

## Information Pages: Fund Balance Policy

The City of Ann Arbor believes that sound financial management principles require that sufficient funds be retained by the City to provide a stable financial base at all times. In order to do so, the City needs to maintain a fund balance sufficient to fund all cash flows of the City, to provide for financial reserves for unanticipated one-time expenditures, revenue shortfalls, and/or emergency needs.

**Purpose** The purpose of this policy is to specify the size and composition of the City's desired fund balance (net assets for enterprise funds) and to identify certain requirements for classifying fund balance in accordance with Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

### Policy

1. **Classifications** The following individual components shall constitute the fund balance for all of the City's Governmental Funds:

Classification	Definition	Examples	
<b>Nonspendable</b>	"Amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact." <sup>1</sup>	<ul style="list-style-type: none"> <li>• Inventories,</li> <li>• Prepaid items,</li> <li>• Long-term receivables</li> <li>• Permanent Endowments</li> </ul>	
<b>Restricted</b>	"Fund balance should be reported as restricted when constraints placed on the use of resources are either: <ol style="list-style-type: none"> <li>Externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or</li> <li>Imposed by law through constitutional provisions or enabling legislation."<sup>2</sup></li> </ol>	<ul style="list-style-type: none"> <li>• Restricted by state statute,</li> <li>• Unspent bond proceeds,</li> <li>• Grants earned but not spent,</li> <li>• Debt covenants,</li> <li>• Taxes dedicated to a specific purpose, and</li> <li>• Revenues restricted by enabling legislation.</li> </ul>	
<b>Unrestricted</b>	<b>Committed</b>	"Used for specific purposes pursuant to constraints imposed by formal action of the government's highest level of decision-making authority" <sup>3</sup>	<ul style="list-style-type: none"> <li>• Amounts City Council sets aside by resolution.</li> </ul>
	<b>Assigned</b>	"Amounts that are constrained by the government's intent to be used for specific purposes, but are neither restricted nor committed" <sup>4</sup>	<ul style="list-style-type: none"> <li>• City Council delegates the authority to assign fund balance to the Chief Financial Officer.</li> <li>• City Council has appropriated fund balance during the budget process- this is titled "subsequent year's expenditures"</li> </ul>
	<b>Unassigned</b>	Unassigned fund balance is the residual classification for the General Fund. This is fund balance that has not been reported in any other classification. The General Fund is the only fund that can report a positive unassigned fund balance. Other governmental funds would report deficit fund balances as unassigned. <sup>5</sup>	

<sup>1</sup> GASB Statement No. 54, ¶ 6

<sup>2</sup> GASB Statement No. 54, ¶ 8

<sup>3</sup> GASB Statement No. 54, ¶10

<sup>4</sup> GASB Statement No. 54, ¶13

<sup>5</sup> GASB Statement No. 54, ¶17

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**Committing Fund Balance** In order to commit fund balance, the City Council, as the highest level of decision-making authority, must incorporate in a resolution the commitment of funds for specific purposes. These funds must be fully expended for their committed purpose or a separate action by Council for the funds to become uncommitted.

**Assigning Fund Balance** In order to assign fund balance, City Council designates the Chief Financial Officer, or his designee, as the authority to assign fund balance.

2. **Minimum Level of Fund Balance/Net Assets** The City will establish and maintain minimum levels of fund balance/net assets in each of the various fund types of the City as follows:

- a. **General Fund-** In the General Fund, there shall be a minimum balance (~~assigned and~~ unassigned fund balance) of ~~815%~~ to ~~1220%~~ of recurring expenditures (excluding AAATA pass-through & reimbursed GASB #68 other reimbursed pass-through expenditures). For purposes of this calculation, the expenditures should be the budget as originally adopted in May of each year. Non-recurring revenues may be a source of accumulating fund balance and should not be relied upon for operational needs. The General Fund should seek to have recurring surpluses sufficient to fund the historic level of non-recurring expenditures. Fund balance may be higher than this minimum to save for large planned expenditures (i.e. capital projects, restructuring charges, etc), credit rating agency concerns, liquidity, and/or to address volatility in economic conditions.
- b. **Special Revenue Funds-** Special revenue funds are created to account for the proceeds from specific revenue sources that are legally restricted for specific purposes (i.e. grants, weight and gas tax, dedicated millages). No specific reservation of fund balance is created by this policy. Rather, each fund must adhere to any underlying guidelines attached to that revenue source. The largest funds are:
  - i. Open Space Millage – fund balance is for the purpose of acquiring property as it becomes available at an affordable price.
  - ii. Construction Code Fund – it is desirable to have a minimum of nine months of operating expenditures in unassigned fund balance. In order to capture the cyclical effect of construction, a five year average of revenue and expense performance will be considered.
  - iii. Local and Major Street Funds – a one year’s collection of the weight and gas tax revenues are held in fund balance. This allows us the City to leverage unanticipated/unbudgeted events such as harsh winters. In addition, it allows us the City a safety net for revenue collection from the State as well as the ability to provide matching dollars for state and federal aid projects.

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- iv. Street Repair & Sidewalk Repair Millage – a half one-year's collection of the repair millage are held in fund balance since ~~this is a short-term millage and require frequent the voters have repeatedly renewals renewed from votersthis short-term millage.~~ This single-partial year coverage would permit ~~either an extended renewal or~~ a smoother tail-off of funding from street repairs were renewal not approved at exactly the five year timeframe. In addition, the fund balance provides for the matching funds required to capture state and federal aid projects. The fiscal year end (June 30<sup>th</sup>) occurs during early construction season so at that point in the year, fund balance may appear artificially high since monies have been collected but not expended for projects within that construction season.
- c. **Debt Service Funds**- Debt service funds are very specific with the amount of fund balance required to be held. The reserve requirement for any outstanding bond issue will be consistent with the resolution or ordinance authorizing the bonds.
- d. **Capital Projects Funds**- Capital project funds are created to account for resources set aside to construct or acquire fixed assets or improvements. These projects may extend beyond one fiscal year. No specific reserve is required. However, the fund must ensure enough reserve exists to cover existing construction commitments for the oncoming year. Project funds will remain open until all claims on the project are settled.
- e. **Enterprise Funds**- Enterprise funds should strive for positive net operating income to provide for necessary operating (25% of operational expenditures) and capital reserves while maintaining sufficient debt service coverage ratios. A specific percentage or dollar amount will vary due to the following considerations:
  - i. Water – working capital, debt coverage, asset replacement, rate smoothing, and revenue volatility.
  - ii. Sewage Disposal – working capital, debt coverage, asset replacement, rate smoothing and revenue volatility.
  - iii. Stormwater Sewer – working capital, debt coverage, asset replacement, rate smoothing, and revenue volatility.
  - iv. Solid Waste – working capital, and asset replacement, and business risks
  - ~~v. Golf - working capital, and asset replacement~~
- f. **Internal Service Funds**- Internal Service funds, by nature, are designed to operate on a break-even basis for operations, while, if applicable, accruing additional funds to finance future capital costs or potential liabilities.
  - i. **Fleet Services, Central Stores (Radio) and Information Technology funds**- Funding is provided in an amount to fund the replacement of assets (i.e. vehicles, computers, software) at a level consistent with a depreciation-based methodology. Funding shall

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be designated to maintain the condition of assets at a desirable service level without shifting the costs disproportionately to future taxpayers.

- ii. **Insurance Fund**- Funding is provided in an amount to fund the costs of employee benefits, worker's compensation, insurance claims and premiums, and safety. This fund calculates a reserve for IBNR (incurred but not reported) claims as determined by an actuarial calculation.

3. **Replenishment of the General Fund Minimum Requirements** Should the minimum balance ~~(assigned and unassigned fund balance as a percentage of total expenditures)~~ fall below the 815% threshold for the General Fund, the City Council must approve and adopt a plan to restore this balance to the target level within a specific period of time. When developing a restoration plan, the following items should be considered in establishing the appropriate time horizon:
  - a. The budgetary reasons behind the fund balance targets
  - b. Recovery from an extreme event
  - c. Financial planning time horizon
  - d. Long-term forecasts and economic conditions
  - e. Milestones for gradual replenishment
  - f. External financing expectations
4. **Order of Resource Use** In general, restricted funds are used first when an expenditure is incurred for the purposes for which both restricted and unrestricted fund balance is available. In addition, for unrestricted fund balance, the order of use of fund balance shall generally be: 1) committed; 2) assigned; and 3) unassigned.