times the maximum annual principal and interest requirements of relevant outstanding revenue bonds at the end of the fiscal year, and at least 1.3 times maximum-year requirements at all times, measured during a fiscal year using the previous year net revenues available for debt service.

8. Current revenues which are more than operating expenses and debt service will be used for capital expenditures and other water and wastewater purposes.

9. Funds available from current rates in each fiscal year for system rehabilitation, replacement, and expansion will be appropriated equal to or more than financial statement depreciation expense reasonably estimated in the same year.

10. Capital financing will be provided through a combination of revenue bonds, current revenues, contributed capital, and short-term debt. An equity to debt ratio of at least 20% should be maintained on all capital projects.

11. Retail cost of service studies will be performed at least every two years and reviewed annually. Rate adjustments will be recommended when required, but, normally, no more frequently than annually.

12. Wholesale treated water rates for customer cities and other governmental entities will be determined on the basis of the inter-city agreement ~~of 1979~~ currently in effect. Wholesale wastewater and untreated water rates will be determined on the basis of contractual agreements with wholesale customers. Rates shall be adjusted annually if cost of service studies indicate a need therefor.

13. Funds generated by Dallas Water Utilities will be used solely for the development, operation, and maintenance of the water and wastewater utility system.