City of Culver City, California

City Council Agenda Item Report

Meeting Date: 11/07/05		Item Number: A-7
AGENDA ITEM: Discussion of a Best Business Practice to Charge Funds a Monthly Interest Assessment (Payable to the General Fund) When Showing a Negative Cash Balance.		
Contact Person/Dept.: Crystal C. Alexander/City Treasurer's Office		Phone Number: (310) 253-5865
Fiscal Impact: Yes [X] No []		General Fund: Yes [X] No []
Public Hearing: []	Action Item: [X]	Attachments: []
Public Notification: Master Notification List on 11/2/05		
Department Approval: Crystal C. Alexander 10/25/05		CAO Approval: Jerry Fulwood 11/2/05
City Controller Approval: Marlee Chang 11/1/05		

RECOMMENDATION:

That the City Council approve this best business practice and direct the City Treasurer to draft a City Council policy on this concept for adoption.

BACKGROUND:

Part of this year's budget preparation process included an in depth review of each fund's fund balance and the interplay of the various funds, in particular the impact other funds have on the City's primary fund, the General Fund. At the request of the CAO, the City Treasurer's Office has prepared a best business practice to address the concern that certain funds are, during the year, conducting short-term borrowing from the General Fund. This proposal comports with the Government Finance Officers Association 1996 recommended practice[1] for setting charges and fees, which calls for full costing incorporating direct *and* indirect costs.

There are certain City funds that have insufficient cash, on a month to month basis, to operate independently. The City Treasurer's Office pools the cash of all the funds together (separately for the Redevelopment Agency monies) to maximize investment returns. Those funds with insufficient cash can have disbursements paid with cash from the City investment pool.

In effect, those funds are borrowing cash from the City investment pool. The lion's share of the City's investment pool (short and long term portions) is associated with

[1] "Recommend Practices for State and Local Governments," Government Finance Officers Association, March 2000.

income for General Fund purposes. Thus, the short term borrowing that is occurring comes from the General Fund and it is that fund that is losing interest income because of it.

The cash flow requirements of the City are such that the liquid (short term) portion of the investment pool is used to smooth out the peaks and valleys of the cash flow. These funds, readily turned into cash, are used to make payments because invoices must be paid if legal, budgetarily authorized and properly approved. Examples of payments may be an accounts payable expense to an outside vendor, or a payroll payable expense to City employees.

The reason why an individual fund may have insufficient cash is the different timing of the cash in (revenues) versus the cash out (expenses). This is a cyclical reason for a temporary cash shortfall and is normal as far as typical business practices are concerned. An example is the Capital Grants Fund, where the City receives funds from grantor agencies on a reimbursement basis. It might take some years (as in the case of a large, multi-grant funded project such as the Senior Center) before the cash is received. In other cases there is a chronic cash shortfall due to other reasons, such as in the Refuse Disposal Fund.

DISCUSSION:

The City Treasurer's Office makes the following recommendations regarding short-term cash borrowing by certain funds from the investment pool that is, basically, the General Fund. This only pertains to the City's general investment pool, and does not apply to individual bond proceeds/debt service portfolios, which are restricted in their use, nor the Redevelopment Agency's separate investment pool.

1) Whenever possible, each fund should be self-supporting and financially viable enough to generate a positive cash balance monthly. In particular, the enterprise funds (currently Municipal Bus Lines, Refuse Disposal, and Sewer Enterprise) are dependent on service fees and charges to support their operations, and the fee schedules should be designed to ensure sufficiency of the cash flow. This is also true for the Internal Service Funds. Internal Service Funds account for financial transactions related to the repair and usage of City-owned equipment and vehicles, the City's self-insurance programs, the purchase and distribution of office supplies, and the City's innovation fund. These services are provided to other departments or agencies of the City on a cost reimbursement basis.

2) Whenever an enterprise fund is determined, at the end of a month, to have a negative cash balance, an appropriate interest charge will be booked for accrual to the fund. This action will take place for only those internal service funds where

allowable by governmental accounting standards, and as allowable by other governing documents and laws, in particular those pertaining to grant funds. Generally, this would exclude the Operating and Capital Grant Funds. Whenever an enterprise fund is determined, at the end of the month, to have a positive cash balance, it is considered, per current practice, to be a participant in the City's investment pool and will receive its proportionate share of investment earnings for the month.

3) The interest charge to be accrued will be based on the monthly revenue earned on the total City's investment portfolio. For example, if revenue earned from investment earnings in the month of May is 4%, then this will be the rate used to calculate the interest expense for the fund with the cash shortfall.

4) If a fund accruing such interest charges has a positive cash balance position, the payment for the interest charges will be transferred over to the General Fund. If a fund accruing such interest charges is, at the end of a fiscal year in a negative cash balance position, the accrual will be carried forward into the new fiscal year as a debt owed to the General Fund. Interest charges will be compounded, meaning there can be interest on unpaid interest. The compounded interest rate is the same rate discussed in number 3 and will likely vary month to month.

FISCAL ANALYSIS:

There are a number of factors which could impact the monthly cash balance position (positive or negative) of any fund. Careful management of a particular fund could result in practices that could lessen the occurrences of a negative monthly cash balance. However, it is unlikely that negative monthly cash balances will go away completely depending on the funds and the funds ability to increase its revenue.

CTO staff has reviewed the monthly cash balance position of various funds at sample time periods during this current fiscal year. Figures coming for this sampling, which we caution may not be replicated in the new fiscal year due to the vagaries of the cash flow, indicate that about $71,000 in interest income would be owed to the General Fund due to the short term borrowing. The estimate is based on funds which we believe would be allowed to make such interest payments.

Primary funds allowing interest payments for short term borrowing would be the enterprise funds, with the caveat that the heavily grant funded nature of the Municipal Bus Lines may restrict our ability to do so with much effect to that fund.

The General Fund is the largest component part of the investment portfolio, so it is highly unlikely it would be conducting such short term borrowing (and paying interest) unless the City were in a severe bad economic condition.

MOTION:

That the City Council:

Discuss the best business practice and direct the City Treasurer to draft this concept in the form of a City Council policy for adoption.