

Fund Balance 101

*MFOCTA and BLOA Joint
Annual Meeting
October 26 – 29, 2010*



What Is A Fund Balance?

- Current Assets Minus Current Liabilities Equals Fund Balance.
- A Government's Fund Balance Is Its Working Capital.
- Fund Balance Is A Measure Of Resources Immediately Available To Finance Ongoing Operations.

Why Maintain A Fund Balance?

- Governments Maintain Fund Balances:
 - To Smooth Cash Flow Related To Revenue Cycles.
 - As An Alternative To Tax Anticipation Notes And Associated Costs.
 - To Maintain Stronger Credit Ratings.

Why Maintain a Fund Balance?

- To Weather Revenue Shortages Caused By Economic Downturns, Or Natural Disasters.
- To Limit Exposure To Risk.
- To Provide Flexibility.

What Is The “Right” Level Of Fund Balance?

- No One Size Fits All Recommendation On The Appropriate Level Of Fund Balance To Maintain.
- A Variety Of Factors May Affect The Amount Of Unreserved Fund Balance A Government Maintains In Its General Fund.

What Is The “Right” Level Of Fund Balance?

- Each Government Must Analyze Its Weaknesses, Risks, And Financial Goals To Determine The Best Fund Balance Policy For Their Organization.
- Individual Perception Of Appropriateness Of Fund Balance Levels Influenced By Political Beliefs And Risk Tolerance.

Factors Which Affect Need For Fund Balance

- Factors Affecting Cash Flow
 - Starting Month Of Fiscal Year Relative To Timing Of Revenue Receipts.
 - Diversity Of Available Revenues And Timing Of Revenue Receipts.

Factors Which Affect Need For Fund Balance

- Timing Of Large Expenditure Item Purchases Relative To Revenue Inflow.
- Percent Of Personnel Related Expenses To Total Budget. (Recurring Payroll Expenses).
- Vulnerability To Natural Disasters And Associated Costs.

Factors Which Affect Need For Fund Balance

- Desired Creditworthiness And Bond Rating.
- Volatility Of Revenue And Expenditure Sources.
 - Dependence On Single Business Or Industry.
 - Local Economic Conditions.

Adequacy Of Available Fund Balance

- No Hard Fast Rule.
- GFOA Recommends, At A Minimum, That General-purpose Governments, Regardless Of Size, Maintain Unrestricted Fund Balance In Their General Fund Of No Less Than Two Months Of Regular General Fund Operating Revenues Or Regular General Fund Operating Expenditures.

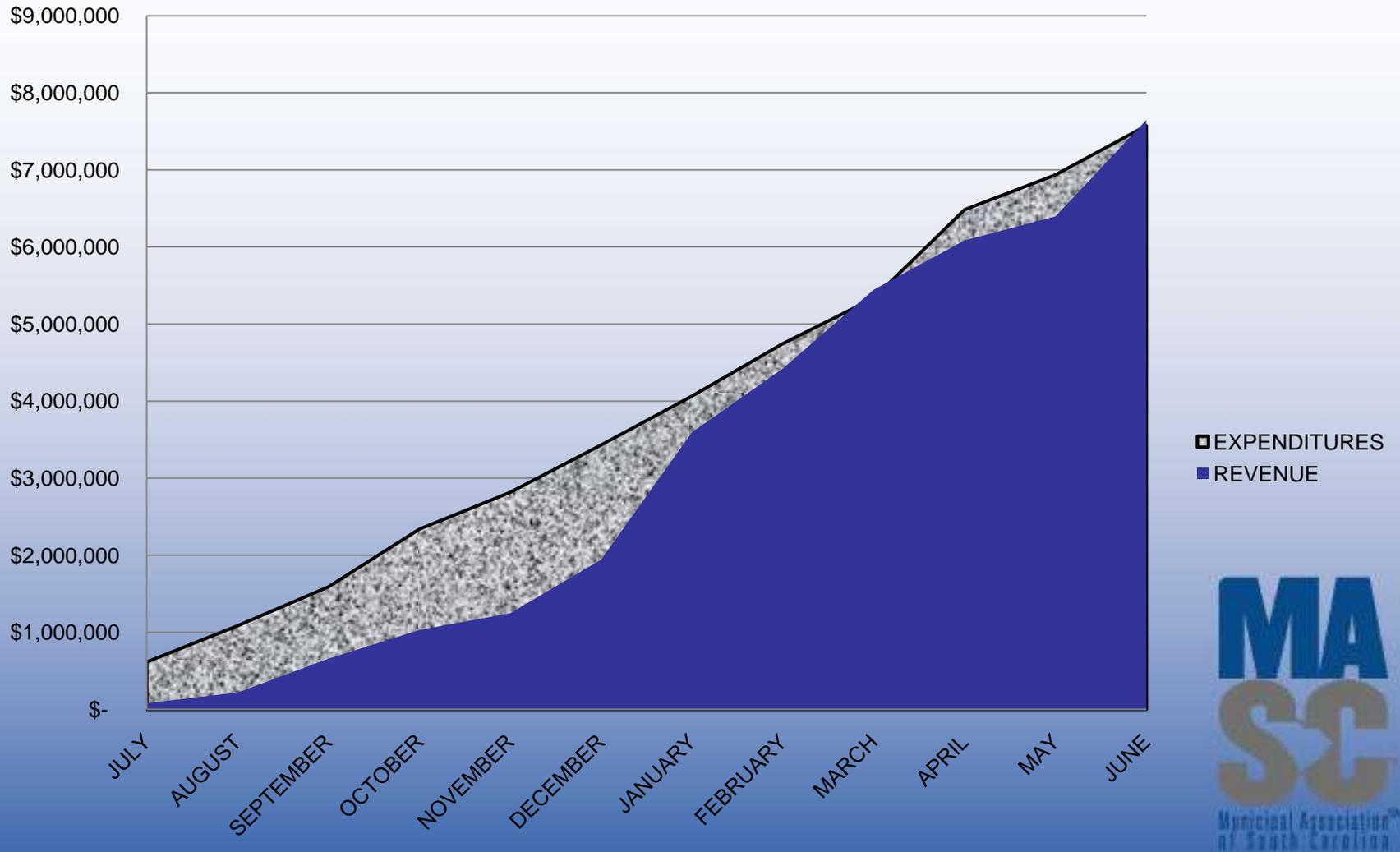
Adequacy Of Available Fund Balance

- “A Government's Particular Situation May Require Levels Of Unreserved Fund Balance In The General Fund Significantly In Excess Of These Recommended Minimum Levels.”
- Municipalities That Regularly Rely On Fund Balance To Meet Cash Flow Or Other Recurring Needs May Wish To Consider Additional Fund Balance To Insure A Reasonable Balance Of Funds Is Available At All Times.

Adequacy Of Available Fund Balance

- Assuming An Even Pro-ration Of Revenue Receipts And Expenditures, A Minimum Fund Balance Of 17% (1/12th) Would Be Required To Meet The GFOA Recommendation.
- An Average City With Diverse Revenue Sources Needs 18 – 20 % Of Budget In Available Cash To Bridge Cash Flow Gaps From July- November.

Adequacy Of Available Fund Balance



Adequacy Of Available Fund Balance

- One Of The Most Important Steps Is The Development Of A Formal Fund Balance Policy Statement Approved By The Municipal Council.
- An Adequate Fund Balance Policy Provides Specific Plans For Increasing Or Decreasing The Level Of Unreserved Fund Balance Should It Fall Outside The Parameters Established By The Policy.

Politics Of Fund Balance

- Both Internal And External Factors Influence Fund Balance Policy Decisions.
- The Existence And Level Of Municipal Fund Balances Can Be Controversial Because It Involves The Use Of Public Funds Which Impacts Tax Payers.

Politics Of Fund Balance

- Fund Balance Is Sometime Misunderstood And Criticized As An Unnecessary Accumulation Of Money That Could Be Used To Lower Taxes And Fees.
- Critics Often Fail To Recognize Or Do Not Want to Understand The Complex Nature Of Municipal Revenues And Expenditures.

Politics Of Fund Balance

- Financial Management Views Fund Balance As A Necessary Reserve For Cash Flow, Unexpected Expenditures And As Risk Management Tool.
- Finding An Acceptable Balance Between These Two Opposing Opinions Is Not An Easy Task.

Politics Of Fund Balance

- Therefore, It Is Important That Your Municipality Objectively Evaluate, Justify And Communicate To The Council, Public And Business Community The Need To Maintain A Reasonable Fund Balance.
- Role Of Staff Is To Educate And Prepare Council To Make The Fund Balance Policy Decision.

Politics Of Fund Balance

- By Showing Council
 - Historically How Revenues Are Received And Expenditures Paid.
 - The Impact Of Revenue And Expenditure Patterns On Cash Flow.
 - Peak Cash Flow Needs Over Most Recent Years.

Politics Of Fund Balance

- Balance Of Available Cash For Emergencies During Peak Cash Flow Needs.
- An Assessment Of The Municipalities Risks Which Could Occur Simultaneous With Peak Cash Flow Needs.
- Importance Of Maintaining Fund Balance On Credit Rating

Politics Of Fund Balance

- The Interest Cost Of Annual Borrowing For Cash Flow Needs In The Absence Of Adequate Fund Balance.
- Potential Impact On Goal Achievement If Expenditures Moved To Periods When There Is Adequate Current Revenue.

Politics Of Fund Balance

- The Answers To These Questions Should Allow Council To Determine What Is An Adequate Fund Balance.
- Establish A Policy To Maintain The Desired Fund Balance Level.

What Is Happening In Your Municipality?

- Is The Maintenance Of An Adequate Fund Balance Controversial In Your Municipality?
- How Many Of You Have An Adopted Fund Balance Policy?
- How Many Of You Believe That Your Policy Provides For The Maintenance Of An Adequate Fund Balance?

What Is Happening In Your Municipality?

- How Many Of Your Councils Follow Their Adopted Policy?