


## Developing an Effective Fund Balance Policy

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**NYS COMPTROLLER  
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## Learning Objectives

- What Is Fund Balance?
- History of Fund Balance Legislation
- What Are the Components of Fund Balance?
- Benefits of a Fund Balance Policy
- What Is a “Reasonable Amount” of Fund Balance?
- Keeping Fund Balance at Desired Levels



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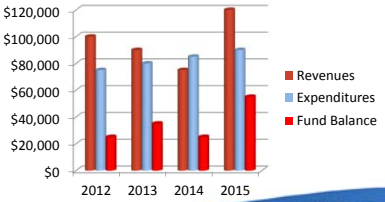
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## Fund Balance – What Is It?

- Fund Balance is the total accumulation of operating surpluses and deficits since the beginning of a local government’s existence.



Year	Revenues	Expenditures	Fund Balance
2012	\$100,000	\$80,000	\$20,000
2013	\$90,000	\$85,000	\$5,000
2014	\$75,000	\$90,000	-\$15,000
2015	\$115,000	\$95,000	\$20,000



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### Excessively Low Fund Balance

- Normally caused by:
  - Poor budget practices
  - Desire to reduce taxes, or keep them at same level
  - Political reasons
- Can result in:
  - Short-term borrowing (RANs, TANs, Budget Notes)
  - Deficit financing
  - Credit rating reduction
- Should be increased in conformity with long-term plans

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### Excessively High Fund Balance

- Normally caused by:
  - Poor budget practices
  - Unduly high property taxes
  - Political reasons
- Greater opportunity for fraud if controls are weak
- Should be appropriated or reduced in conformity with long-term plans

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### Components of Fund Balance

GASB 54

- Five Categories
  - Nonspendable (accounts 806 & 807)
  - Restricted (accounts 814-898 )
  - Committed (account 913)
  - Assigned (accounts 914 & 915)
  - Unassigned (account 917)

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## Fund Balance Limits

- Prior to January 2001
  - Counties, Towns, Villages and Fire Districts had no legal authority to carry over any unappropriated / unreserved balance
- Chapter 528 of the Laws of 2000
  - Bill submitted by Comptroller to provide mandate relief and greater flexibility to local governments
  - Counties, Towns, Villages and Fire Districts can carry over a **“reasonable amount”** of unreserved / unappropriated fund balance

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## Legislative Intent - Prior to 2001

- Public Policy Underlying Rule of Law:
  - Governments need to make a full accounting of all public funds to prevent municipal governments from acquiring tax proceeds faster than they are needed
  - Municipal governments should not accumulate funds for the remote future or for contingencies which may never occur
  - Protection provided to taxpayers from misuse of surplus funds to hide deficit spending or to reap political gain

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## So Why the Change?

- Legislators recognized the need to set aside a portion of unrestricted fund balance in order to:
  - Reduce the cost of borrowing for cash flow
  - Offset revenue shortfalls in poor economic times as well as unexpected expenditures
  - Stabilize taxes and maintain services without budget cutbacks
  - Improve long-term planning initiatives
  - Enhance the credit ratings of local government

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### So Why the Change? (Cont'd)

- Legislators also recognized the potential for abuse if local governments were allowed to amass excessive fund balances
  - The legislation was intended to strike a balance between the potential misuse of fund balance and the inflexibility of the previous legislation
- Legislation did not define what is meant by a “reasonable amount”
- An OSC July 2001 accounting bulletin recommended each local government assess what is a “reasonable amount” for its particular situation and adopt a fund balance policy

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### Benefits of a Fund Balance Policy

- Provides for an orderly provision of services
- Provides taxpayers with information about why resources have been set aside
- Provides a framework to help guide budgetary decisions and multi-year plans
- Helps ensure an adequate fund balance is available to:
  - Ensure efficient cash flow for daily needs
  - Protect against unforeseen expenditures related to emergencies
  - Offset economic downturns or revenue shortfalls
  - Maintain investment-grade bond rating

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### Effective Fund Balance Policies

- Should:
  - Be adopted by the governing board with input from key officials (e.g., CFO, budget officer)
  - Be in written form and subject to review by governing board on a regular basis
  - Be used to develop and amend multi-year capital and operational plans
  - Address how surplus balances will be applied
  - Address the timing for balances to be replenished to the desired level

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## So What Is a “Reasonable Amount”

- GASB 54 eliminated the unappropriated / unreserved terminology and instructed local governments to apply the “reasonable amount” calculation to the “unrestricted portion” of fund balance, defined as:
  - The total of the committed (913), assigned (914 & 915), and unassigned fund balance classifications (917)
  - In determining the amount to carry over, this total should then be reduced by any amount appropriated for the ensuing year’s budget (914)
- Local government officials must consider a number of factors when determining how much unrestricted fund balance is “reasonable” to carry over

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## “Reasonable” Factors to Consider

- Composition of the fund balance (is it all cash?)
- Timing of receipts and disbursements
- Volatility of revenues and expenditures
- Contingent appropriations
- Established legal reserves
- Potential for one-time outlays not provided for by reserves
- Dependence on resources from other funds as well as the need to provide resources to other funds
- Size of the fund
- Experience in prior fiscal years

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## Common Methods Used to Calculate a “Reasonable Amount”\*

- Percentage of Expenditures or Revenues
  - Example: 15% of annual operating expenditures
- Expenditures or Revenues for a set number of months
  - Example: Total estimated expenditures for the first two months of the fiscal year
- Specific dollar amount

**\*OSC does not recommend any one method or amount – these decisions are the responsibility of each local government based on its own situation.**

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## Estimating Available Fund Balance

### General Fund

Fund Balance @ 1/01/XX	\$782,005
+ Revenues to date (8/31/xx)	\$916,870
- Expenditures to date (8/31/xx)	<u>\$1,151,525</u>
<b>Balance to date</b>	<b>\$547,350</b>
+ Projected Revenues (9/1/ -12/31/XX)	\$177,004
- Projected Expenditures (9/1/-12/31/XX)	<u>\$125,349</u>
<b>Estimated Fund Balance at Year-End – 12/31/XX*</b>	<b><u>\$599,005</u></b>

Allocation of Estimated Fund Balance @ 12/31/XX:

Restricted (A878, Capital Reserve -\$175,000 + A806, Prepaid Insurance - \$12,500)	\$187,500
Unrestricted / Assigned, Appropriated (A914)	\$100,000
Unrestricted / Assigned, Unappropriated (A915 + A917)	\$311,505

\* Fund balance must be able to be converted to cash within the first 2 months of the fiscal year

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## Budget Requirement

County Law §355((g)); Town Law § 107(1)(b), 181(2)(b); Village Law §5-506(1)(c)

- Each municipal budget MUST contain:
  - A statement for each fund of the fund balance estimated to be on hand at the close of the current fiscal year, together with a breakdown of such fund balance estimated for:
    - Encumbrances
    - Amount appropriated for ensuing year’s budget
    - Amounts reserved for stated purpose
    - Remaining unappropriated amount, not to exceed a “reasonable amount”.




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## Schedule of Estimated Fund Balances

	General (A)	Highway (DA)	Water Dist (SW)
Estimated Total Fund Balance @ 12/31/15	\$599,005	\$786,990	\$76,650
<b>Nonspendable Portion</b> (Prepaid Insurance)	\$12,500	\$7,800	\$0
<b>Restricted Fund Balance:</b>			
Capital Reserve (878)	\$175,000	\$75,000	\$0
Repair Reserve (882)	\$0	\$50,000	\$22,000
<b>Total Estimated Unrestricted FB @ 12/31/15</b>	<b>\$411,505</b>	<b>\$654,190</b>	<b>\$54,650</b>
<b>Assigned, Appropriated</b> toward 2016 Budget (914)	\$100,000	\$170,000	\$10,000
<b>Assigned, Unappropriated / Unrestricted FB</b>	<b>\$311,505</b>	<b>\$484,190</b>	<b>\$44,650</b>
Assigned for Highway Projects	-	\$65,400	-
Encumbrances	\$3,650	\$6,230	-
Other Assignments	-	\$412,560	\$44,650
<b>Unassigned (917)</b>	<b>\$307,855</b>	<b>-</b>	<b>-</b>

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## A Four-Pronged Approach to Managing Excess Unrestricted Fund Balance

- One-shot expenditures
- Reduce Debt Principal
- Finance Reserve Funds
- Reduce Property Taxes

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## One-Shot Expenditures

- Expenditures that do not normally occur annually, such as:
  - Equipment and capital outlay expenditures (.2)
  - Court-ordered judgments
  - Extraordinary public service contracts (legal, assessor, etc.).

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## Reduce Debt Principal

- Decreases future interest payments
- Shortens life of the loan
- Improves credit ratings

Note: Since not all debt instruments allow for the reduction of principal ahead of schedule, local governments should check with their lender or bond counsel before pursuing this option.

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## Finance Reserve Funds

- Reserves must be legally established
  - General Municipal Law (§§ 6-c through 6-r)
  - Town Law (§§ 55, 55-a, 55-b)
  - County Law (§ 372)
- Reserves should be limited to amounts specified in resolution or other statutory limitations
- Establishment and use of reserves should be linked to long-term capital and operational plans

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## Reduce Property Taxes

- Be cautious (one-shot revenues should not be used to fund recurring expenditures)
- Consider budgetary practices
  - Operating surpluses (deficits)
- Can result in unstable tax rates
- Link to long-term plans

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## Appropriated Fund Balance (a.k.a. Planned Deficit)

	2012	2013	2014	2015
Beginning Unrestricted FB	\$440,000	\$335,000	\$198,600	\$ 41,430
Budgeted Appropriations	\$1,300,000	\$1,339,000	\$1,379,170	\$1,379,170
Estimated Revenues	\$780,000	\$750,000	\$815,000	\$820,000
Appropriated FB	\$90,000	\$159,000	\$134,170	<b>\$41,430</b>
Tax Levy	\$430,000	\$430,000	\$430,000	<b>\$517,740</b>
Budgeted Operating Deficit	(\$90,000)	(\$159,000)	(\$134,170)	<b>(\$41,430)</b>
Actual Operating Surplus (Deficit)	(\$105,000)	(\$136,400)	(\$157,170)	<b>?</b>

**\$87,740 increase in taxes (20%)**

**\$0 available to offset 2015 revenue shortfalls and/or unexpected expenditures**

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## Replenishing Unrestricted Fund Balance

- **Budgetary Provisions**
  - When possible - replenish to desired levels in next fiscal year budget
  - When not possible – develop a plan to replenish to desired level over a period of years (e.g., 3 years)
  - Maximum use of contingency account and apply budget surpluses to replenish fund balance
- **One-Shot Revenues**
  - Sale of equipment & property
  - Gifts / donations

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Thank You



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