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### **Fund Balances for Local Governments – Office of the State Auditor Statement of Position**

*By Rebecca Otto, Minnesota State Auditor*

The Office of the State Auditor recently revised its Statement of Position on Fund Balances for Local Governments. The statement of position provides recommendations on fund balance policies to be adopted by local governments.

#### *Adoption of Fund Balance Policy*

The Office of the State Auditor recommends that each local government establish a formal policy on the level of unreserved fund balance that should be maintained in the general fund and special revenue funds. The policy should be set by the governing body and should provide both a time frame and a specific plan for increasing or decreasing the level of unreserved fund balance. If the fund balance does not match the policy, a plan should be developed by the governing body that will allow for compliance with the policy.

The Office of the State Auditor recommends each local government adopt a policy specifying the types of future expenditures to be designated, how the amounts for such designations are arrived at, and whether the governing body will set the designations annually or will set up a designation process and appoint someone to make the determination based on the guidelines established by the governing body.

The local government's revenue streams should be kept in mind when drafting such a policy. For example, funds that rely heavily on property taxes must maintain sufficient financial resources to provide adequate resources until the next tax revenue collection cycle. Funds that rely on state appropriations and grants should consider the timing of those payments. Also, local governments need to maintain a prudent level of financial resources to protect against a forced service level reduction or having to raise taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures.

Other considerations include the predictability of revenues and the volatility of expenditures-- higher levels of unreserved fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile. The availability of resources in other funds as well as the potential drain on the general fund resources from other funds could affect the level of unreserved fund balance needed. The availability of resources in other funds may reduce the amount of unreserved fund balance needed in the general fund, just as deficits in other funds may require that a higher level of unreserved fund balance be maintained in the general fund.

In some cases, the unreserved fund balance in special revenue funds may not be available for use for general operations of the local government, for example a park dedication special revenue fund in a city or a ditch special revenue fund in a county. In these situations, it is important for the local government's fund balance policy to document that these type of funds are not available for future appropriation to the general operations of the local government.

### *Appropriate Fund Balance Levels*

The Office of the State Auditor recommends that at year-end local governments maintain an unreserved fund balance in their general fund and special revenue funds of approximately 35 to 50 percent of fund operating revenues or no less than five months of operating expenditures, which should provide the local government with adequate funds until the next property tax revenue collection cycle. The adequacy of unreserved fund balance should be assessed based on an individual local government's own circumstances. If the local government's unreserved fund balance is less than or greater than the 35 to 50 percent recommended above the local government should be able to explain the reason for the difference.

Local governments should also consider taking a position on the level of unreserved fund balance in other funds that have unrestricted revenues. In setting an appropriate level, the local government should consider any long-term forecasting/planning issues, to avoid the risk of placing too much emphasis on the level of unreserved fund balance at any one time.

For the complete statement of position, see [http://www.auditor.state.mn.us/other/Statements/fundbalances\\_0708\\_statement.pdf](http://www.auditor.state.mn.us/other/Statements/fundbalances_0708_statement.pdf).

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