

South Bay Cities Council of Governments

May 11, 2015

To: Steering Committee

From: Suzanne Charles, Administrative Officer

Subject: Proposed Reserve and Cash Flow Policy

Adherence to Strategic Plan:

Goal D: Organizational Stability. Be a high performing organization with a clear path to long-term financial health, staffing continuity and sustained board commitment.

One of the recommendations of the Ad Hoc Finance Committee was for the SBCCOG to update its Reserve Policy and consider a Cash Flow Policy. In consultation with the SBCCOG's new Treasurer, Patsy Chavez from Lomita, the following analysis and recommendations were prepared.

BACKGROUND

An operating reserve is an unrestricted fund balance set aside to stabilize an organization's finances by providing a cushion against unexpected events, losses of income, and large unbudgeted expenses. The most common trigger for use of operating reserves is on the income side, such as when a previously reliable source is reduced or withdrawn. Since operating reserves are most valuable if they are reliable, an important factor in using reserves is also having a realistic plan to replenish them. Operating reserves should not be used to cover a long-term or permanent income shortfall. Reserves can allow an organization to weather serious bumps in the road by buying time to implement new strategies. To be prudent, reserves should be used to solve temporary problems, not structural financial problems. In the worst-case scenario, reserves can be used for an orderly shut down of the organization.

Cash Flow - Operating reserves may be a part of the organization's unrestricted cash or working capital. Every government organization needs to have sufficient cash flow coming in from various income sources and going out to pay expenses and other obligations when they are due. Some organizations create reserves by setting aside cash in addition to the regular bank fund balances for use when regular cash flow is disrupted. In addition a line of credit may be established to be used for cash flow purposes although at this time a line of credit is not recommended by SBCCOG's Treasurer and SBCCOG's Administrative Officer

In the past the reserve policy for the South Bay Cities Council of Governments was 25% of operating budget expenses and 5% of all contractor expenses as well as employee salaries on grants. At this time it is recommended that the reserve policy be amended to more fully encompass the organization's needs for reserves to cover all expenses including the contract expenses as well as cash flow disruptions.

A commonly used reserve goal is three to six months' expenses. At the high end, reserves should not exceed the amount of two years' budget.

PROPOSED POLICY

The purpose of the Operating Reserve Policy for South Bay Cities Council of Governments is to ensure the stability of the mission, programs, employment, and ongoing operations of the organization. The Operating Reserve is intended to provide an internal source of funds for situations such as a sudden increase in expenses, one-time unbudgeted expenses, unanticipated loss in funding, or uninsured losses. The Reserve may also be used for one-time, nonrecurring expenses that will build long-term capacity, such as staff development, research and development (new contracts), or investment in infrastructure.

Operating Reserves are not intended to replace a permanent loss of funds or eliminate an ongoing budget gap. It is the intention of South Bay Cities Council of Governments for Operating Reserves to be used and replenished within a reasonably short period of time.

The Operating Reserve Policy will be implemented in concert with the other governance and financial policies of South Bay Cities Council of Governments and is intended to support the goals and strategies contained in these related policies and in the SBCCOG strategic plan.

DEFINITIONS AND GOALS

The Operating Reserve Fund is defined as a designated fund set-aside by action of the Board of Directors. The minimum amount to be designated, as Operating Reserve will be established in an amount sufficient to maintain ongoing operations and programs for a set period of time, measured in months. The Operating Reserve serves a dynamic role and will be reviewed and adjusted in response to internal and external changes. The target minimum Operating Reserve Fund is equal to three months of average operating costs (25%). The calculation of average monthly operating costs includes all recurring, predictable expenses such as salaries and benefits, occupancy, office, travel, program, and ongoing professional services. Depreciation, in-kind, and other non-cash expenses are not included in the calculation. The calculation of average monthly expenses also excludes some expenses including the pass through expenses of the Measure R program; one-time expenses or unusual, capital purchases.

The amount of the Operating Reserve Fund target minimum will be calculated each year after approval of the annual budget, reported to the Finance Committee/Board of Directors, and included in the regular financial reports.

ACCOUNTING FOR RESERVES

The Operating Reserve Fund will be recorded in the financial records as Board-Designated Operating Reserve.

The Reserve Fund will be available in cash or cash equivalent funds. 10% of Operating Reserves will be maintained in a segregated bank account or investment

Fund (LAIF) in accordance with investment policies and 90% will be commingled with the general cash accounts of the organization and may be used for cash flow interruptions.

FUNDING OF RESERVES

The Operating Reserve Fund will be funded with surplus unrestricted operating funds. The Board of Directors may from time to time direct that a specific source of revenue be set-aside for Operating Reserves. Examples may include one-time gifts or bequests, special grants, or special appeals.

USE OF RESERVES

Use of the Operating Reserves requires three steps:

1) IDENTIFICATION OF APPROPRIATE USE OF RESERVE FUNDS

The Executive Director, Treasurer and staff will identify the need for access to reserve funds and confirm that the use is consistent with the purpose of the reserves as described in this Policy. This step requires analysis of the reason for the shortfall, the availability of any other sources of funds before using reserves, and evaluation of the time period in which the funds will be required and replenished.

2) AUTHORITY TO USE OPERATING RESERVES

Authority for use of Operating Reserves is delegated to the Executive Director in consultation with the Treasurer. The use of Operating Reserves will be reported to the Steering Committee/Board of Directors at their next scheduled meeting, accompanied by a description of the analysis and determination of the use of funds and plans for replenishment to restore the Operating Reserve Fund to the target minimum amount. The Executive Director must receive prior approval from the Steering Committee/Board of Directors if the Operating Reserves will take longer than 12 months to replenish.

3) REPORTING AND MONITORING

The Executive Director is responsible for ensuring that the Operating Reserve Fund is maintained and used only as described in this Policy. Upon approval for the use of Operating Reserve funds, the Executive Director will maintain records of the use of the funds and plan for replenishment. He/she will provide regular reports to the Steering Committee/Board of Directors of progress to restore the Fund to the target minimum amount.

REVIEW OF POLICY

This Policy will be reviewed every other year, at minimum, by the Steering Committee or the Finance Committee if there is one, or sooner if warranted by internal or external events or changes. The Steering Committee will present recommended changes to the Policy to the Board of Directors.

RECOMMENDATION

Recommend that the Board of Directors approve this new Cash Flow and Reserve Policy