

## Fund Balance Policy Discussion

For Finance Committee Meeting on Sept 7, 2021

**The purpose of this memo is to 1) inform Finance Committee members of the funds, their attributes and related policies, and 2) propose concepts on which to base rationale for future fund balance policy.**

### General Fund:

- accounts for financial resources not reported in other funds
- most operating activities are accounted for in this fund
- accounts for major city operating functions such as police, parks, public works and administration.
- may include grant revenues, donor restricted revenues, and related expenditures
- majority of the fund balance is “unassigned”
- the city has non-codified practice of “balancing” the unassigned portion of the general fund; that is unassigned revenues minus operating expenditures should be around zero each year.

Current fund balance policy: (Section 2-10, b (3)): Note: this isn't formally defined as a fund balance policy per se; as it's part of the investment policy, but it has been used in practice with fund balance management:

*“Reserves shall be maintained that are within a range of 30 to 50% of the city's prior year operating expenses or revenue, which ever is greater, exclusive of grant revenues, to be kept in the city's general fund cash and investment reserves.”*

The issue I see with the above policy is that it implies an upper limit. Historically the city has been in the 90% range. It also addresses reserve as Cash and Investments, which is not the same as fund balance.

If we are to revise the policy, I think the first decision is how much to have in fund balance to cover operating expenses in the unlikely event revenue is substantially decreased. In this scenario, operating expenditures would need to continue for some time. Determine the length of time first, for example, 6 months to a year. If for 6 months, fund reserve should be at 50% of operating expenditures. I think using prior year expenditures as a proxy would be sufficient, or use the current budget.

The more likely the scenario is that revenues have a short-term decline and the city continues to operate as normal during this period of decline. Reducing the rate from 6 months to 4 months (50% to 33%) offers more flexibility to pay expenditures during the decline.

In general, I believe the city should continue its practice of balancing the General Fund unassigned portions of the budget, and therefore continue to have a fund balance that is almost a year's worth of expenditures. The fund balance lower limit comes into play only in situations of financial hardship and would prevent us from going too “low” with our ability to pay our obligations.

### **Capital Projects Fund:**

- Accounts for resources that are restricted, committed or assigned for capital outlays
- Funded by local .5 % sales tax
- Expenditures in this fund must be for Capital Outlays only

Current fund balance policy: none.

If we are to create a policy, in my opinion it should reflect the outcome of long-term forecasting, for example 5 – 8 years.

With Capital, the forecast could reveal that a major, expensive project is needed 3 years in the future. If a savings mentality is adopted, that would mean Capital spending is curtailed for 2 years prior to the project to build up the fund balance to cover the project in year 3. Of course, the fund balance at year 1, 2 and 3 would look different and it's unlikely a General Fund type policy with a ratio would work. I would recommend a policy that addresses the need for long-term forecasting rather than fund balance. In current practice, we do prepare a long-term capital forecast, but don't forecast that out in a financial statement format. That would be the next step in the process.

### **Special Revenue Funds:**

Special revenue funds exist to provide an extra level of accountability and transparency that tax dollars will go toward an intended purpose. The fund balance policy should therefore follow determination of that intended purpose. Unless there is a reason to "save" for future expenditures under the intended purpose definition, I would argue that the fund balance should be managed like the general fund. That is, have a lower limit ratio to cover a certain period of expenses.

The following are the city's special purpose funds:

#### **County Road Fund:**

- This is special revenue fund that accounts for revenues that are restricted or committed to expenditures for specific purposes.
- Funded by property taxes collected for road projects
- Expenditures in this fund must be for road improvement and/or maintenance.
- Current practice is to charge this fund with salaries of Public Works employees who work on roads. This is a percentage allocation of their salary based on time worked.

#### **Storm Water / Parks Fund:**

- This is special revenue fund that accounts for revenues that are restricted or committed to expenditures for specific purposes.
- Funded by .5% local sales tax.
- Expenditures in this fund must be for Storm Water and Parks operations and capital outlays.

- Current practice is to charge this fund with Community Center and Aquatics Facility wages (both part-time and full-time), COP debt service and engineering costs for contemplated parks projects.

### **Public Safety Fund (new in 2022)**

- This is special revenue fund that accounts for revenues that are restricted or committed to expenditures for specific purposes.
- Funded by .5% sales tax collected by St. Louis County and then 5/8ths of which is remitted to the city based on population.

### **Conclusion**

Fund balance is the amount of net assets available for the city to meet future obligations. It is essentially a financial cushion. Because of the importance of understanding how much cushion may be needed, long-term forecasting should be done for all funds.

General Fund is for all resources and related expenditures which don't need to be legally reported in another fund. For the City, any grants and donor restricted activity needs to be parsed out to understand routine unassigned revenue and expenditures.

Capital Fund is only for capital items. Grant revenues, donor restricted revenue and interest income from investments may be recorded here, but expenditures must be used for capital purposes. Because capital needs vary from year to year, no specific policy is recommended at this time.

Special revenue funds are established to show that restricted revenues are used for their intended purpose. Grant revenues, donor restricted revenue and interest income from investments may be recorded here, but expenditures must be used for the intended purpose. In the City's case, unless there is a need to "save" for capital items which fall under that purpose, I recommended a fund balance policy similar to the general fund; that is create a reserve for a set period of future expenditures.

Submitted by Susanna Messmer  
Finance Director  
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