2.4 Financial Planning and Budgeting
Monitoring period: FY2023 Budget

Finance Committee Meeting Date: September 13, 2022

Board Meeting Date: September 28, 2022

INFORMATION TYPE
Decision
RECOMMENDED ACTION(S):
The Finance Committee recommends that the board accept the Monitoring report as A, Compliant.
BACKGROUND
Monitoring Reports are a key Policy Governance tool to assess organizational/CEO performance in achieving Ends (1.0) within Executive Limitations (2.0).
ISSUE SUMMARY:
This policy was scheduled for submission in September and submitted to the Finance Committee for review and consideration on August 30, in preparation for the September Finance Committee meeting. TheRide's Board of Directors establish policies that define what methods are unacceptable to use to achieve expected results, called Executive Limitations. This monitoring report provides the CEO's interpretations of those policies, evidence of achievement, and an assertion on compliance with the Board's written goals. As with other monitoring reports, the Board decides whether the interpretations are reasonable, and the evidence is convincing. I certify that the information is true and complete, and I request that the Board accept this as indicating an acceptable level of compliance. CEO's Signature   Date   September 6, 2022
ATTACHMENTS:
1. Monitoring report for Policy 2.4 Financial Planning/Budgeting 2. Operating & Capital Budget for FY2023 Version 1.0, Draft Budget FY2023 3. Presentation of FY2023 Operating and Capital Draft Budget, as presented on August 18, 2022

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Fully Compliant Partially Compliant Non-Compliant

Preliminary CEO Interpretations and Evidence

2.4 FINANCIAL PLANNING AND BUDGETING **Financial planning for any fiscal year or the remaining part of any fiscal year shall not deviate from Board's Ends priorities, risk fiscal jeopardy, or fail to be derived from a strategic multi-year plan. Further, without limiting the scope of the foregoing by this enumeration, the CEO shall not cause, allow, or fail to address budgeting that:**
Degree of Compliance: Fully Compliant
Interpretation
This policy is fully interpreted in the sub-policies below.
Evidence
Evidence of compliance with sub policies below provides evidence of compliance with this policy. The evidence of compliance throughout this Monitoring Report comes from the process by which the annual budget was developed, and the resulting document – the Draft FY2023 Budget (herein also referred to as "the budget"). Additional evidence comes from corporate strategy documents and previously published Auditor reports and Quarterly Financial Reports that are publicly available on TheRide's website and have been provided to the Board. These documents are cited as evidence of compliance with sub policies in this section.

2.4.1 Risks incurring those situations or conditions described as unacceptable in the Board policy "Financial Condition and Activities."

Degree of Compliance: Fully Compliant

Interpretation

I interpret this policy to mean that I must consider budgeting elements of Policy 2.5 Financial Conditions and Activities that are not otherwise covered in policy 2.4. Additional requirements are:

- **2.5.6 Contracts in the budget** - I interpret this policy to mean that anticipated contracts greater than $250,000 must be listed in the budget to be considered approved as part of the budget. Any contract not included in this list over $250,000 will come to the board for approval.

- **2.5.9 Adjustment of fares or tax rate** - I interpret this policy to mean that staff may not change fares or tax rates without Board approval. Neither the CEO nor the Board has the power to change the tax rate (mill rate). The Board must approve any proposed change which is then voted on by residents.

- **2.5.10 Real estate** - I interpret this policy to mean that staff may not buy, sell, or borrow against real estate without Board approval.

Evidence

Source of data: FY2023 Draft Budget, presented to the Board on August 18, 2022

Date of data collection: 8/30/22 as verified by the Deputy CEO, Finance and Administration

Data:

- **2.5.6 Contracts:** a list of all anticipated contracts and their dollar value is included in Appendix 8.3, page 45, of the budget.

- **Fares and Taxes:** The budget includes a table of fares, which are provided in detail in Appendix 8.4, Table 8.4 (pp. 46-47), of the budget document. There are no recommended changes to fares for this fiscal year. The current fares as presented in the budget were approved by the Board in September 2021 and implemented in August 2022. Although not applicable to the FY2023 budget, policy compliance for changing fares would be provided in the Monitoring Report for 2.5.12 Adjust Passenger Fares.

  Primary property tax rates in Ann Arbor and Ypsilanti are unchanged in the budget. The expansion millage in Ann Arbor, Ypsilanti, and Ypsilanti Township were restored after voters approved renewal of the 0.7 mill rate in August 2018. Millage rates are automatically reduced by state law (Headlee Amendment).

- **Real Estate:** The budget does not anticipate land acquisition for FY2023. The CEO acknowledges that only the Board can make the decision to purchase real estate. Staff are prohibited by Policy 2.5.9 from buying land without Board approval.

2.4.2 Fails to place business decisions in a comprehensive, strategic context that illustrates progress towards Ends and compliance with Executive Limitations.

Degree of Compliance: Fully Compliant

Interpretation

I interpret this policy to mean that the budget should be accompanied by a multi-year corporate plan that illustrates how a single year fits into a longer-term approach to advancing the Board's policy goals, while also meeting expectations for risk management and prudent management of the agency's resources.

Together, the corporate plan and the budget must provide clear goals and priorities, illustrate how recommended efforts advance the policy goals of the Board, address all aspects of TheRide's business, and help the organization become more compliant with Board policies.

Evidence

Source of data: FY2023 Draft Budget, presented to the Board on August 18, 2022

Date of data collection: 8/30/22 as verified by the Deputy CEO, Finance and Administration

Data:

Strategic Context: The FY2023 Operating and Capital Draft Budget (the budget) is the fiscal year's financial plan that supports activities to accomplish goals and objectives as defined in Board's Ends Policies and is aligned with TheRide's Corporate Business Plan. All policies and plans support the stated policy of providing public transportation options that contribute to the Ann Arbor-Ypsilanti Area's social, environmental, and economic vitality at a cost that demonstrates value and efficient stewardship of resources. This plan illustrates strategic context for the budget by:

- Aligning priorities and resources towards the Board's written policy goals, and providing clear objectives for the budget (pp. 7-9, 12-14, 31-33, 41),
- Establishing a situational awareness of the current status of the agency (pp. 12-21), and
- Explicitly connect proposed initiatives with specific policy goals of the Board (pp. 41).

The budget is aligned with the Long-Range plan for transit services approved by the Board in July 2022. References to alignment with the Long-Range plan are provided throughout the budget and addressed specifically with a list of initiatives on page 41. Long-term financial context is provided on pages 32-33 and 35.

Comprehensiveness: The budget encompasses all elements of TheRide's business. It combines the operating budget (pp. 22-33) and capital budget (pp. 34-37) in one document. Existing services and infrastructure are funded and maintained (see "State of Good Repair" budget on p. 34, and details on pp. 35-36).
Risk is addressed in several parts of the recommended FY 2023 Budget, for example:

- Ensuring adequate reserves (p. 15),
- A focus on addressing deferred maintenance (see "Facilities Rehabilitation," p. 43),
- Strengthening against risks of uncertainty and contingencies (p. 29),
- Adjustments within various budget line times too numerous to list, and
- By placing the budget in the context of the Corporate Business Plan, and the Long-Range Plan.

Both the CEO and CFO attest that, to the best of their knowledge, there are no elements missing from the budget. This confidence comes, in part, from a collaborative effort to develop the budget where staff, the public and Board members have been consulted during budget development (pp. 10-11).

2.4.3 Omits credible projection of revenues and expenses, separation of capital and operational items, cash flow, and disclosure of planning assumptions.

Degree of Compliance: Fully Compliant

Interpretation

I interpret this policy to mean that each recommended annual budget must include realistic estimates of future costs and revenues, sufficient to contextualize the annual budget and demonstrate longer-term financial implications.

In this context, a "credible projection" is an extrapolation of future costs and revenues based historic financial evidence, identified risks, and reasonable and realistic assumptions about future circumstances (i.e., inflation, ridership trends, anticipated economic changes, etc.). In this context the forecasted cash flow is presented as annualized totals.

Furthermore, forecasts must clearly distinguish operating and capital expenses. The time horizon for operating forecasts will cover at least the next 5-year millage cycle, while capital costs are projected over a ten-year timeframe due to longer project-development and implementation cycles.

Evidence

Source of data: FY2023 Draft Budget, presented to the Board on August 18, 2022

Date of data collection: 8/30/22 as verified by the Deputy CEO, Finance and Administration

Data:

Operations: The operating budget and 7-year forecast of revenues, expenses and cash flow for operating costs are presented on page 33 of the budget. Projections are based on several factors, including historic trends (found on page 13), known business changes, estimated impacts of post-pandemic recovery, and implementation of agency initiatives. Detailed revenue and expense assumptions are described starting on page 23 of the budget. The recently approved millage provides sustainable funding through the seven-year projection period, as illustrated in Figure 3 (p. 14) of the budget.

- **Capital:** The capital budget and 10-year forecast of capital expenses are presented on p. 33 of the budget. Planning assumptions for each project are summarized in Appendix 8.2, pp. 42-44.

2.4.4 Is unclear about long-term funding needs and growth projections.

Degree of Compliance: Fully Compliant

Interpretation

I interpret this policy to mean that the budget must anticipate and clearly account for the funding required in future years to 1) provide for services, 2) maintain assets as per policy 2.8: Asset Protection, 3) mitigate against foreseeable risks, and 4) implement plans for change adopted by the agency (e.g. expansion plans, new services, etc.).

In this context I believe that "needs" will be clear when specific priority expenditures (e.g. projects, initiatives, line items, etc.) are identified in the budget, and when the scope and rationale for the expenditures is provided and is acceptable for the full Board. Clarity also requires:

- Realistic estimates of future costs,
- Adjustments for inflation and other reasonable assumptions about future economic conditions,
- Accounting for full-year costs of earlier partial-year initiatives, and
- Anticipation of operating costs that accompany new capital projects (e.g. utilities for a new building).

I interpret a "growth projection" to mean forecasts of changes in expenditures and revenues which are used to guide budget development.

I believe that “long-term” for budgeting purposes means that operational needs will be illustrated for at least a rolling five-year period, and capital for a rolling ten-year period. A longer-range forecast/plan can be adopted if helpful, for example based on a long-range service plan.

Evidence

Source of data: FY2023 Draft Budget, presented to the Board on August 18, 2022

Date of data collection: 8/30/22 as verified by the Deputy CEO, Finance and Administration

Data:

- **Operating Needs:** The budget contains the expenditures necessary to provide transportation services as described in the “budget overview” and the “operations overview” on pages 22-23. As noted, the budget includes funding for full services for fixed-route and paratransit services, beginning the first phase of the long-range service plan and describes how TheRide has addressed operating and financial risks related to labor shortages. Forecasts of operational revenues and costs for 2023-2030 are provided on page 33, preceded by historic trends on page 32.

- **Capital Needs**: As illustrated on pp. 34-36 of the budget, ten years’ worth of projected capital needs have been organized into four categories: State-of-Good-Repair, Value Added, Expansion, and Research and Development. The first two categories are well populated with projects for maintaining and improving existing services and infrastructure. The “Expansion” category is populated by projects that are aligned with expansion plans established in the Long-Range Plan.

- **Risk**: Risks and mitigations are discussed in the budget on page 29 of the budge.

- **Corporate Strategy:** The operational and capital projections in the budget are further contextualized by the pandemic implications, timelines, work plan, and service restoration discussion provided in the Long-Range Plan and Corporate Business Plan.

2.4.5 Causes deficit spending.

Degree of Compliance: Fully Compliant

Interpretation

I interpret this policy to mean that the TheRide should not risk financial jeopardy or services to existing passengers by budgeting or allowing overall spending to exceed revenue (i.e. deficit spending). For annual budgeting, this means that:

- Proposed expenses (operating and capital) in the recommended annual budget must be equal to or less than anticipated revenues,
- New expenses cannot create unfunded liabilities in future years.
- We cannot use reserves to pay for ongoing operating costs, and
- Should debt-financing be recommended as a part of an annual budget, the costs of financing a debt will be clearly articulated and will not cause operating deficits.

It is not acceptable to increase short-term spending by creating future financial burdens that are imprudent or excessively risky, or not clearly identified for the Board. Specifically, ongoing operating costs cannot be funded by debt, drawing down the reserve (unrestricted net asset), or under-funding capital or maintenance activities. While multi-year forecasts can show projected deficits in future years as part of the financial planning exercise, the CEO will not recommend an annual budget for approval that includes deficits.

Furthermore, during a fiscal year should it become apparent that total annual expenses will actually exceed total revenue, the CEO is required to adjust spending or revenue to avoid deficit spending.

Evidence

Source of data: FY2023 Draft Budget, presented to the Board on August 18, 2022

Date of data collection: 8/30/22 as verified by the Deputy CEO, Finance and Administration

Data:

The FY2023 Budget:

- Is balanced (no deficit) with total revenues meeting or exceeding total expenses (p. 28).
- Creates no unfunded liabilities in fiscal years 2023-2029. There are no anticipated unfunded liabilities such as unfunded pensions or post-employment benefits in the budget.

As illustrated on p. 31, funding sources (i.e., revenues) do not include any contribution from the reserve or debt financing. The reserve (unrestricted net asset) is expected to remain at or above the reserve level target sufficient to support a minimum of 2.5 months of operations (p. 39).

AAATA carries no debt. This is validated by the 2021 audit conducted by UHY LLC (see Board Packet for March 17, 2022), demonstrated on the balance sheets of the Quarterly Financial Reports, and most recently as Board Agenda Item 3.5, Q3 Financial Report, presented to the Board on August 18, 2022. These documents are available on TheRide's website.

2.4.6 Does not provide for adequate reserves.

Degree of Compliance: Fully Compliant

Interpretation

I interpret this policy to mean that TheRide must have enough liquid financial resources available to prevent interruption to regular operations in the event of a temporary disruption to funding sources. For example, we need to have enough money to make payroll should funding from the State of Michigan or federal government be delayed (as has occurred in the past). Processing errors and federal government shutdowns have caused such delays in the past.

I define "adequate" to mean 2.5 months' worth of regular operating expenses (excluding one-time expenses). We will consider TheRide to have adequate reserves when we have a minimum of 2.5 months of operating expense in reserve for 12 consecutive months. A ratio is preferable to a fixed dollar amount as it will keep pace with budget changes. The specific threshold of 2.5 months is considered reasonable based on government finance standards and agency history.

The Government Finance Officers Association (GFOA) best practice recommends, at a minimum, that governments maintain at least two months of regular operating expenditures in reserve. However, several factors should be considered in determining the appropriate level of operating reserves, including the predictability of revenues, volatility of expenditures, and other considerations. The CEO and CFO believe that 2.5 months should continue to be TheRide's target. This determination is based on GFOA's recommendations and considers risks related to state and local funding, economic impacts on revenues and expenses, and the constrained ability to generate additional revenues to cover unpredictable changes in expenses.

Evidence

Source of data: FY2023 Draft Budget and Q3 Financial Report, presented to the Board on August 18, 2022

Date of data collection: 8/30/22 as verified by the Deputy CEO, Finance and Administration

Data:

As demonstrated in the 2022 Q3 Financial Report presented to the Board on August 18, 2022, operating reserves were $12.9 million, or approximately 2.8 months of budgeted operating expenses. The reserve balance has been at or slightly above the target for four consecutive quarters and is forecasted to remain at or above the target level for FY2023 and through the projection period (see Figure 24 of the budget, Projected Operating Reserves, p. 39). As noted under Policy 2.4.6 above, there are no plans to use the reserve to cover operating expenses. In the near term, federal pandemic relief funding will continue to provide operating surpluses and in 2024 when pandemic relief funding is fully utilized, the 2024-2028 approved millage with provide sustainable funding for current and expanded services.

2.4.7 Provides less for Board prerogatives during the year than is set forth in the Cost of Governance policy.

Degree of Compliance: Fully Compliant

Interpretation

I interpret this policy to mean that the budget must include funds for the Board to do its work and that the amount of funding be determined by the Governance Committee. Examples of past expenses in this area have included group and individual education and training, facilitators, and governance advisory consultation.

Evidence

Source of data: FY2023 Draft Budget, presented to the Board on August 18, 2022

Date of data collection: 8/30/22 as verified by the Deputy CEO, Finance and Administration

Data:

For FY2023 the Governance Committee accepted a staff recommended budget of $35,000, which is consistent with the FY2022 budget. This amount is included within the “other expenses” category shown in the budget. While this line item is not called out specifically in the budget, the amount is budgeted in account 300-509-017 (Board Governance & Training), and can be utilized for meetings, policy development, and board recruitment and development expenses. Prior and current year expenditures have included governance coach fees, policy governance training, and advertising costs for Board recruitment.

2.4.8 Funds ongoing operations via debt or creates unfunded future obligations.
Degree of Compliance: Fully Compliant
Interpretation
I interpret this policy to mean that, with respect to recurring operating expenses, the AAATA must live within its means and avoid over-extending ourselves financially. Using debt or creating future obligations (e.g. unfunded pension liabilities, etc.) in order to allow more spending today are not a transparent means of paying for existing services, and are prohibited. Specifically, we cannot borrow funds or otherwise leverage the Authority for the purpose of paying for ongoing operating costs such as payroll, fuel, bus services, geographic coverage, etc. Furthermore, we cannot create new expenses that will cause forecasted expenses to exceed reasonably foreseeable revenues. (This policy does not apply to capital projects where debt may be a reasonable means of financing large projects.)
Evidence
Source of data: FY2023 Draft Budget and Q3 Financial Report, presented to the Board on August 18, 2022 **Date of data collection:** 8/30/22 as verified by the Deputy CEO, Finance and Administration **Data:** AAATA has no debt, as is indicated in the FY2021 audited financial statements, liabilities, (see p. 8 of the audit report). The multiyear forecast presented in the budget (pp. 32-33) demonstrates that the CEO has not caused new obligations for the AAATA that cannot be funded with reasonably foreseeable revenues. While new costs have emerged from the pandemic, they are anticipated to be fully funded with pandemic relief funds.

Policy Trendline

The policy trends for this policy are as shown below. The trendline for FY 22 is not final and is dependent on the Board's decision on September 28, 2022

Policies	FY 21	FY 22
2.4	3	3
2.4.1	3	3
2.4.2	3	3
2.4.3	3	3
2.4.4	3	3
2.4.5	3	3
2.4.6	3	3
2.4.7	3	3
2.4.8	3	3

Legend	
1	Policy is not compliant
2	Policy is partially compliant
3	Policy is fully compliant

CEO Notes

Board's Conclusion on Monitoring Report

Guidance on Determining "Reasonableness" of CEO Interpretations

The International Policy Governance Association has developed the following guidance for Board members to use in deciding whether a CEO's interpretation is "reasonable":

An interpretation is deemed to be reasonable when it provides an operational definition which includes defensible measures and standards against which policy achievement can be assessed…

Defensible measures and standards are those that:

- *Are objectively verifiable (e.g., through research, testing, and/or credible confirmation of observable phenomena.)*
- *Are relevant and conceptually aligned with the policy criteria and the board's policy set.*
- *Represent an appropriate level of fulfillment within the scope of the policy.*

- "*What makes an Interpretation Reasonable and What are the Expectations for the Operational Definition: Policy Governance Consistency Framework Report Number 2".* International Policy Governance Association. June 11, 2016. Available on the IPGA website.

Board's conclusion after monitoring the report.
Following the Board's review and discussion with the CEO, the Board finds that the CEO:

A. **Is in compliance**.

B. Is in compliance, except for item(s) noted.

C. Is making reasonable progress toward compliance.

D. Is *not* in compliance or is *not* making reasonable progress toward compliance.

E. Cannot be determined.

Board's notes (where applicable)

The Board found the CEO to be (A), in compliance.