DEVELOPING AN EFFECTIVE FUND BALANCE POLICY

Tug Hill Commission’s 26th Annual Local Government Conference

Presented by:
Julie Landcastle, Associate Examiner

Office of the State Comptroller
Thomas P. DiNapoli

State & Local Government Accountability
Andrew A. SanFilippo
Executive Deputy Comptroller

Local Government & School Accountability
Gabriel F. Deyo
Deputy Comptroller
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
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.
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
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
Components of Fund Balance

- Total Fund Balance is comprised of two components:
  - Restricted Fund Balance – that portion that has been legally set aside for a specific purpose by the governing board (e.g. – GML reserve funds) and any portion that is considered non-spendable (e.g., inventory, pre-paid expenses)
  - Unrestricted Fund Balance – Total Fund Balance less Restricted Fund Balance

This is the portion of Fund Balance that Boards have some discretion with at budget time
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
Legislative Intent - Prior to 2001

- Public Policy Underlying Rule of Law:
  - Governments need to make a full accounting of all public funds and prevent municipal governments from collecting taxes 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.
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, stabilize taxes and enhance credit ratings.

- Legislators also recognized the potential for abuse if local governments were allowed to amass excessive fund balances.

- 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.
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.
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.
“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 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
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.
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)  

Balance to date  $547,350
  + Projected Revenues (9/1/-12/31/XX)  $177,004
  - Projected Expenditures (9/1/-12/31/XX)  

Estimated Fund Balance at Year-End – 12/31/XX*  $599,005

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

Restricted
(Capital Reserve -$175,000 + Prepaid Insurance - $12,500)  $187,500

Unrestricted  $411,505

* Fund balance must be able to be converted to cash within the first 2 months of the fiscal year
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”**.
## Schedule of Estimated Fund Balances

<table>
<thead>
<tr>
<th></th>
<th>General (A)</th>
<th>Highway (DA)</th>
<th>Water Dist (SW)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimated Total Fund Balance @ 12/31/12</td>
<td>$599,005</td>
<td>$786,990</td>
<td>$76,650</td>
</tr>
<tr>
<td>Nonspendable Portion (Prepaid Insurance)</td>
<td>$12,500</td>
<td>$7,800</td>
<td>$0</td>
</tr>
<tr>
<td>Restricted Fund Balance:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Reserve</td>
<td>$175,000</td>
<td>$75,000</td>
<td>$0</td>
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<tr>
<td>Repair Reserve</td>
<td>$0</td>
<td>$50,000</td>
<td>$22,000</td>
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<tr>
<td>Total Estimated Unrestricted FB @ 12/31/12</td>
<td>$411,505</td>
<td>$654,190</td>
<td>$54,650</td>
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<tr>
<td>Amount appropriated toward 2013 Budget</td>
<td>$100,000</td>
<td>$170,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Unappropriated / Unrestricted FB</td>
<td>$311,505</td>
<td>$484,190</td>
<td>$44,650</td>
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</table>
A Four-Pronged Approach to Managing Excess Unrestricted Fund Balance

- One-Shot Expenditures
- Reduce Debt Principal
- Finance Reserve Funds
- Reduce Property Taxes
One-Shot Expenditures

Expenditures that do not normally occur annually, such as:

- Equipment and capital outlay expenditures
- Court-ordered judgments
- Extraordinary public service contracts (legal, assessor, etc.).
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.
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.
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
## Appropriated Fund Balance (a.k.a. Planned Deficit)

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Unrestricted FB</td>
<td>$440,000</td>
<td>$335,000</td>
<td>$198,600</td>
<td>$41,430</td>
</tr>
<tr>
<td>Budgeted Appropriations</td>
<td>$1,300,000</td>
<td>$1,339,000</td>
<td>$1,379,170</td>
<td>$1,379,170</td>
</tr>
<tr>
<td>Estimated Revenues</td>
<td>$780,000</td>
<td>$750,000</td>
<td>$815,000</td>
<td>$820,000</td>
</tr>
<tr>
<td>Appropriated FB</td>
<td>$90,000</td>
<td>$159,000</td>
<td>$134,170</td>
<td>$41,430</td>
</tr>
<tr>
<td>Tax Levy</td>
<td>$430,000</td>
<td>$430,000</td>
<td>$430,000</td>
<td>$517,740</td>
</tr>
<tr>
<td>Budgeted Operating Deficit</td>
<td>($90,000)</td>
<td>($159,000)</td>
<td>($134,170)</td>
<td>($41,430)</td>
</tr>
<tr>
<td>Actual Operating Surplus (Deficit)</td>
<td>($105,000)</td>
<td>($136,400)</td>
<td>($157,170)</td>
<td>?</td>
</tr>
</tbody>
</table>

- $87,740 increase in taxes (20%)
- $0 available to offset 2012 revenue shortfalls and/or unexpected expenditures
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 contingent account and apply budget surpluses to replenish fund balance

- **One-Shot Revenues**
  - Sale of equipment & property
  - Gifts / donations
Questions?

Contact the Syracuse Regional Office
Muni-Syracuse@osc.state.ny.us
315-428-4192