

### **OMF 4.03.01 Internal Services Fund Reserves Procedures**

#### **Purpose**

These procedures provide the framework to manage the Office of Management and Finance (OMF) Internal Service Funds reserves.

#### **Definitions**

Internal Service Funds: These funds provide services on a 100 percent cost recovery basis to other City bureaus and outside agencies and include:

- Facilities Services
- CityFleet
- Technology Services (BTS)
- Enterprise Business Solution (EBS)
- Printing and Distribution Services (P&D)
- Insurance and Claims
- Workers' Compensation

Reserves: Money held outside of the regular annual operating and capital budgets for these purposes:

- To limit financial risk such as unanticipated expenses or revenue shortfalls
- To provide funding for major maintenance projects
- For the specific use of either equipment replacement or major maintenance
- For self-insurance program requirements
- For specific one-time projects

#### **Types of Reserves**

The internal services funds have seven categories of reserves:

- Operating Reserves
- Major Maintenance Reserves
- Insurance Actuarial Reserves
- Insurance Rate Stabilization Reserves
- Equipment Replacement
- Major Maintenance Accounts
- Dedicated Project Monies

#### **Operating Reserves**

Operating Reserves are needed to allow the OMF funds to limit their financial risks. The funds face risk in several areas. First, the funds may incur higher than planned operational costs that are funded by fixed rates, such as unanticipated increases in electricity costs. Second, the funds are dependent on the service levels requested by City bureaus and outside agencies for their revenues. There is always the possibility that bureaus could cut back on services, turn in equipment, or vacate space. Third, the funds have high levels of fixed costs.

Each fund maintains an Operating Reserve. Operating Reserves can be used for the following purposes:

- To fund one-time, emergency, or unanticipated expenditure requirements.
- To maintain current service levels in the event of unanticipated revenue reductions within a fiscal year.

Operating Reserves are set at a minimum of five percent of one year's fixed cost operating budget. The fixed cost operating budget is the sum of all budgeted fund costs, including General Fund Overhead, less one-time costs for capital projects and pass-through costs for bureaus.

The Operating Reserve in each fund can be used only after it is determined that the operating budget cannot support the expenditure and the bureau director and Chief Administrative Officer have approved the use. Additional criteria for the use of Operating Reserves includes that the use must be for a one-time project or event, and the one-time project or event was unknown at the time the budget was developed.

### **Major Maintenance Reserves**

The OMF funds of P&D, EBS, Technology Services, Facilities, and CityFleet have Major Maintenance Reserves.

The Major Maintenance Reserves are used for the following purposes:

- To fund one-time and unanticipated expenditure requirements that cannot be covered by the major maintenance budget.
- To maintain major maintenance project funding levels in the event of unanticipated revenue reductions within a fiscal year.
- To fund investment opportunities that will allow the City to take advantage of emerging technologies or other business opportunities that will increase service levels and/or reduce costs. The fund's first priority for funding emerging technologies or business opportunities is to use the portion of the fund balance not dedicated. However, the Major Maintenance Reserve can be used to fund these types of projects when it is a good business decision and the reduction in the level of the Major Maintenance Reserve will not impact the ability to fund planned projects. The division manager and OMF Business Operations will approve these uses of the Major Maintenance Reserve by evaluating the requests in the context of other needs requiring major maintenance funding.

In P&D the Major Maintenance Reserve is used to replace production equipment that has become obsolete, or has high maintenance costs. For the Major Maintenance Reserve, the target standard is ten percent of replacement value for the equipment the fund owns.

In Technology Services, the Major Maintenance Reserve serves to backstop the replacement and major maintenance accounts and provides funding for one-time projects that are required for programs that have no capital component in their rates, or where the capital component is

insufficient. This reserve is funded by the under spending of the expense budget or higher than planned revenues.

In Facilities, EBS, and CityFleet Major Maintenance Reserves serve to backstop the major maintenance accounts.

### **Insurance Actuarial Reserves**

The Insurance and Claims and Workers' Compensation funds include insurance programs, and as a result they maintain Insurance Actuarial Reserves. The amounts of these Insurance Actuarial Reserves are determined by actuarial studies. The actuarial studies analyze each fund's liabilities based on outstanding claims, exposure due to the number of City employees they cover, the type of work the employees do, and trends in the industries in order to establish levels of reserves for established confidence levels.

### **Insurance Rate Stabilization Reserves**

The Insurance Rate Stabilization Reserves in the Insurance and Claims and Workers' Compensation funds are the amounts of monies in the funds in excess of the Insurance Actuarial Reserve requirements. The drawdown of these Rate Stabilization Reserves over five years is a part of each fund's rate setting process. This five-year smoothing of interagency rates is designed to mitigate large fluctuations in rates from year to year. There is no trigger for the reserves use. The Rate Stabilization Reserve is factored into each year's update to the fund's five year plan for rates.

### **Equipment Replacement Accounts**

Most OMF funds that provide assigned units to bureaus include in their rates either a replacement component or a major maintenance component. Equipment rates include a component to replace the equipment at the end of its useful life. The rates take into account salvage value of the existing equipment, expected lives, replacement costs, and interest earnings. The money accumulates in accounts reflected within fund balance. These accounts are not General Ledger accounts within SAP and are monitored outside of SAP by OMF Business Operations. OMF Policy 4.05 Replacement of Internal Services Funds' Assets describes the replacement programs of OMF's internal service funds.

CityFleet maintains vehicle replacement accounts. Within this account each customer has their own sub-account for vehicle replacements.

P&D maintains a copier replacement account for the replacement of copiers assigned to bureaus.

Technology Services has two categories of equipment replacement accounts, Radio System Equipment and PC Replacement:

- Radio system equipment, video equipment, and/or miscellaneous electronic equipment replacement accounts. Within this account, sub-accounts are maintained at a customer/equipment class level. BTS no longer annually collects Radio System

## OMF PROCEDURES: Finance

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Equipment replacement funding, but holds money from prior years. The fund expects this to be reinstated sometime in the future.

- Bureau PC replacement accounts. Bureaus pay an annual amount to Technology Services for ongoing PC and laptop replacement. Technology Services maintains this money in separate bureau accounts until PCs are scheduled to be replaced. Currently PCs and laptops are replaced on a five year cycle.

### **Major Maintenance Accounts**

For buildings and infrastructure, it is impractical to fund replacement in rates, and, since there is a need to keep the assets for the long-term, a major maintenance component is included in the rates for these assets. By including a major maintenance component in the rates, the funds are able to maintain a stable funding source for these important projects. It is assumed that by completing these major maintenance projects each year, or saving up to do large-scale projects in the future, the City will be able to use the facilities or infrastructure, at a minimum, for their expected lives.

The funds that have major maintenance accounts are Facilities, EBS, and Technology Services.

Each fund that includes a major maintenance component in its rates shall have a separate account to sequester the money in fund balance to account for the collection of revenue over a relatively long period of time to fund large-scale projects.

Major maintenance accounts in fund balance will be segregated according to which tenants or group of users were the source of the revenue. For example, in Facilities, major maintenance money from Police facilities goes only to Police facilities and major maintenance money from the Portland Building goes only to the Portland Building. However, within the Police account, money from one facility can be used for another facility.

Technology Services' major maintenance account is dedicated to funding GIS, Production System, 800 MHz system and IRNE maintenance, upgrade, and improvement projects. The accounts are not segregated by customers but are held as system accounts. Accounts are funded by rates in the respective areas.

EBS maintains a major maintenance account for saving money for future enhancements and updates to the City's enterprise business solution to keep it current, functional, and continue to meet the evolving business needs of City bureaus.

### **Major Maintenance Projects**

Major maintenance projects fall into three categories and are those projects costing more than \$10,000 each. Work costing less than \$10,000 should be covered under the fund's Operating Budget.

1. Basic maintenance projects:

## OMF PROCEDURES: Finance

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- Facilities examples include carpet replacement and painting in common areas due to normal use of the building, exterior painting, elevator lobby renovations, exterior sealing and waterproofing projects, restroom renovations, etc.
  - Technology Services examples include radio tower painting and generator building roof replacements.
2. Replacement of building or system components:
- Facilities examples include HVAC systems, roofs, plumbing, lighting, etc.
  - Technology Services examples include replacement of IRNE components and 800 MHz system software upgrades, etc.
3. Renewal/upgrade of building or system features to meet functional needs:
- Facilities examples include upgrading electrical capacity to accommodate increased tenants requirements.
  - Technology Services examples include upgrading feature components of the IRNE and 800 MHz systems to meet customers expanding needs.
  - EBS examples include large system upgrades.

Major maintenance does not include tenant improvements, such as painting and carpeting tenant space, constructing conference rooms, computer rooms and reception areas, and other tenant-specific features or technologies unique to a customer or an expansion of the systems to service new users or facilities/areas. Major maintenance is not available for use on customer's equipment or building space. This work would be billed to the customer per the applicable rate schedule.

### *Major Maintenance Budget Process*

The Bureau Director or Division Manager, working collaboratively with OMF Business Operations, recommends which projects to include in the OMF five-year plan prepared annually for those facilities or other capital assets owned by the fund. These decisions will be based on customers' business needs, asset maintenance needs, and the availability of resources.

City Council approves the uses of major maintenance resources and holds the authority to determine the actual methods used for major maintenance money received from net income from rates or savings from capital improvement projects (CIPs). Fund managers are responsible for making recommendations to City Council regarding the use of major maintenance resources.

A model of each program's major maintenance account will be prepared for the five-year plan process and updated periodically throughout the fiscal year to determine the level of resources available for projects. The model forecasts major maintenance collections in the rates that will go into the account. The model will assume the account is not increased or decreased by net income or loss on rates.

Projects proposed during the budget process, or that come up during the fiscal year, will be inserted into the model. Projects may be moved between fiscal years in order to keep the account positive in each year of the five years.

The model can also be used for analyzing additions, deletions, changes, and substitutions of projects.

### *Major Maintenance Rates*

There is a component for major maintenance in rental charges to tenants of all facilities owned by Facilities Services. The policy goal is to set aside three percent of a building's replacement value each year for major maintenance projects.

A major maintenance component is also included in Technology Services' rates for:

- 800 MHz radio system
- IRNE system
- Production Services systems

The policy goal is to set aside monies annually to fully fund each asset's life cycle costs.

### Increasing Major Maintenance Funding

The funds may use the following four methods to contribute to major maintenance funding:

1. Any additional capacity in the rate budget after it is increased for inflation is dedicated to major maintenance.
2. Allocate any net income earned on rates to major maintenance funding.
3. Request funding from the City's General Fund Capital Set-Aside. This funding is limited to major maintenance that primarily benefits General Fund bureaus.
4. Request funding through rate increases in a decision package in the budget process.

### **Dedicated Project Monies**

Under certain conditions OMF funds may receive money from customers for specific one-time projects in one fiscal year and hold it until the project can be done in a later fiscal year. The CAO, City Budget Office and City Council review and approve such transactions in one of the seasonal BMP reports. Additionally, the funds occasionally sell debt to finance projects. Debt proceeds are a component of fund balance until spent on the capital project.

### **Managing reserves**

#### Loans of fund balances

Funds may provide internal financing to customers or itself when the fund has adequate reserves. For these loans, an interest rate equal to what the money is projected to earn at City Treasury is used. An amortization period of not more than ten years would be required.

#### Replenishing reserves

If a fund's reserves are lower than the target levels, the fund will use income from higher-than-budgeted collections or lower-than-budgeted expenditures to come up to the required reserve. Rates can be set at levels higher than actual costs call for in order to replenish reserves, as long as overall costs to customers stay within the level of inflation.

Additionally a fund's manager has the option of going to Council and – through a decision package – requesting a rate increase over the level of targeted inflation to replenish reserves.

In the case of the insurance funds, the funds will charge what is necessary to keep the funds actuarially sound over the five-year financial projection period at established confidence levels.

*Return of operating reserves to customers*

Any return of operating reserves to customers will be done in one of two ways:

- Rates can be reduced gradually over a period of years to avoid a rate increase when the money is exhausted.
- Rebates can be given back to customers. These rebates would be back to the funds of the customers of the internal service provider. The rebates would be allocated to each customer funds based on their pro rata share of the most recent fiscal year's Adopted Budget interagency agreements.