



JUDICIAL COUNCIL OF CALIFORNIA

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REPORT TO THE JUDICIAL COUNCIL

Item No.: 20-045

For business meeting on: July 24, 2020

Title

Trial Court Budget: Minimum Operating and
Emergency Fund Balance Policy

Agenda Item Type

Action Required

Effective Date

July 1, 2020

Rules, Forms, Standards, or Statutes Affected

None

Date of Report

July 2, 2020

Recommended by

Trial Court Budget Advisory Committee
Hon. Jonathan B. Conklin, Chair

Contact

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Executive Summary

The Judicial Council's suspension of the minimum operating and emergency fund balance policy expires as of June 30, 2020. The minimum operating and emergency fund balance policy, established by the Judicial Council in October 2006, requires trial courts to set aside a percentage of funds for use in emergency situations or when revenue shortages or budgetary imbalances may exist. This policy has been suspended by the Judicial Council since August 31, 2012, due to changes in statute and to provide for the opportunity to seek further statutory amendments. The Trial Court Budget Advisory Committee recommends that the Judicial Council approve an extension to the suspension of the minimum operating and emergency fund balance policy.

Recommendation

The Trial Court Budget Advisory Committee (TCBAC) unanimously recommends that, effective July 1, 2020, the Judicial Council extend the suspension of the minimum operating and emergency fund balance policy for two fiscal years until June 30, 2022—or earlier if Government Code section 77203 is amended.

Relevant Previous Council Action

On August 31, 2012, the council suspended the minimum operating and emergency fund balance policy through June 30, 2014, which required courts to maintain a fund balance or reserve that was approximately 3 to 5 percent of their prior year general fund expenditures (Link A).

The council's action was taken in the context of two statutory changes. First, Government Code section 68502.5 required, starting in 2012–13, the establishment of the 2 percent reserve in the Trial Court Trust Fund (TCTF). Each court contributed towards the reserve from its base allocation for operations. Second, Government Code section 77203 imposed, effective June 30, 2014, a 1 percent cap on fund balance that courts can carry forward from one fiscal year to the next. In recognition of the efforts to either eliminate or increase the 1 percent cap, the council suspended, instead of eliminated, the minimum operating and fund balance policy.

On October 28, 2014, the council extended the suspension on the minimum operating and emergency fund balance policy for two more fiscal years until June 30, 2016 (Link B). The council requested that the minimum operating and emergency fund balance policy be in addition to the 1 percent reserve cap while in the interim it would seek the repeal of Government Code section 77203.

At its April 15, 2016 business meeting, the Judicial Council adopted a process, criteria, and application form for courts to request funds be retained in the TCTF as restricted fund balance for the benefit of those courts (Link C). The process is intended only for expenditures that cannot be funded by a court's annual budget or three-year encumbrance term, and that require multiyear savings to implement. These requests are reviewed by the Fiscal Planning Subcommittee of the TCBAC with recommendations made to the Judicial Council.

Effective July 1, 2016, the 2 percent reserve requirement in the TCTF which each court contributed from its base allocation for operations was replaced with a new reserve policy for trial courts by providing \$10 million General Fund one-time as a reserve in the TCTF. In response to requirements set out in Government Code section 68502.5(c)(2)(B), the Judicial Branch Budget Committee recommended, and the Judicial Council approved, the \$10 Million State-Level Reserve Process for requesting emergency funding on October 28, 2016 (Link D). Funds used from the reserve are replenished annually out of base allocations to all trial courts. The 1 percent fund balances that courts can carry forward from one fiscal year to the next are still in place.

On January 19, 2017, the council extended the suspension on the minimum operating and emergency fund balance policy again for two more fiscal years until June 30, 2018—or earlier if Government Code section 77203 was repealed or amended—while in the interim the council would continue to seek repeal of Government Code section 77203 (Link E).

Finally, on May 24, 2018, the council again approved an extension on the suspension of the minimum operating and emergency fund balance policy for two more fiscal years until June 30, 2020—or earlier if Government Code section 77203 was repealed or amended—while in the

interim the council would continue to seek repeal of Government Code section 77203 (Link F). The most recent Fund Balance Policy is included as Attachment A.

Analysis/Rationale

Recent efforts by the Judicial Council and the trial courts to amend Government Code section 77203 and increase the amount of the 1 percent cap have been supported by the Department of Finance and the Legislature. Commencing June 30, 2014, and concluding June 30, 2019, a trial court could carry over unexpended funds in an amount not to exceed 1 percent of the court's operating budget from the prior fiscal year. In 2019, Government Code section 77203 was amended so that a trial court may carry over unexpended funds in an amount not to exceed 3 percent of the court's operating budget from the prior fiscal year commencing June 30, 2020 (Attachment B).

At its June 11, 2020 meeting, the TCBAC reviewed a recommendation brought forward by Judicial Council Budget Services staff to extend the suspension of the minimum operating and emergency fund balance policy while advocacy efforts for further changes to Government Code section 77203 remain a discussion item with the administration.

Policy implications

None.

Comments

This item was not circulated for comment. Public comment was not received for this item.

Alternatives considered

None.

Fiscal and Operational Impacts

None.

Attachments and Links

1. Attachment A: Fund Balance Policy
2. Attachment B: Government Code section 77203
3. Link A: Judicial Council Meeting Minutes, August 30–31, 2012, including Item N: *Trial Court Trust Fund Allocations: Statewide Programs*, <http://www.courts.ca.gov/documents/jc-20120831-minutes.pdf>
4. Link B: Judicial Council Meeting Minutes, October 27–28, 2014, including Item M: *Trial Court Budget: 2 Percent State-Level Reserve Process and Minimum Operating and Emergency Fund Balance Policy*, <http://www.courts.ca.gov/documents/jc-20141028-minutes.pdf>
5. Link C: Judicial Council Meeting Minutes, April 15, 2016, including Item 16-055: *Trial Court Allocations: Trial Court Reserves Held in the Trial Court Trust Fund*,

<https://jcc.legistar.com/View.ashx?M=A&ID=463457&GUID=194A3350-D97F-452B-ACF4-1EBE6C105CCA>

6. Link D: Judicial Council Meeting Minutes, October 28, 2016, including Item 16-195: *Trial Court Budget: \$10 Million State-Level Reserve Process*,
<https://jcc.legistar.com/View.ashx?M=M&ID=463482&GUID=71780E2D-3758-4213-B3A5-7100073AB7CF>
7. Link E: Judicial Council Meeting Minutes, January 19, 2017, including Item 17-002: *Trial Court Budget: Minimum Operating and Emergency Fund Balance Policy*,
<https://jcc.legistar.com/View.ashx?M=M&ID=523723&GUID=AAC05972-68BD-4B48-B46C-240B851E3CEF>
8. Link F: Judicial Council Meeting Minutes, May 24, 2018, including Item 18-095: *Trial Court Budget: Minimum Operating and Emergency Fund Balance Policy*,
<https://jcc.legistar.com/View.ashx?M=M&ID=559783&GUID=1C4B0F75-3F17-4F8A-9712-034640BB460C>

FUND BALANCE POLICY

BACKGROUND

In the Supplemental Report of the 2006 Budget Act, the Legislature specified that the Judicial Council report on court reserves and provide its policy governing trial court reserves. On October 20, 2006 and revised on April 23, 2009, the Judicial Council approved a fund balance policy for trial courts. Financial accounting and reporting standards and guidelines have been established by the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB). The Trial Court Financial Policy and Procedures Manual, in compliance with these standards and guidelines, specifies that the trial courts are responsible for the employment of “sound business, financial and accounting practices” to conduct their operations.

In addition, Government Code section 77203 specifies that the Judicial Council has the authority to authorize trial courts to carry over unexpended funds from one year to the next. Consistent with this provision, this policy provides courts with specific directions for identifying fund balance resources necessary to address statutory and contractual obligations on an accurate and consistent basis as well as maintaining a minimum level of operating and emergency funds. In addition, this policy provides the necessary structure to ensure funds are available to maintain service levels for various situations that confront the trial courts including a late state budget.

GASB Statement 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, is effective for financial statements for periods beginning after June 15, 2010, and will impact year-end closing statements for the fiscal year 2010–2011.

PURPOSE

Governmental agencies/entities report the difference between their assets and obligations as fund balance. Under GASB Statement 54, fund balances for governmental funds must be reported in classifications that comprise a hierarchy. The statement distinguishes between nonspendable and other amounts that are classified based on the relative strength of the constraints that control the purposes for which specific amounts can be spent. Under GASB 54, the number of classifications has been expanded from 2 to 5.

The purpose of this policy is to establish uniform standards, consistent with GASB 54, for the reporting of fund balance by trial courts and to maintain accountability over the public resources used to finance trial court operations.

POLICY

As publicly funded entities, and in accordance with good public policy, trial courts must ensure that the funds allocated and received from the state and other sources are used efficiently and accounted for properly and consistently. The trial courts shall account for and report fund balance in accordance with established standards, utilizing approved classifications. Additionally, a fund balance can never be negative.

Fund Balance Classifications

Beginning with the most binding constraints, fund balance amounts must be reported in the following classifications:

- Nonspendable Fund Balance
- Restricted Fund Balance
- Committed Fund Balance
- Assigned Fund Balance
- Unassigned Fund Balance (General Fund only)

When allocating fund balance to the classifications and categories, allocations must follow the following prioritization:

1. Nonspendable Fund Balance
2. Restricted Fund Balance
3. Contractual commitments to be paid in the next fiscal year
4. The minimum calculated operating and emergency fund balance
5. Other Judicial Council mandates to be paid in the next fiscal year
6. Contractual commitments to be paid in subsequent fiscal years
7. Assigned Fund Balance designations
8. Unassigned Fund Balance

If there is insufficient fund balance to cover any or all of the first five priorities, the shortfall should be explained in detail in attached footnotes. Also, there are additional reporting requirements when the amount allocated to the operating and emergency category is below the minimum required.

Nonspendable Fund Balance

Nonspendable Fund Balance includes amounts that cannot be spent because they are either (a) not in spendable form (not expected to be converted to cash) or (b) legally or contractually required to be maintained intact. Examples include:

- Inventories
- Prepaid amounts Long-Term Loans and Notes Receivable
- Principal of a permanent (e.g., endowment) fund

This represents the 'newest' classification in comparison to the descriptions used before the creation of GASB 54. To some extent, the remaining 4 classifications are somewhat mirrored in the prior definitions.

Restricted Fund Balance

Restricted Fund Balance includes amounts constrained for a specific purpose by external parties, constitutional provision or enabling legislation.

- Externally imposed
Imposed externally by grantors, creditors, contributors, or laws or regulations of other governments (i.e., monies received by a grantor that can only be used for that purpose defined by the grant).
- Imposed by Law (Statutory)
A restricted fund balance that consists of unspent, receipted revenues whose use is statutorily restricted (e.g., children’s waiting room and dispute resolution program funding).

Committed Fund Balance

Committed Fund Balance includes amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the Judicial Council. These committed amounts cannot be used for any other purpose unless the Judicial Council removes or changes the specified use by taking the same type of action it employed to previously commit those amounts.

Committed Fund Balance must also include contractual obligations to the extent that existing resources in the fund have been specifically committed for use in satisfying those contractual requirements. While the requirement to include contractual commitments is a policy decision of the Judicial Council, the type, number and execution of contracts is within the express authority of presiding judges or their designee.

[The following struckthrough language is suspended until June 30, 2020]

~~The Judicial Council has authorized a stabilization arrangement (Operating and Emergency fund category) to be set aside for use in emergency situations or when revenue shortages or budgetary imbalances might exist. The amount is subject to controls that dictate the circumstances under which the court would spend any of the minimum operating and emergency fund balance.~~

~~Each court must maintain a minimum operating and emergency fund balance at all times during a fiscal year as determined by the following calculation based upon the prior fiscal year’s ending total unrestricted general fund expenditures (excluding special revenue, debt service, permanent, proprietary, and fiduciary funds), less any material one time expenditures (e.g., large one time contracts):~~

~~——— Annual General Fund Expenditures
——— 5 percent of the first \$10,000,000
——— 4 percent of the next \$40,000,000
——— 3 percent of expenditures over \$50,000,000~~

~~If a court determines that it is unable to maintain the minimum operating and emergency fund balance level as identified above, the court must immediately notify the Administrative Director of the Courts, or designee, in writing and provide a plan with a specific timeframe to correct the situation.~~

Assigned Fund Balance

This is a fund balance that is constrained by the Presiding Judge, or designee, with the intent that it be used for specific purposes or designations that are neither unspendable, restricted nor committed.

Constraints imposed on the use of assigned amounts are more easily removed or modified than those imposed on amounts that are classified as committed. Assigned amounts are based on estimates and explanations of the methodology used to compute or determine the designated amount must be provided.

Assigned fund balances include:

- All remaining amounts that are reported in governmental funds, other than general fund, that are not classified as nonspendable and are neither restricted nor committed and
- Amounts in the general fund that are intended to be used for a specific purpose in accordance with the provision identified by the Presiding Judge, or designee.

Courts will identify assigned fund balances according to the following categories:

1. **One-time facility – Tenant improvements** Examples include carpet and fixture replacements.
2. **One-time facility – Other Examples** include amounts paid by the Judicial Council on behalf of the court.
3. **Statewide Administrative Infrastructure Initiatives.** Statewide assessment in support of technology initiatives (e.g., California Case Management System and Phoenix) will be identified in this designation.
4. **Local Infrastructure (Technology and non-technology needs)** Examples include interim case management systems and non-security equipment.
5. **One-time employee compensation (Leave obligation, retirement, etc.)** Amounts included in this category are exclusive of employee compensation amounts already included in the court's operating budget and not in a designated fund balance category.
 - a. One-time leave payments at separation from employment. If amounts are not already accounted for in a court's operating budget, estimated one-time payouts for vacation or annual leave to employees planning to separate from employment within the next fiscal year should be in this designated fund balance sub-category. This amount could be computed as the average amount paid out with separations or other leave payments during the last three years. Any anticipated non-normal or unusually high payout for an individual or individuals should be added to at the average amount calculated.

In a footnote, the court should note the amount of its employees' currently earned leave balance that is more than the established designated fund balance. The amount would be determined by multiplying the hours of earned vacation or annual leave on the payroll records for each employee times his or her current salary rate minus the designated fund balance established.

- b. Unfunded pension obligation. If documented by an actuarial report, the amount of unfunded pension obligation should be included as a designated fund balance. Employer retirement plan contributions for the current fiscal year must be accounted for in the court's operating budget.

In a footnote, the court should note the amount of the current unfunded pension obligation that is in excess of the established designated fund balance.

- c. Unfunded retiree health care obligation. If documented by an actuarial report, the amount of unfunded retiree health care obligation should be included as a designated fund balance.

The current year's unfunded retiree health care obligation contains: (i) the current year Annual Required Contribution (ARC) based on a 30-year amortization of retiree health costs as of last fiscal year-end **and** (ii) the prior year retiree health care obligation **less** (iii) the retiree health care employer contributions and any transfers made to an irrevocable trust set up for this purpose. The current year's unfunded retiree health care obligation is to be added to the prior year's obligation.

Note: The ARC amounts are located in each court's actuarial report, which is entitled "Postretirement Benefit Valuation Report".

In a footnote, the court should note the amount of the cumulative unfunded retiree health care obligation that is in excess of the established designated fund balance.

- d. Workers compensation (if managed locally). The amount estimated to be paid out in the next fiscal year.
 - e. Use of reserve funds for liquidation of outstanding leave balances for employees in a layoff situation, consistent with the requirements of GASB 45; other examples would include reserving funds for the implementation of "enhanced retirement" or "golden handshake" programs in the interest of eliminating salaries at the "high end" or "top step", and thereby generating salary savings or rehires at the low end of a pay scale for position(s), but realizing one-time costs in the interest of longer term savings for the court.
- 6. **Professional and consultant services.** Examples include human resources, information technology, and other consultants.
 - 7. **Security.** Examples include security equipment,-and pending increases for security service contracts.
 - 8. **Bridge Funding.** A court may choose to identify specific short or intermediate term funding amounts needed to address future needs that are otherwise not reportable, nor fit the criteria, in either restricted nor committed classifications, that it believes are necessary to

identify through specific designations. These designations must be listed with a description in sufficient detail to determine their purpose and requirements.

9. **Miscellaneous (required to provide detail).** Any other planned commitments that are not appropriately included in one of the above designated fund balance sub-categories should be listed here with a description in sufficient detail to determine its purpose and requirements.

Unassigned Fund Balance – for General Fund Use Only

Unassigned Fund Balance is the residual classification for the general fund. This classification represents fund balance that has not been assigned to other fund balance and that has not been restricted, committed, or assigned to specific purposes within the general fund.

The general fund is the only fund that shall report a positive unassigned fund balance amount.

Government Code section 77203, effective June 27, 2019

(a) Prior to June 30, 2014, a trial court may carry over all unexpended funds from the courts operating budget from the prior fiscal year.

(b) Commencing June 30, 2014, and concluding June 30, 2019, a trial court may carry over unexpended funds in an amount not to exceed 1 percent of the court's operating budget from the prior fiscal year. Commencing June 30, 2020, a trial court may carry over unexpended funds in an amount not to exceed 3 percent of the court's operating budget from the prior fiscal year. The calculation of the percentage authorized to be carried over from the previous fiscal year shall not include funds received by the court pursuant to the following:

(1) Section 470.5 of the Business and Professions Code.

(2) Section 116.230 of the Code of Civil Procedure, except for those funds transmitted to the Controller for deposit in the Trial Court Trust Fund pursuant to subdivision (h) of that section.

(3) Subdivision (f) of Section 13963, Sections 26731, 66006, 68090.8, 70640, 70678, and 76223, subdivision (b) of Section 77207.5, and subdivision (h) of Section 77209.

(4) The portion of filing fees collected for conversion to micrographics pursuant to former Section 26863, as that section read immediately before its repeal, and Section 27361.4.

(5) Sections 1027 and 1463.007, subdivision (a) of Section 1463.22, and Sections 4750 and 6005, of the Penal Code.

(6) Sections 11205.2 and 40508.6 of the Vehicle Code.