TOWN OF FLETCHER
FUND BALANCE POLICY

PURPOSE

The Town desires to maintain a prudent level of financial reserves to guard its citizens against service disruption in the event of unexpected temporary revenue shortfalls or unpredicted one-time expenditures.

The primary reasons for a general fund reserve policy are to:

- **Plan for contingencies**. Because of volatile revenue sources such as property and sales tax, governments will always face challenges when it comes to matching planned revenues with actual expenditures. Local events, such as the closure of a major employer, can also negatively affect revenue. Finally, extreme weather events such as winter storms or hurricanes can increase operating and/or capital costs. Reserves can be used to make up these temporary shortfalls.
- **Maintain good standing with rating agencies**. Bond rating agencies consider an adequate level of reserves a sign of creditworthiness because it enhances a government's ability to repay debt on time and in full.
- **Avoid interest expenses**. Cash reserves may be used rather than debt to fund capital projects.
- **Generate investment income**. Reserves can be a source for investment revenue, effectively reducing the burden on the property tax rate. To maintain the reserve's value as a risk mitigation device, investments will remain relatively liquid.
- **Serve as cash flow management tool**. Reserves can be used to cover times of the year that normally experience low levels of cash.
- **Create a shared understanding**. A formal reserve policy clearly outlines appropriate use of the reserves.

COMPONENTS OF FUND BALANCE

Fund Balance vs. Reserves – "Fund balance" is an accounting term defined as the difference between assets and liabilities in a governmental fund. The term *"reserves"* is often used by public finance practitioners, but is not an actual government accounting term. It refers to the portion of fund balance held in reserve to provide a buffer against financial distress or risk.

In governmental funds, "reserves" comprise a portion of total fund balance. Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* governs the descriptions used to report fund balance. The statement focuses on the "extent to which the government is bound to honor constraints on the specific purposes for which amounts in the fund can be spent" and breaks total fund balance into (5) different components:

- **Non-spendable fund balance**. Fund balance in this category is inherently non-spendable.

- **Restricted fund balance.** This category has externally enforceable limitations on the use of fund balance, imposed by parties such as creditors, grantors, or laws or regulations of other governments.
- **Committed fund balance.** This encompasses limitations imposed by the government on itself at its highest level of decision making (e.g., governing board through a resolution). For example, the governing board might like to commit a portion of fund balance to a "stabilization fund" to provide a cushion against unknown economic downturns and revenue declines.
- **Assigned fund balance.** This category is for the portion of fund balance that is earmarked for an intended use. The intent is established at either the highest level of decision making or by a body or an official designated for that purpose. For example, a portion of fund balance might be assigned to offset a gap in the budget stemming from a decline in revenues or a portion could be assigned to pay for an upcoming special project. A typical assigned fund balance item is the amount of fund balance that is appropriated in the subsequent year's budget ordinance that is not already classified as restricted or committed.
- **Unassigned fund balance.** This encompasses all fund balances that are left after considering the other four categories. Use is least constrained in this category of fund balance.

The last three components (committed, assigned and unassigned fund balance) together comprise "unrestricted fund balance", which is the part of fund balance covered by this reserve policy because unrestricted fund balances are either unconstrained or the constraints are self-imposed, so they could be lifted in order to make fund balances available for other purposes. Conversely, restricted fund balances or non-spendable fund balances are not suited to many of the purposes a reserve policy typically is intended to fulfill.

SIGNIFICANT POLICIES

Required Reserve Levels

The North Carolina State Treasurer recommends a minimum unassigned fund balance in the general fund of eight percent (8%). However, the Town policy is more restrictive by requiring a minimum unassigned general fund balance of forty-five percent (45%) of the total actual expenditures. The minimum requirement will be reviewed by the Finance Director as changes in economic conditions occur, new legislation is enacted or revenue sources change.

Reserve Draw Downs

Fund balance appropriated will not exceed an amount management can reasonably expect to save during the year. If fund balance is appropriated to balance the following year's budget in an amount that, if spent, would reduce the percentage below forty-five percent (45%) an explanation of the circumstances of the utilization and a plan to save or replenish the fund balance will be included in the budget message and audit?

The unassigned fund balance may be purposefully drawn down below the minimum required percentage of forty-five (45%) for emergencies.

Excess Reserves

Unassigned fund balance percentages in excess of sixty-five percent (65%), calculated at the previous fiscal year-end, may be drawn down for nonrecurring expenditures as follows:

1. One-time expenditures that do not increase recurring operating costs that cannot be funded through current revenues. Emphasis will placed on one-time uses that reduce future operating costs, or
2. Start-up expenditures for new programs, provided that such action is approved by the Town Council and is considered in the context of multi-year projections of revenue and expenditures as prepared by the Town Manager and Finance Director, or
3. Appropriated to lower the amount of outstanding principal on existing debt, or
4. Lowering the property tax rate.

Reserve Replenishment

If the fund balance falls below the minimum required percentage of 45% for two consecutive fiscal years, the Town will replenish funds by direct appropriation beginning in the following year. In that instance, the Town will annually appropriate 25% of the difference between the minimum required percentage level and the actual balance until the minimum required level is met. In the event appropriating 25% is not feasible, the Town will appropriate a lesser amount and shall reaffirm its commitment to fully replenish the fund balance over a longer period of time.

This policy will be reviewed at least annually and updated on an as-needed basis.

Adopted this 9 day of October, 2017

William B. Moore, Mayor
Town of Fletcher

Christine Thompson MMC, NCCMC
Town Clerk