

Date: May 3, 2011

Memorandum to: Honorable Mayor and Board of Trustees

From: Francis A. Frobels, Village Manager

Subject: Fund Balance/General Fund Policy

Presently, the Village has a policy governing the establishment and maintenance of an undesignated fund balance in the range of 7 to 10% of the operating budget (see excerpt on Page 2). What is suggested in this memorandum is that the policy be elaborated upon for clarity and purpose.

Accountants use the term fund balance to describe assets depicted on the financial statements of municipalities. In interpreting those accounts, there are a variety of special purposes intended to serve as a measure of financial resources available. For example, often times terms employed are: restricted, committed, assigned and unassigned (see Page 11, Addendum C: "Other Matters Management Letter Hastings-on-Hudson dated May 31, 2010). When we talk about a fund balance, we are referring to an unrestricted fund balance designation as contained in the general fund.

The Government Financial Officers Association (GFOA) recommends and believes it is the best practice that a municipality maintains an appropriate cash level in an un-restricted fund balance in the general fund of no less than two months of the operating budget. In our situation that would amount to proximately \$2 million. The current policy in effect calls for a fund balance to be held in the range of 7 to 10% of the current operating budget. That would be approximately \$1.3 million. Even the experts disagree on the amount of ready cash available to a municipality. For the longest time, credit rating agencies have encouraged maintenance of a balance between 10 and 15% of the operating budget.

Experts in the profession do agree that the purpose of maintaining an adequate level of fund balance is intended to guard against current and future risk. By definition these could include revenue shortfalls or unanticipated expenditures. Over my career I've referred to this type of fund as a 'rainy day fund' and one that would grow during strong, healthy economic times when revenues exceed expectations and one intended to be used in periods of time to stabilize tax rates when revenues drop off. Stability in a tax rate is a critical part of ensuring the financial health of the municipality. Spikes and drop-offs in the property tax rate which often times parallel events

Honorable Mayor and Board of Trustees

Page 2

May 3, 2011

should be resisted. Credit rating agencies monitor the level of the fund balance to evaluate governments continued credit worthiness. The opinions of those agencies are important, for if the municipality finds itself issuing bonded indebtedness for capital investment, it is one reason why sufficient fund balance is important. Other reasons include maintaining liquidity for investment purposes (interest earnings), ability to increase out-of-pocket insurance deductibles (result is assuming greater risk while improving the level of coverage at a reduced cost), guarding against interruptions in receipt of state or county revenue streams, addressing cash flow concerns and ability to financially manage capital investment needs.

It has been the goal, over the past several budget cycles, to increase the fund balance. For the past three budgets, dependence on relying on the fund balance was avoided. The goal was to wean dependence off the fund balance for the reasons outlined above. Because of the recession with the resulting drop-off in revenues, the budget was unable to contribute to fund balance growth. With a hard discipline and decisions made this year, we have the opportunity to begin the process of growing the fund balance to a level where it should be established.

I would suggest the current policy of maintaining the fund balance between the 7 and 10% range. Following is draft language to modify the policy.

OPERATING BUDGET POLICY (excerpt)

7. The village shall maintain an undesignated fund balance in the range of 7%-10% of the operating budget.

RESOLUTION – REAFFIRMATION OF FUND BALANCE POLICY

The Board of Trustees believes that sound financial management principles require that sufficient funds be retained by the Village to provide a stable financial foundation at all times. To provide this stable financial base, the Village must maintain a general fund balance sufficient to provide cash flow for daily requirements; secure and maintain investment grade bond rating; offset economic downturns or revenue shortfalls; provide for all existing encumbrances and provide for unforeseen expenditures related to emergencies.

The unassigned fund balance in the general fund shall be maintained to a minimum of ten (10%) percent of the current fiscal year expenditures.