

# DEVELOPING AN EFFECTIVE FUND BALANCE POLICY

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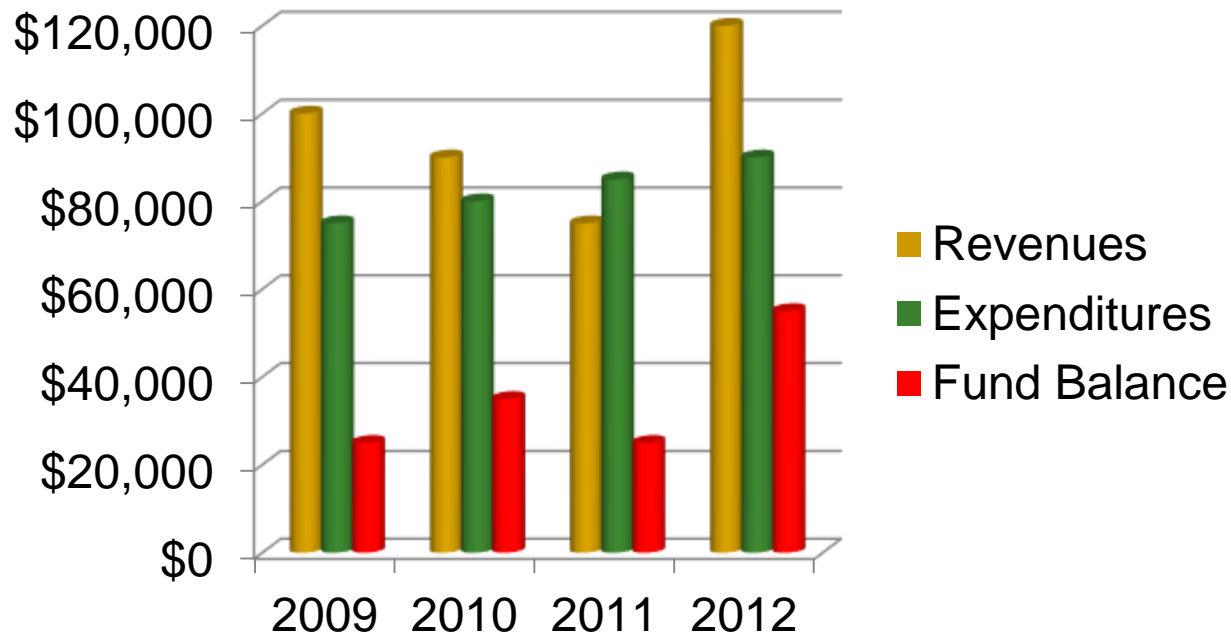
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# Learning Objectives

- 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

# 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 Fun 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.

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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.

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

## 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

# 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".

# Schedule of Estimated Fund Balances

	<i>General (A)</i>	<i>Highway (DA)</i>	<i>Water Dist (SW)</i>
Estimated Total Fund Balance @ 12/31/12	\$599,005	\$786,990	\$76,650
Nonspendable Portion (Prepaid Insurance)	\$12,500	\$7,800	\$0
Restricted Fund Balance:			
Capital Reserve	\$175,000	\$75,000	\$0
Repair Reserve	\$0	\$50,000	\$22,000
Total Estimated Unrestricted FB @ 12/31/12			
Amount appropriated toward 2013 Budget	\$100,000	\$170,000	\$10,000
<b>Unappropriated / Unrestricted FB</b>	<b>\$311,505</b>	<b>\$484,190</b>	<b>\$44,650</b>



# 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.).

# 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.



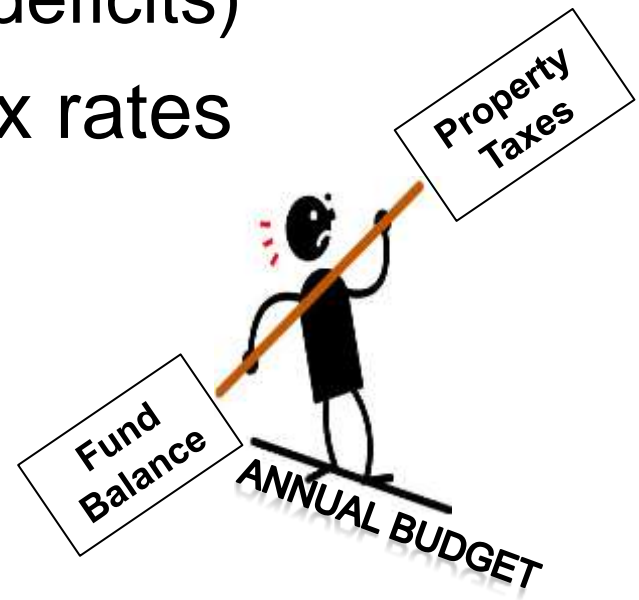
# Finance Reserve Funds

- 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)

	2009	2010	2011	2012
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 2012 revenue shortfalls and/or unexpected expenditures**

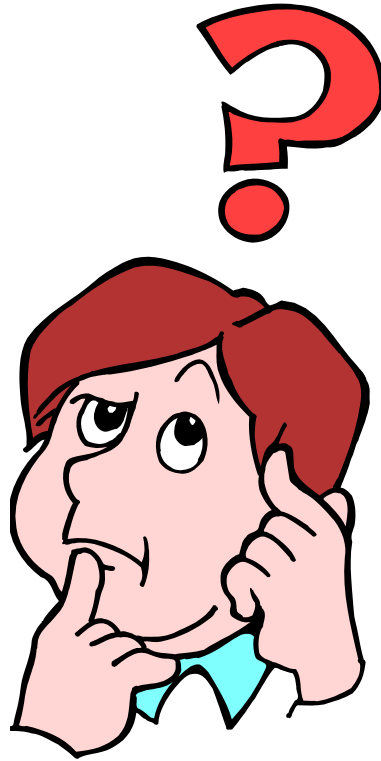
# Replenishing Unrestricted Fund Balance

## ■ 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

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