

APPENDIX B

FACTORS INFLUENCING GENERAL AND SPECIAL REVENUE UNRESERVED FUND BALANCES

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Minnesota cities report their fund balances at the close of their fiscal year (which runs concurrent with the calendar year). This creates an impression that cities have excessive amounts of revenue held in reserve. In reality, city fund balances should be relatively large at the end of the year because of local government cash-flow cycles. Cities must rely on their fund balances to meet expenses during the first five months of the next fiscal year, until they receive the first property tax payments (May) and aid payments from the state (July).

Unlike state government, which collects income tax withholding and sales tax receipts regularly throughout the year, Minnesota's cities do not have a constant flow of revenue from which they are able to fund local government operations. Property tax levies, state aid to local governments, and property tax credits comprise the majority of city discretionary revenues. Minnesota statutes govern the flow of these major revenue sources into city treasuries.

- Counties distribute the cities' share of the first-half property tax levies in late May and early June.
- Cities receive the first half of their state aid and property tax credits from the state in July of each year.
- Counties distribute the cities' share of the second-half property tax levies in late October and early November.
- Cities receive the second half of their state aid and property tax credits from the state in December of each year.

Given this state-controlled flow of revenue, city fund balances (which are measured on December 31) are the primary source of funds available to cities for their operating expenses during the first five months of the next fiscal year. An adequate fund balance will provide a local government with the cash flow required to finance expenditures without short-term borrowing.

Unique Circumstances of Each Jurisdiction Determine the Size of Fund Balance Needed

While cities must rely on the fund balances for cash flow purposes during the first five months of a year, the unique circumstances of each local government will determine the size of a fund balance that must be maintained to avoid the need for short-term borrowing and to operate effectively.

Numerous factors must be considered in determining the size of a fund balance necessary for a city to avoid short-term borrowing.

- If cities receive relatively large amounts of revenue from sources such as fees, fines, charges for services, other intergovernmental grants and aids, or interest on investments during the first five months of the calendar year, then they will be less dependent on their fund balances for cash flow purposes.
- Cities are often able to delay certain purchases until after the initial property tax and state aid payments are received. While payments for employee salaries, wages, and most benefits cannot be delayed during the first five months of the year, purchases of supplies and capital equipment may be delayed.

The individual cash flow needs of a city will determine the minimum fund balance that is necessary for a city to operate effectively. Cities with the ability to generate significant revenues from sources other than property taxes and state aid payments are often able to minimize the need for large fund balances to support their cash flow requirements. Conversely, cities that rely heavily on property taxes and state aid for the majority of their revenues will need relatively large fund balances to meet their cash flow needs from January 1 through June 1 of every calendar year.

While there are many factors that help determine the minimum fund balance needed to maintain financial health, the State Auditor has set a standard of between 35 and 50 percent of current expenditures as an acceptable level. The Auditor has concerns about the financial health of cities maintaining an unreserved fund balance lower than this standard. These cities may not have enough reserves to carry them through financial downturns or unexpected contingencies. Conversely, the Auditor has concerns about cities that maintain unreserved fund balances exceeding what is needed to carry them through financial downturns. Taxpayers in cities that maintain a fund balance higher or lower than this standard should press their city official to explain their fund balance policy.