

FUND BALANCE POLICY



1.1 AUTHORITY

The Village President and Village Council are responsible for legislation, policy formulation, and overall direction setting of the government. This includes the approval of financial policies which establish and direct the operations of the Village of Three Oaks. The Village Manager is responsible for carrying out the policy directives of the Village Council and managing the day-to-day operations of the Village departments. The Village Manager and Treasurer are charged with carrying out this policy.

1.2 PURPOSE

The Village desires to maintain a prudent level of financial reserves to guard its citizens against service disruption in the event of unexpected temporary revenue shortfalls or unpredicted one-time expenditures. The fund balance has been accumulated to meet this purpose-to provide stability and flexibility to respond to unexpected adversity and/or opportunities.

The primary reasons for a general fund reserve policy are to:

- **Plan for contingencies.** Because of the volatile revenue sources such as property and sales tax, governments will always face challenges when it comes to matching planned revenues with actual expenditures. Local events, such as the closure of a major employer, can also negatively affect revenue. Finally, extreme weather events such as winter storms or tornados can increase operating and/or capital costs. Reserves can be used to make up these temporary shortfalls.
- **Maintain good standing with rating agencies.** Bond rating agencies consider an adequate level of reserves a sign of creditworthiness because it enhances a government's ability to repay debt on time and in full.
- **Avoid interest expenses.** Cash reserves may be used rather than debt to fund capital projects.
- **Generate investment income.** Reserves can be a source for investment revenue, effectively reducing the burden on the property tax rate. To maintain the reserve's value as a risk mitigation device, investments will remain relatively liquid in compliance with the Village Investment Policy.
- **Serve as cash flow management tool.** Reserves can be used to cover times of the year that normally experience low levels of cash.
- **Create a shared understanding.** A formal reserve policy clearly outlines appropriate use of the reserves.

1.3 COMPONENTS OF FUND BALANCE

Fund Balance vs. Reserves "Fund balance" is an accounting term defined as the difference between assets and liabilities in a governmental fund. The term "reserves" is often used by public finance practitioners, but is not an actual government accounting term. It refers to the portion of fund balance held in reserve to provide a buffer against financial distress or risk.

In governmental funds, "reserves" comprise a portion of total fund balance. Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance reporting and Governmental Fund Type Definitions* governs the descriptions used to report fund balance. The statement focuses on the "extent to which the government is bound to honor constraints on the specific purposes for which amounts in the fund can be spent" and breaks total fund balance into five (5) different components:

- **Non-spendable fund balance.** Fund balance in this category is inherently non-spendable.
- **Restricted fund balance.** This category has externally enforceable limitations on the use of fund balance, imposed by parties such as creditors, grantors, or laws or regulations of other governments.
- **Committed fund balance.** This encompasses limitations imposed by the government on itself at its highest level of decision making (e.g., governing board through a resolution). For example, the governing board might like to commit a portion of fund balance to a “stabilization fund” to provide a cushion against unknown economic downturns and revenue declines.
- **Assigned fund balance.** This category is for the portion of fund balance that is earmarked for an intended use. The intent is established at either the highest level of decision making or by a body or an official designated for that purpose. For example, a portion of fund balance might be assigned to offset a gap in the budget stemming from a decline in revenues or a portion could be assigned to pay for an upcoming special project. A typical assigned fund balance item is the amount of fund balance that is appropriated in the subsequent year’s budget ordinance that is not already classified as restricted or committed.
- **Unassigned fund balance.** This encompasses all fund balances that are left after considering the other four categories. Use is least constrained in this category of fund balance.

The last three components (committed, assigned and unassigned fund balance) together comprise “unrestricted fund balance”, which is the part of fund balance covered by this reserve policy because unrestricted fund balances are either unconstrained or the constraints are self-imposed, so they could be lifted to make fund balances available for other purposes. Conversely, restricted fund balances or non-spendable fund balances are not suited to many of the purposes a reserve policy typically is intended to fulfill.

1.4 SIGNIFICANT POLICIES

Required Reserve Levels

The Government Finance Officers Association (GFOA) recommends, at a minimum, no less than two months of regular general fund operating revenues or regular general fund operating expenditures. However, the Village policy is more restrictive by requiring a minimum unassigned general fund balance of twenty-five percent (25%) of the total actual expenditures and an additional committed general fund balance of five percent (5%) of the previous years total actual expenditures, to be used for grant matches. The minimum requirement will be reviewed by the Village Manager and Treasurer as changes in economic conditions occur, new legislation is enacted or revenue sources change.

Reserve Draw Downs

Fund balance appropriated will not exceed an amount management can reasonably expect to save during the year. If fund balance is appropriated to balance the following year’s budget in an amount that, if spent, would reduce the percentage below twenty-five percent (25%) an explanation of the circumstances of the utilization and a plan to save or replenish the fund balance will be included in the transmittal letter of the Comprehensive Annual Financial Report (CAFR).

The unassigned fund balance may be purposefully drawn down below the minimum required percentage of twenty-five (25) for emergencies.

Excess Reserves

Unassigned fund balance percentages more than thirty percent (30%), calculated at the previous fiscal year-end, may be drawn down for nonrecurring expenditures as follows:

1. One-time expenditures that do not increase recurring operating costs that cannot be funded through current revenues. Emphasis will be placed on one-time uses that reduce future operating costs, or
2. Start-up expenditures for new programs, provided that such action is approved by the Village Council and is considered in the context of multi-year projections of revenue and expenditures as prepared by the Village

Manager, Treasurer, and Clerk, or

3. Fund accrued liabilities, including but not limited to debt service, pension, and other post-employment benefits. Priority will be given to those items that relieve budget or financial operating pressure in future periods, or
4. Appropriated to lower the amount of bonds or contributions needed to fund future capital projects.

Reserve Replenishment

If the fund balance falls below the minimum required percentage of twenty five percent (25%) for two consecutive fiscal years, the Village will replenish funds by direct appropriation beginning in the following year. In that instance, the Village will annually appropriate twenty five percent (25%) of the difference between the minimum required percentage level and the actual balance until the minimum required level is met. In the event appropriating 25% is not feasible, the Village will appropriate a lesser amount and shall reaffirm its commitment to full replenish the fund balance over a longer period.

This policy will be reviewed at least annually and updated on an as-needed basis.

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