

Fund Balance Policy

Ensuring Financial Stability and Sustainability

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Introduction to Fund Balance

•Definition of Fund Balance:

- The difference between assets and liabilities in a governmental or organizational fund.
- Represents a reserve or cushion to address unforeseen expenses or economic shifts.
- It's an accounting term used to measure the financial resources available to an organization.

•Importance:

- Fund Balance represents a pool of accumulated funds that provides an organization with financial flexibility to manage unexpected expenses, cover short-term cash flow needs, and maintain operational stability, essentially acting as a "rainy day fund" to prevent the need for emergency borrowing and safeguard against unforeseen events; a healthy fund balance can also positively impact an organization's credit rating.



Introduction to Fund Balance

- **Key points about the importance of fund balance:**

- **Financial stability:**

A sufficient fund balance acts as a buffer against economic downturns or sudden cost increases, allowing an organization to continue operations without significant disruption.

- **Debt management:**

A healthy fund balance can reduce the need to take on high-interest debt to cover immediate expenses.

- **Investment opportunities:**

Excess funds in a fund balance can be invested to generate additional revenue for the organization.

- **Creditworthiness:**

A positive fund balance is often considered a key indicator of financial health by lenders, leading to better credit ratings and access to favorable loan terms.

- **Planning and budgeting:**

A well-managed fund balance allows for strategic planning and budgeting, enabling organizations to allocate funds for future projects or initiatives.



Types of Fund Balances (According to GASB 54)

Non-spendable: Funds that are not expected to be converted to cash (e.g., inventory, pre-paid items).

Restricted: Funds with externally imposed constraints (e.g., grants, donations).

Committed: Funds set aside by formal action of the governing body.

Assigned: Funds earmarked for specific purposes by the governing body or management.

Unassigned: Funds that are not designated for any specific purpose and can be used for general operations.



Why Establish a Fund Balance Policy?

Financial Stability: Ensures The Organization Can Cover Unexpected Expenses Or Revenue Shortfalls.

Improves Credit Rating: A Well-maintained Fund Balance Can Enhance The Organization's Creditworthiness.

Avoids Borrowing: Helps To Reduce Reliance On Short-term Borrowing And Debt.

Transparency & Accountability: Clearly Defines How Funds Should Be Managed, Fostering Trust With Stakeholders.



Key Components of a Fund Balance Policy

Target Fund Balance Levels: Define the optimal reserve levels, often based on a percentage of annual revenues or expenditures.

Criteria for Use: Specify circumstances under which fund balance can be used (e.g., emergencies, unexpected shortfalls).

Replenishment Strategy: Outline how the fund balance will be replenished after use (e.g., within a certain timeframe).

Monitoring and Reporting: Regular reviews and reporting of fund balance levels to ensure compliance with policy.



Setting Target Fund Balance Levels

Minimum Level: Typically, organizations aim for a minimum fund balance (e.g., 10-25% of operating revenues).

Maximum Level: To avoid excessive reserves, some organizations set an upper limit (e.g., 50% of revenues).

Factors to Consider:

- Revenue volatility.
- Economic conditions.
- Budgeting practices and historical performance.



Fund Balance Policy Examples

Example 1: A city may establish a policy to maintain a minimum of 15% of annual general fund expenditures in unrestricted fund balance.

Example 2: A non-profit might set a target of 6 months of operational expenses to be kept as reserves

Example 3: A school district may define specific scenarios under which they will use reserves (e.g., during a revenue shortfall, or unexpected facility repairs).



Best Practices for Fund Balance Management

Maintain Flexibility: Adapt The Policy To Changing Financial Conditions.

Plan For Long-term Sustainability: Regularly Adjust The Target Balance Based On Future Needs Or Risks.

Review Annually: Make Adjustments After Each Fiscal Year To Ensure The Policy Reflects The Current Financial Situation.

Engage Stakeholders: Involve Leadership, Financial Staff, And Auditors To Align Goals With Organizational Strategy.



Challenges in Fund Balance Management

Political Pressure: Some stakeholders may push for lower balances to reduce taxes or increase spending.

Economic Volatility: Sudden economic downturns can disrupt revenue projections.

Compliance Risks: Failing to meet policy guidelines can lead to financial instability and loss of trust.



Conclusion

Recap: A well-defined fund balance policy ensures financial resilience and operational continuity.

Call to Action: Establishing or reviewing a fund balance policy is a critical step toward financial management success.

Questions?





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