Best Practices on Fund Balance

Key Questions

- What is the right level of fund balance?
- What factors influence the "right" level of fund balance?
- What are the most important elements of a fund balance policy?
- How can you develop a strategy for using fund balance for budgetary stabilization?
- What are the implications of GASB Statement No. 54 for fund balance strategy and policy?

The Right Level of Fund Balance?

- What part of fund balance to measure?
  - Traditionally, measure "unreserved" balance
  - Under 54, use "unrestricted" balance
- How to measure
  - Fund balance as a percent of
    - Regular revenues or...
    - Regular expenditures
  - Choice depends upon which is more predictable

The Right Level of Fund Balance?

- What does GFOA recommend?
  - As a baseline for the general fund:
    - 5 to 15% of regular operating revenues
    - 1 to 2 months of regular operating expenditures
- S&P’s views on available fund balance
  - Low: Below 0%
  - Adequate: 1%-4%
  - Good: 4%-8%
  - Strong: 8%-15%
  - Very strong: Above 15%
Factors Influencing the “Right” Level?
- GFOA recommendation just a baseline
- Need to adjust based on local conditions
- Conduct an analysis
  - Catalogue major influencing factors
  - Analyze past experience on factors
  - Judge implications for fund balance

Factors to Consider
- Vulnerability to Extreme Events & Public Safety
- Government Size
- Budget Practices

Factors to Consider
- Own Source Revenue Stability
  - Potential for shortfall in important revenue sources?
- Intergovernmental Revenue
  - Importance and dependability?
- Expenditure Volatility

Factors to Consider
- Leverage
  - Equipment replacement
  - Long-term debt
- Borrowing Capacity
  - External and internal borrowing capacity?
- Liquidity
  - How much liquidity is usually available?
- Other Reserves
  - What level of fund balance are in other funds?
Factors to Consider

- Designations
  - Any “Designations” or “Assignments”?
- Growth
  - High growth expected?
- Capital Projects
  - Do critical projects have a funding source?

Factors to Consider

- Political Support
  - Is there a level of reserves that resonates?
  - Can elected officials be engaged in the analysis?
  - How likely are officials to look to reserves versus cut spending?

Most Important Policy Elements?

- Fund balance target levels
  - Consider breaking into subcategories
  - Key word: credibility
- How to reach target levels
  - Broad guidance in policy
  - Use a long-term financial plan for more specifics
- Conditions for use of reserves
  - Use of Reserves
  - Authority to Use Reserves
  - Replenishment of Reserves
  - Excess Reserves

Using Reserves for Stabilization?

- Describe how reserves fit into “bridging” strategy
- Have a credible fund balance policy
- Get skilled at distinguishing between one-time and permanent decreases
  - If it is permanent, how long is the downturn expected to last?
- Develop a plan for after it is used
  - How will it be replaced?
  - By when will it be replaced?
Impact of GASB 54

- GASB 54 shifts the focus of "fund balance"
- 5 categories of fund balance
  - Non-spendable fund balance
  - Inherently non-spendable
  - Restricted fund balance
  - Externally enforceable limitations on use
  - Committed fund balance
    - Self-imposed limitations
  - Assigned fund balance
    - Limitation resulting from intended use
  - Unassigned fund balance
    - Residual net resources

Not Typically Relevant to the Policy

- Use constrained by outside parties
- Non-spendable fund balance
  - Long-term portion of loans receivable
  - Principle of an endowment
- Restricted fund balance
  - Externally imposed by creditors, grantors, contributors or laws or regulations of other governments
  - Imposed by law through constitutional provisions or enabling legislation.

A Policy Typically Covers...

- "Unrestricted fund balance," which comprises three GASB 54 categorizations...
  - Committed fund balance
    - Limitations imposed by government on itself
  - Assigned fund balance
    - Assigned to a particular intended use
  - Unassigned fund balance
    - Anything that doesn’t fall into the other categories

The End

- Resources
  - Financial Policies: Design & Implementation
  - "Fund Balance: New & Improved"
  - April 2009 GFR
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