



BUSINESS OF THE CITY COUNCIL CITY OF MERCER ISLAND

AB 5931
August 31, 2021
Regular Business

AGENDA BILL INFORMATION

TITLE:	AB 5931: First Review of the City's Updated Financial Management Policies	<input checked="" type="checkbox"/> Discussion Only
RECOMMENDED ACTION:	Review and provide feedback on the City's updated Financial Management Policies.	<input type="checkbox"/> Action Needed: <input type="checkbox"/> Motion <input type="checkbox"/> Ordinance <input type="checkbox"/> Resolution

DEPARTMENT:	Finance
STAFF:	Matthew Mornick, Finance Director
COUNCIL LIAISON:	Wendy Weiker Salim Nice Craig Reynolds
EXHIBITS:	1. Financial Management Policies 2. Appendix A – Fund Balances and Reserves
CITY COUNCIL PRIORITY:	2. Articulate, confirm, and communicate a vision for effective and efficient city services. Stabilize the organization, optimize resources, and develop a long-term plan for fiscal sustainability.

SUMMARY

In March 2021, the City Council established an Ad-Hoc Finance Committee (Finance Committee) to draft policies that guide how the City will manage its financial resources. Exhibit 1, Financial Management Policies, is the result of the Finance Committee's collaborative efforts over the past six months. Exhibit 2 is the Appendix to the policy document and lists the City's various Funds and Reserves. Together, these documents inform the purpose and formation of the biennial budget, the capital improvement program, and other long-term fiscal management strategies.

The purpose of the agenda bill is to provide the City Council background on the resulting body of work and to solicit feedback from the City Council on the draft Financial Management Policies. Revisions agreed upon by the majority of the City Council will be incorporated into a final draft for consideration at a City Council meeting later this fall.

BACKGROUND

On March 16, 2021, the City Council established a three-member Finance Committee to draft revised financial management policies (see [AB 5829](#)). From March through August of this year, Deputy Mayor Weiker, Councilmember Nice, Councilmember Reynolds, and the Finance Director met on six occasions to incrementally draft new financial policies, pulling from current budget and finance policies, recent experiences, and established best practices in municipal finance. The City Manager and City staff have also been involved in the policy development and review process.

At the April 27, 2021 City Council Planning Session, staff provided insight into the Finance Committee’s strategy for drafting the new Financial Management Policies (see [AB 5864](#)). Focus was placed on establishing one comprehensive policy document to address the many aspects of financial management.

The Finance Committee’s intent was to draft policies that guide financial decisions, make clear what actions are and are not acceptable, identify lines of responsibility between the City Council and the City Manager, and increase transparency and accountability.

The draft Financial Management Policies do not include procedural-level detail on the administration of these policies. Once adopted, Finance Department staff and the City Manager will ensure that procedures are implemented consistent with adopted policy direction.

The draft Financial Management Policies, as presented, will exist separate from the biennial budget, and will be reviewed and updated as required or at minimum, every five to seven years.

The draft Financial Management Policies underwent multiple rounds of revisions under the guidance of the Finance Committee. Members of the City’s Leadership Team, the City Manager, the City’s Bond Counsel, as well as a former City Manager/Finance Director also collaborated on the review process. In sum, the draft Financial Management Policies are the result of a six-month collaboration that builds upon the City’s history of strong fiscal management while incorporating established best practices to lead the City into the future.

DISCUSSION

The draft Financial Management Policies are compiled in a 15-page document, with 10 sections as summarized below, compared to 102 pages and 30 subsections in [Section H Budget Policies](#) of the 2019-2020 biennial budget.

Financial Management Policy Sections

- | | |
|-------------------------------------|--|
| 1. Background and Purpose | 6. Reserves and Fund Balance |
| 2. Fiscal Sustainability Philosophy | 7. Long-term Financial Planning |
| 3. Operating Budget | 8. Accounting, Financial Reporting, and Auditing |
| 4. Revenues and Expenditures | 9. Investments |
| 5. Capital Budget | 10. Debt Management |

The first five sections of the draft Financial Management Policies provide background information, outline staff and the Finance Committee’s underlying fiscal sustainability philosophy and convey key objectives for the purpose and formation of the Operating Budget and Capital Improvement Program.

Section 6 (Reserves and Fund Balance) lays out the City’s resources to respond to unexpected issues, manage cash flows, buffer against economic duress, and fund long-term liabilities. The Finance Committee worked closely with the Finance Director to evaluate the City’s numerous reserves, define common terminology, and establish guidelines for when to use and how to replenish Fund Balances and Reserves.

Notable recommendations in the draft Financial Management Policies document include:

- Transition the City from Accrual Basis to Cash Basis Accounting.
- Sunset 10 reserves and the Youth Services Endowment Fund.
- Establish a minimum Operating Fund Balance for the Youth & Family Services Fund with a funding target of six-months of YFS expenditures.

- Implement a strategy to pay down the LEOFF-1 long-term care costs and the retirement excess compensation long-term liabilities paid for by the LEOFF-1 Reserve and Firefighter’s Pension Fund.
- Set a funding target of 50% of the total liability for the Compensated Absences Reserve.
- Introduce Expenditure Control Budgeting, a new budgeting approach that offers more flexibility to respond to emerging needs.
- Create an Emerging Innovations Investments Reserve to fund projects with a tangible return on investment or projects that reduce ongoing expenditures while maintaining service levels.

Section 7 (Long-term Financial Planning) outlines tools and standards for conducting and incorporating long-term financial planning into organizational and public policy decision-making.

The final three sections provide standards for accounting practices, investing public funds, and guidelines to issue and repay debt.

Taken together, the draft Financial Management Policies empower staff to manage the City’s fiscal health and helps guide City Council policy decisions now and in the future. Financial Management Policies also support good bond ratings and reduce the cost of borrowing. They will provide consistency and continuity spanning multiple biennial budgets and serve as a basis for executing long-term financial strategies to strengthen the City’s financial position.

Policy Discussion

Staff seeks feedback from the City Council regarding the draft Financial Management Policies in its entirety with specific emphasis on section “6.2 Replenishment Guidance” of the Reserves and Fund Balance section. This subsection outlines when funding targets for the City’s Reserves are reached, how remaining funds can be strategically used, and places these uses in an order of priority (items 6.2.9 – 6.2.14). Staff seeks the City Council’s feedback on the different uses and whether an order of priority is desired.

NEXT STEPS

Staff will receive recommendations from the City Council and incorporate them into a revised draft for consideration at the September 21, 2021, City Council meeting. If the recommended changes are significant, additional review time may be needed. The goal is to adopt the new Financial Management Policies ahead of the mid-biennial budget discussion scheduled to commence at the end of October.

RECOMMENDED ACTION

Receive and provide feedback on the draft Financial Management Policies.