

*City of San José, California*

**COUNCIL POLICY**

<b>TITLE</b> GOVERNMENTAL FUND BALANCE FINANCIAL REPORTING POLICY	<b>PAGE</b> 1 of 4	<b>POLICY NUMBER</b> 1-22
<b>EFFECTIVE DATE</b> June 21, 2011	<b>REVISED DATE</b>	
<b>APPROVED BY COUNCIL ACTION</b>	6/21/11, Item 3.9, Resolution No. 75904	

**PURPOSE**

The purpose of the Governmental Fund Balance Financial Reporting Policy (“Policy”) is to set forth the policy direction for the implementation of Governmental Accounting Standards Board Statement No. 54, ***Fund Balance Reporting and Governmental Fund Type Definitions*** which establishes a hierarchy of fund balance classifications which are based primarily on the extent to which the City is bound by constraints placed on resources.

**POLICY**

This Governmental Fund Balance Financial Reporting Policy sets forth the policy direction for the Finance Department’s preparation of financial statements which accurately categorize fund balance in accordance with Governmental Accounting Standards Board (“GASB”) Statement No. 54, ***Fund Balance Reporting and Governmental Fund Type Definitions*** (“GASB 54” or the “Statement”). The requirements of the Statement are effective for financial statements covering reporting periods beginning after June 15, 2010. The objective of the Statement is to improve the usefulness, including the understandability, of governmental fund balance information. This Policy establishes the new fund balance classifications for governmental funds for external financial reporting purposes such as in the City’s Comprehensive Annual Financial Report. Certain commitments and assignments of fund balance will help ensure there will be adequate financial resources to protect the City against unforeseen circumstances and events such as revenue shortfalls and unanticipated expenditures. The fund balance disclosures, consistent with GASB 54, provides more clearly defined categories to make the nature and extent of the limitations placed on the City’s fund balance more transparent. The increased transparency provides users of the financial statements information necessary to understand the processes under which constraints are imposed upon the use of resources and how those constraints may be modified or eliminated.

**FUND BALANCE DEFINITION**

Fund Balance is defined as the excess of total assets as compared to total liabilities in a governmental fund. As defined by GASB 54, the financial statement reporting for governmental funds will classify fund balances based primarily on the extent to which the government is bound to honor constraints on the specific purpose for which those fund can be spent.

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**FUNDS TYPES DEFINITION**

Governmental funds are used to account for governmental activities. Governmental funds are classified as the following: General Fund, Special Revenue Funds, Capital Project Funds, Debt Service Funds, Permanent Funds and specifically excludes proprietary and fiduciary funds. For purposes of GASB 54, only governmental funds will be required to be classified under the new fund balance classifications. The classification of proprietary funds and fiduciary funds will not be affected by the implementation of GASB 54.

**GOVERNMENTAL FUND TYPE DEFINITIONS**

GASB 54 provides further clarification on the use of various governmental fund types: General Fund, Special Revenue Funds, Capital Projects Funds, Debt Service Funds, and Permanent Funds.

- **General Fund:** Account for and report all financial resources not accounted for and reported in another fund.
- **Special Revenue Funds:** Account for and report the proceeds of specific revenue sources that are:
  1. Restricted or committed to expenditure for specified purposes other than debt service or capital projects.
  2. Proceeds of specific revenue sources establish that one or more specific restricted or committed revenues should be the foundation for a Special Revenue Fund. The specific restricted or committed revenues may be initially received in another fund and subsequently distributed to a special revenue fund.
  3. The restricted or committed proceeds of specific revenue sources should be expected to continue to comprise a substantial portion of the inflows reported in the fund.
  4. Other resources (investment earnings and transfers from other funds, for example) also may be reported in the Special Revenue Fund if those resources are restricted, committed, or assigned to the specified purpose of the fund.
  5. Special Revenue Funds should not be used to account for resources held in trust for individuals, private organizations, or other governments.

Notes to the financial statements should disclose the purpose for each major Special Revenue Fund including identifying which revenues and other resources are reported in each of the Special Revenue Funds.

- **Capital Projects Funds:** Account for and report financial resources that are restricted, committed, or assigned to expenditure for capital outlays, including the acquisition or construction of capital facilities and other capital assets.
- **Debt Service Funds:** Account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest. Debt service funds should be used to report resources if legally mandated. Financial resources that are

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being accumulated for principal and interest maturing in future years should be reported in Debt Service Funds.

- **Permanent Funds:** Account for and report financial resources that are restricted to the extent that only earnings, and not principal, may be used for purposes that support the City’s programs for the benefit of the City and residents.

**NEW FUND BALANCE CLASSIFICATIONS**

GASB 54 outlines the requirement to report the fund balance for governmental funds in specific classifications which create a hierarchy primarily based on the extent to which the City is bound to the constraints on the specific purposes for which funds can be spent.

- **Nonspendable Fund Balance:** Amounts that are not in a spendable form, such as inventories, prepaid items, and long-term receivables. It also includes amounts that are legally or contractually required to be maintained intact or required to be retained in perpetuity, such as the principal of an endowment fund.
- **Restricted Fund Balance:** Amounts reported as restricted when constraints placed on use of resources are either (1) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or (2) imposed by law through constitutional provisions or enabling legislation.
- **Committed Fund Balance:** Amounts that have been limited to specific purposes as defined in the City Charter or through a formal budgetary action of the City Council occurring through adoption of an ordinance or resolution. These commitments may be changed or lifted, but only by the same formal action that was used to impose the constraint originally. City Council action to commit fund balance must occur within the fiscal reporting period while the amount committed may be subsequently determined.
  - **Highest Level of decision making authority** – City Council
  - **Formal Action Required to Establish/Modify/Rescind** – City Council resolution or ordinance or voter approval in the case of modifying or rescinding funds established in the City Charter.
- **Assigned Fund Balance:** Amounts that are intended to be used for specific purposes through City Council budgetary actions. For all governmental funds other than the General Fund, any remaining positive amounts not classified as nonspendable, restricted or committed must be designated as Assigned Fund Balance.
  - **Body/Official Authorized to Assign Amounts** – City Council through budget adoption and amendments
  - **Policy Established by City Council to Delegate Authorization** – “Governmental Fund Balance Financial Reporting Policy”, however no delegation is provided.
- **Unassigned Fund Balance:** Amounts within the General Fund, the residual resources, either positive or negative, in excess of what can be properly classified in one of the other four fund balance categories. Within all other governmental funds, the negative residual resources in excess of what can be properly classified as nonspendable, restricted, or committed.

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**ORDER OF FUNDS SPENDING**

The City will spend the most restricted dollars in accordance with restrictions imposed before less restricted in the following order:

- a. Nonspendable
- b. Restricted
- c. Committed
- d. Assigned
- e. Unassigned

**STABILIZATION ARRANGEMENTS AND FUNDS**

Stabilization Arrangements and Funds (“Stabilization Funds”) can be established for items such as revenue shortfalls, emergencies or for covering unplanned budgetary imbalances. The Stabilization Funds are restricted to the controls that dictate the circumstances under which they can be spent.

For the purpose of reporting fund balance under GASB 54, stabilization is considered a specific purpose and to which the government is bound to honor constraints on the specific purposes or circumstances for which amount in those funds can be spent. The City has set aside the amounts currently listed as Contingency Reserve, Cash Reserve Fund and Emergency Reserve Fund in the General Fund. These reserves may be reported as part of the Committed Fund Balance in accordance with GASB 54 provided that the following requirements are met:

- **Highest Level of decision making authority** – City Council
- **Formal Action Required to Establish/Modify/Rescind** – City Council resolution or ordinance. With respect to the Cash Reserve Fund or the Emergency Reserve Fund, they can only be modified or rescinded by amendments to the City Charter.
- **Parameters for Establishment** --Established through formal City Council action which describes the specific circumstances under which need for Stabilization Fund arises and parameters for spending funds. In the case of the Cash Reserve Fund and the Emergency Reserve Fund they are established by City Charter (Section 1212 and Section 1213, respectively)

**Any changes or the removal of the reserve balances and any modifications to the specified use will require the same type of formal action taken to establish the reserve balance.**