



Midpeninsula Regional
Open Space District

ACTION PLAN & BUDGET COMMITTEE

R-14-141
November 18, 2014

AGENDA ITEM 2

AGENDA ITEM

Fund Balance Policy and Revisions to Capitalization Policy

DISTRICT CONTROLLER'S RECOMMENDATION

Review the proposed new District Fund Balance Policy and revisions to the Capital Expenditures and Depreciable Fixed Assets Board Policy.

SUMMARY

This report outlines (1) a proposed Fund Balance Policy to establish appropriate District reserves for financial stability and in accordance with GASB 54 and (2) proposed revisions to the District's existing Capital Expenditures and Depreciable Fixed Assets Policy to increase capitalization thresholds streamline the calculation of depreciation and reduce the accounting entries for asset disposals and retirements.

DISCUSSION

As the District has grown in size over the years, the complexity of its financial operations has also increased and the recent passage of Measure AA will add to the complexity. The District Controller recommends the Board of Directors adopt a new District Fund Balance Policy and approve revisions to the Capital Expenditures and Depreciable Fixed Assets Policy to strengthen the District's financial management practices.

Fund Balance Policy

The proposed Fund Balance Policy (Attachment 1) meets the requirements of GASB 54 which established the following five fund balance classifications with varying constraints: Non-Spendable, Restricted, Committed, Assigned, and Unassigned. These classifications are defined as part of the draft policy which is attached to this report and include Restricted funds for Hawthorn and OPEB, Committed Funds for (non-Measure AA-funded) infrastructure, emergency (fire, earthquake and flood) response, and equipment replacement, and minimum balance requirements for the General Fund for working capital liquidity and land acquisitions prior to general obligation bond reimbursement. The proposed policy describes the purpose of each fund, authority for establishment and change, amount of each fund, trigger for usage, procedure for replenishment, and frequency of review.

Capital Expenditures and Depreciable Fixed Assets Policy

The District's auditor, Chavan & Associates, recommended the District re-evaluate its capitalization threshold, currently \$10,000, given the value of the District's assets and its annual budget. Similar agencies typically have a capitalization threshold of \$25,000 or more. The proposed policy revisions (Attachment 2) would change the District's capitalization threshold to \$25,000 for vehicles and equipment and \$50,000 for structures and infrastructure. Attachments 2 and three provide a summary of the changes and capital asset definitions and Attachment 4 presents proposed changes to the current Board policy.

FISCAL IMPACT

The policy changes discussed in this report would have no fiscal impact.

PUBLIC NOTICE

Notice was provided pursuant to the Brown Act. No additional notice is necessary.

CEQA COMPLIANCE

No compliance is required as this action is not a project under CEQA.

NEXT STEPS

Following Board acceptance of the recommended policy changes, the General Manager will implement the two policies.

Attachment:

1. Draft Fund Balance Policy in Accordance with GASB Statement No. 54
2. Fund Balance Policy Best Practices and MROSD Proposed Reserve Funds
3. Summary of Proposed Capitalization Policy Changes
4. Capital Assets Definitions
5. Proposed Revisions to the Capital Expenditures and Depreciable Fixed Assets Policy

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Midpeninsula Regional Open Space District

Board Policy Manual

Fund Balance Policy in Accordance with GASB Statement No. 54	Policy # Chapter 4 – Finance & Administration
Effective Date:	Revised Date:
Prior Versions:	

Purpose

The following policy is created and approved by the Board of Directors in order to [1] provide adequate funding to meet the District's short-term and long-term plans, [2] provide funds for unforeseen expenditures related to emergencies such as natural disasters, [3] strengthen the financial stability of the District against present and future uncertainties such as economic downturns and revenue shortfalls, and [4] maintain an investment-grade bond rating. This policy has been developed, with the counsel of the District auditors, to meet the requirements of GASB 54.

This policy identifies the required components of fund balance, the level of management authorized to approve or change target balances in each fund, the amounts that the District will strive to maintain in each fund, and the conditions under which fund balances may be spent, reimbursed and reviewed.

Policy

The components of District fund balance are as follows:

Non-Spendable fund balance includes amounts that cannot be spent either because they are not in spendable form, e.g. prepaid insurance, or because of legal or contractual constraints. At all times, the District shall hold fund balance equal to the sum of its non-spendable assets.

Restricted fund balance includes amounts that are constrained for specific purposes which are externally imposed by constitutional provisions, enabling legislation, creditors, or contracts. Individual funds will be identified by the General Manager and Controller and the amounts set based on legal or contractual requirements. Funds may only be spent as specified by contract or as externally directed. The continuing need for each fund and the amount reserved will be reviewed annually.

Committed fund balance includes amounts that are constrained for specific purposes that are internally imposed by the District Board of Directors. Individual funds and target amounts will be established by the Board. Projects to be funded by committed funds require the approval of the Board. Funds spent from committed funds shall be reimbursed from the general fund within two years. The continuing need for each fund and the amount reserved will be reviewed annually. Any changes require the approval of two-thirds of the Board.

Assigned fund balance includes amounts that are intended to be used for specific purposes that are neither restricted nor committed. Such amounts may be assigned by the General Manager if authorized by the Board of Directors to make such designations. Projects to be funded by assigned funds require the approval of the General Manager. Funds spent from assigned funds shall be reimbursed from the general fund within two years. The continuing need for each fund and the amount reserved will be reviewed annually.

Unassigned fund balance includes amounts within the general fund which have not been classified within the above categories. The Board shall designate the minimum amount of unassigned fund balance which is to be held in reserve in consideration of unanticipated events that could adversely affect the financial condition of the District and jeopardize the continuation of necessary public services. Any spending from this minimum general fund reserve requires the approval of the Board. Any such spending will be reimbursed from the general fund within two years. The minimum reserve amount will be reviewed annually.

The specific reserve funds and amounts are as follows:

Restricted Funds

[1] **2004 Bond Reserve Fund**: required by the terms of the 2004 Revenue Bonds; held by Bond Trustee; minimum amount \$1,393,435.

[2] **Retiree Healthcare Plan Fund**: established in 2008 with a \$1.9 million contribution to the California Employers' Retiree Benefit Trust; all withdrawals per Board-approved plan; amount of annual contribution authorized by the Board as part of the annual budget.

[3] **Hawthorns Fund**: established in 2011 with a \$2.0 million endowment from the Woods Family Trust, to provide stewardship funding for the Hawthorns property in Portola Valley; amount to be withdrawn each year authorized by the Board as part of the annual budget.

Committed Funds

[1] **Infrastructure Fund**: \$15.0 million; projected requirement for field and office facilities over the next five years; amount to be withdrawn each year authorized by the Board as part of the annual budget.

[2] **Equipment Replacement Fund**: \$2.4 million; projected requirement for equipment and vehicle replacement over the next five years, based on the amount of accumulated depreciation; amount to be withdrawn each year authorized by the Board as part of the annual budget.

[3] **Natural Disaster Fund**: \$3.0 million; projected emergency expenditures required to respond quickly to a major fire, earthquake or flood; all withdrawals require the approval of the General Manager or an Assistant General Manager.

Assigned Funds

None

Unassigned Funds

[1] **General Fund Reserve:** minimum balance of \$10.0 million; estimated amount needed to maintain cash flow liquidity over the fiscal year and to close land acquisition transactions when general obligation bond funding is not available; all withdrawals require the approval of the Board and reimbursement shall be accomplished within one year.

Fund Policy Best Practices

- * Policy in Writing, Board Approved**
- * Reserves Divided into GASB 54 Categories**
- * Purpose Stated for Each Reserve**
- * Maximum Size of Each Reserve**
- * Trigger for Usage of Each Reserve**
- * How/When Reserves are to be Replenished**
- * Frequency of Review of Reserves**
- * Authority for Changing Reserves**
- * Reserves Consistent with Capital Plans**

ATTACHMENT 2: Fund Balance Policy Best Practices and MROSD Proposed Reserve Funds

Proposed MROSD Reserve Funds (per GASB 54)

NON-SPENDABLE FUNDS: Restricted for specific purpose by contract or law (e.g. prepaid insurance)

RESTRICTED FUNDS: Restricted for specific purpose by contract or law (e.g. endowment)

COMMITTED FUNDS: Restricted for specific purpose by board of directors (e.g. capex plan)

ASSIGNED FUNDS: Restricted for specific purpose by management (i.e. no board involvement)

UN-ASSIGNED FUNDS: Not restricted, but board may set minimum balance (i.e. General Fund)

(millions)	<u>RESTRICTED</u>	<u>COMMITTED</u>	<u>ASSIGNED</u>	<u>UN-ASSIGNED</u>
Hawthorn	all			
OPEB (retiree health)	all			
2004 Bonds	\$1.3			
Infrastructure (Staff Facilities)		\$15.0		
Equipment Replacement		\$2.4		
Natural Disaster (Major Fire, Quake, or Flood Remediation)		\$3.0		
Minimum General Fund Balance (for liquidity and land acquisition prior to GO bond reimbursement)				\$10.0
		\$20.4	\$0.0	\$10.0

The current policy document in force (Capital Expenditure and Depreciable Fixed Asset /CapEx Guideline and Calculation) needs to be updated in light of the passage of Measure AA.

The essence is not to define what is a “capital project,” but rather to establish thresholds for which the District will include an expenditure on its balance sheet as a depreciable fixed asset for purposes of its government-wide financial statements.

Capitalization/Depreciable Fixed Assets

<u>Category</u>	<u>Current Policy</u>	<u>Proposed</u>
Land (non-depreciable)	\$5,000	\$1
Equipment (machinery, furniture, fixtures, etc)	\$5,000	\$25,000
Vehicles (patrol, maintenance and administrative office)	\$5,000	\$25,000
Structures & Improvements (buildings, garages, storage areas and related HVAC, heating and other systems)	\$5,000	\$50,000
Infrastructure (trails, bridges, drainage, parking areas, roads, etc)	\$5,000	\$50,000

The proposed changes are based on input from the external auditors, as well as a review of peer agencies including East Bay Regional Park District. In particular, the District’s external auditor has endorsed these levels as being more consistent with similar agencies given the overall size of the District’s balance sheet (in excess of \$400 million).

The primary effect of this change will be to reduce the number of assets that the District tracks for accounting purposes, however, physical tracking of the assets will be maintained. It will streamline the calculation of depreciation and reduce the accounting entries for asset disposals and retirements.

Summary Statement

Up to present, the District has been guided by the Capital Expenditure and Depreciable (CapEx) document first approved by the Board on March 27, 2002 and subsequently amended in March 2005 and December 2010.

Generally accepted accounting principles (GAAP) dictate that the District capitalize certain expenditures on its balance sheet (land, equipment, buildings, etc) as an asset. Under the same principles, a portion of the value of those assets is recorded as a depreciation expense over the estimated useful life of the particular asset (land being the exception and not subject to depreciation).

With the passage of Measure AA, the District needs to define a more formal policy regarding Capital Assets of the District. The purpose of this update is to establish capitalization thresholds which are more consistent with the scale of the District's balance sheet and moreover, to ensure proper and accurate accounting treatment under GAAP as it relates to recording capital (fixed) assets in the District's accounts.

**Capital Assets
Definition**

Assets with the following threshold values, and a useful life of greater than one year will be capitalized:

- Land and permanent easements, either purchased or donated with a value of greater than \$1 are non-depreciable capital assets.
- Land improvements, infrastructure, buildings, other structures and leasehold improvements which are either purchased, constructed or donated to the District, with an estimated total cost or fair market value, greater than \$50,000 are depreciable assets.
- Machinery, equipment, fixtures and vehicles, either purchased or donated to the District with a cost or fair market value greater than \$25,000 are depreciable assets.
- Projects which extend the useful life or materially increase the capacity of an existing capital asset, with a value greater than \$25,000 for machinery, equipment, fixtures and vehicles, or \$50,000 for land, improvements, infrastructure and buildings, are capitalized and depreciated over the remaining useful life of the asset.

Capitalized Costs

Capitalized costs shall include those costs for placing the asset into service as prescribed by GAAP:

- In the case of purchased assets, this shall included purchase costs, taxes, installation, and delivery/freight charges
- For constructed assets, costs include design, engineering (geotechnical, soils, structural, etc), permits, construction and other related costs.

The overriding determination for capitalization of costs shall be conformity with US GAAP and made in consultation with the District Controller and external auditor.

Depreciation & Amortization

For the purposes of presentation in the District's financial statements, capital assets will be depreciated/amortized over their useful lives based on the following categories:

- Vehicles 5 years
- Equipment/fixtures 5 to 20 years
- Structures/improvements 50 years
- Software 5 to 10 years
- Infrastructure for public access 20 to 50 years

Disposal of Capital Assets

Once an asset is either disposed of or no longer in service, it should no longer be maintained in the District's accounting system.

The procedure and methods for disposing those assets deemed to be obsolete or no longer needed shall be subject to a separate policy as approved by the General Manager and/or Board.

Departments are required to report changes (disposals, damages, impairments, casualty loss, etc) for assets under their control to the District Controller and Accounting.

Annual Inventory

The Administrative Services Department performs an annual inventory as part of procedures to safeguard the District's assets. Irrespective of cost, items such as laptops, cameras, printers, tools and other highly portable devices will be tracked as inventory.

Board Policy Manual

Capital Expenditure and Depreciable Fixed Assets (CapEx) Guideline and Calculation	Policy 3.05 Chapter 3 – Fiscal Management
Effective Date: 3/27/02	Revised Date: 11/13/13 12/10/14
Prior Versions: 3/27/02, 3/23/05, 12/8/10, <u>11/13/13</u>	

I. ~~PART I: CAPITAL EXPENDITURE AND FIXED ASSETS:~~

~~A capital expenditure asset is defined as a major, nonrecurring expenditure fixed assets such as land, buildings, and equipment with a useful life of greater than one year and are classified as follows: that exceeds \$10,000 and includes one or more of the following:~~

- ~~1. **Land** - Land and permanent easements, either purchased or donated, with a value greater than \$1 are non-depreciable capital assets.~~
- ~~2. **Structures and Structure Improvements** - Land improvements, infrastructure, buildings, other structures, and leasehold improvements which are purchased, constructed, or donated to the District, with an estimated total cost or fair market value greater than \$50,000, are depreciable assets.~~
- ~~3. **Infrastructure** - Infrastructure assets are long-lived fixed assets, with a value greater than \$50,000, that normally are stationary in nature and can be preserved for a number of years significantly greater than most fixed assets. are capitalized and depreciated over the remaining useful life of the asset. Examples of infrastructure assets include roads, bridges, trail systems, tunnels, drainage systems, water and sewer systems, dams, and parking lots.~~
- ~~4. **Equipment** - Machinery, equipment, and fixtures, either purchased or donated to the District with a cost or fair market value greater than \$25,000, are depreciable assets.~~
- ~~5. **Vehicles** - Vehicles, either purchased or donated to the District with a cost or fair market value greater than \$25,000, include the basic vehicle itself and any added components that are permanently affixed, such as a truck body (used for storage and added to the cab and frame) or emergency vehicle equipment, to which customize the vehicle prior to the in-service date.~~
- ~~6. Projects which extend the useful life or materially increase the capacity of an existing capital asset, with a value greater than \$25,000 for machinery, equipment, fixtures and vehicles, or \$50,000 for land, improvements, infrastructure and buildings, are capitalized and depreciated over the remaining useful life of the asset.~~

The foregoing represents a general framework and is not intended to be exhaustive. The final determination for capitalization issues shall be made in consultation with the District Controller and external auditor.

II. DEPRECIATION AND AMORTIZATION

For the purposes of presentation in the District's financial statements, capital assets will be depreciated/amortized over their useful lives based on the following categories:

<u>Vehicles</u>	<u>5 years</u>
<u>Equipment/fixtures</u>	<u>5 to 20 years</u>
<u>Structures/improvements</u>	<u>50 years</u>
<u>Software</u>	<u>5 to 10 years</u>
<u>Infrastructure for public access</u>	<u>20 to 50 years</u>

PART II: CAPITAL EXPENDITURES:

1. A capital expenditure is defined as a major, nonrecurring expenditure for a new fixed asset or to add to the value of an existing fixed asset, as defined in Part I above. Such expenditures include:

- a. Any construction of a new facility (e.g. a public building, trails and roads, staging area, or the like) or an addition to, or extension of, such a facility.
- b. Any demolition of structures or facilities to eliminate environmental, health, and safety hazards or to prepare a site for future public access.
- c. A nonrecurring rehabilitation (i.e. something which is infrequent and would not be considered annual or recurrent maintenance) or major repair of all or part of a facility, building, or its grounds.
- d. Any planning, feasibility, engineering, or design study related to an individual capital expenditure project or to a program that is implemented through individual capital expenditure projects.

2. The District's Capital expenditures Programs include the following:

- a. Public Access Facilities: Capital expenditures that include such items as structures, trails and roads, staging areas, signage, and fencing on the District's preserves.
- b. Planning Projects: Master Plans, Resource Management Plans, and resource inventories and studies used to prepare such plans.
- c. Unanticipated Capital expenditures: Improvements that may be necessary for properties acquired during the next fiscal year, or for emergency projects (demolitions, barriers, signs, etc.). The Unanticipated Capital expenditures line item budget for the

~~total of unanticipated projects is \$25,000 per year. The cost of an individual unanticipated project, such as work necessary to solve an emergency such as landslide, fire damage, hazard abatement, etc., those described in (3)(b) below does not have to meet the ordinary \$1025,000 CIP threshold.~~

- ~~d. Staff Facilities: Capital improvements to District offices, maintenance, and operations facilities.~~
- ~~e. Land Improvements: Improvements that may be necessary for newly acquired property, such as:~~

Examples of improvements:

- ~~— Gates, fences or other barriers necessary to secure the property~~
- ~~— Initial signage~~
- ~~— Demolition of structures and removal of debris or abandoned vehicles that are clearly visible from a public right-of-way or within an area open for public access, and which constitute an attractive nuisance and/or have been identified in the Board report for immediate action~~
- ~~— Removal of hazardous materials. (However, if the work meets the exclusion from the CapEx project criteria in (3)(a)(4), below is for known pre-existing conditions on the land that require immediate work or repair, for example, remediation includes environmental, contamination, hazard, as soon as the land is purchased and may be reflected in a below market purchase price are to be included as part of the land cost, it and would not become a part of a Capital expenditure Project.)~~
- ~~— Eliminate a hazard that is critical to public safety within an area open for public access (i.e.: abatements)~~

~~3. Items Land and Associated Costs Excluded from the Capital expenditure Guideline calculation:~~

- ~~— The following items are costs directly related to land purchases should be classified as Land and Associated Costs. This includes: (i.e.~~
 - ~~i. The cost of land:~~
 - ~~ii. All non-recurring costs incurred to purchase land are to be included in either the cost of the land (i.e. appraisal fees, site engineering, legal fees, title insurance, acquisition consultant), due diligence (i.e. environmental assessments) and/or demolition work.~~

~~a. Demolition costs~~

- ~~• Include in cost of land: if the demolition work is included in the contractual agreement as a requirement to purchase the land, then the demolition costs are to be included as part of the cost of land.~~
- ~~• Exclude from cost of land: if the demolition work is not considered immediately necessary as part of the purchase, then These costs are to~~

~~be included as a capital project and subject to this CapEx Guideline and calculation.~~

~~b. All project costs following the land purchase and outside the contractual purchase agreement are to be charged to the CapEx capital budget.~~

~~c. Recurring costs are to be charged to Operating Expenses (i.e. Insurance).~~

~~d. Known pre-existing conditions on the land that require immediate work or repair (i.e. remediation includes environmental, contamination, hazard) as soon as the land is purchased, and may be reflected in a below market purchase price, are to be included as part of the land cost.~~

~~e. Expenses incurred as part of the Property Management Program.~~

~~a. 4. Large Unanticipated Capital expenditures (Emergency Projects): Work necessary to solve an emergency such as landslide, fire damage, hazard abatement, etc. that cannot wait for normal budget cycle. (This may cause funding in other project categories to be deferred).~~

~~**Due to potential material and unforeseen costs, a request for exception to the CapEx Guideline will be completed on a case by case basis.**~~

~~**Spending impacts to the current budget by Emergency projects will be evaluated by the General Manager and the District Controller, and if necessary referred to the Administration and Budget Committee. The General Manager and District Controller reserve the right to re-budget the remainder of the year to offset the cost impacts of any unplanned emergency projects.**~~

~~*Examples of emergency projects:*~~

- ~~— Protection of a natural or cultural resource in immediate danger of irreversible damage if no action is taken, where the scope of work meets the capital project criteria, such as major repair to a stream bank where erosion is impacting salmonid habitat.~~
- ~~— Repair storm damage to roads that are required for emergency access and evacuation of residents, where the scope of work meets the capital project criteria.~~

~~**PART II: FIXED ASSETS:**~~

~~1. Included in the District's Capital expenditure and Fixed Asset Guideline Calculation are four (4) categories of depreciable assets (see 1a through 15, below). A fixed asset is capitalized when it is valued at \$5,000 or more and has a useful life of (1) year or more and provides benefits throughout that period. (See definitions stated in the *Administrative Policy, Capitalization Policy For District Fixed Assets, Policy AP-05-03, dated 8/1/05, Exhibit 2b-2*).~~

- a. ~~**Equipment:** Equipment includes costs of equipment, office equipment, machinery, furniture, fixtures and similar items.~~

- b. ~~**Vehicles:** Vehicles include the basic vehicle itself and any added components that are permanently affixed, such as a truck body (used for storage and added to the cab and frame) or emergency vehicle equipment, which customize the vehicle prior to the in-service date.~~

- c. ~~**Structures and Structure Improvements:** Structures are permanent buildings that house persons or personal property. Structure Improvements are long-lived attachments to buildings that significantly increase the building's life, usefulness, or value and cannot be moved or separated from the building. Structure Improvements include assets such as central air conditioning, heating, and fire alarm systems. Structure and Structure Improvements also include the cost of construction (including all charges applicable to the building, such as costs that can be capitalized at and subsequent to the date of asset acquisition).
 - ~~*Structure Component Units* are parts of a structure that, when replaced, prolong the life of that existing structural asset or increase its value. The new Structure Component Unit will be capitalized separately, and the old component unit (subsequent to original construction) will be removed from the fixed asset and/or property report. Examples include HVAC, plumbing and sprinkler systems.~~~~

- d. ~~**Infrastructure:** Infrastructure assets are long-lived fixed assets that normally are stationary in nature and can be preserved for a number of years significantly greater than most fixed assets. Examples of infrastructure assets include roads, bridges, trail systems, tunnels, drainage systems, water and sewer systems, dams, and parking lots.~~

~~**The combined expenditure for the District's Capital expenditure projects and depreciable fixed assets are subject to the limit of 10.5% of property tax revenue based on a 5-year moving average commencing April 1, 2011.**~~

~~**PART III: Calculation of the 5-year moving average plus an example:**~~

- a. ~~Capital expenditure and Fixed Asset spending is limited up to 10.5% of the Property tax revenue (based on a 5-year moving average).
 - The 5-year average calculation requires a (1) year forecast of future projects, rather than calculating the averaging of project spending on the past 5 or 10 years.
 - Use of this new CapEx Guideline commences in FY2011-12 (using FY2010-11 actuals), increasing (1) year each year until FY2013-14 where a full 5-year~~

~~average is calculated (i.e.: at 4/1/2014: use (4) years of past Actuals plus (1) year of forecast (the immediate upcoming year)). See CapEx Example attached.~~

~~b. Grant income and donations can be used to offset CapEx spending.~~