



## TOWN OF PITTSBORO

### *Fund Balance Policy*

### *& Reserve Policy*

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#### **Purpose:**

This policy establishes guidelines for preserving an adequate fund balance in each of the Town of Pittsboro (Town) operating funds in order to sustain financial stability and to provide prudent management of the Town's financial reserves.

Reserve funds are maintained to ensure the continued delivery of Town services. Reserves have been accumulated to provide stability and flexibility, to respond to unexpected adversity and/or opportunities, and to stabilize fluctuations in operations' cash flows and rates. Capital Reserve Funds are used to accumulate funds over time that will be used to complete capital projects, acquire major capital assets and support economic development projects.

#### **Fund Balance:**

Fund balance is the difference between a fund's assets and liabilities.

Based on GASB Statement 54, there may be up to five separate categories of fund balance, based on the extent to which the Town is bound to honor constraints on the specific purposes for which amounts can be spent. An accounting distinction is made between the portions of governmental fund balance that is spendable and non-spendable. The total of the last three categories, which only include resources without a constraint on spending or for which the constraint on funding is imposed by the Town itself, is termed unrestricted fund balance. The five categories are as follows:

1. **Non-spendable** fund balance – includes amounts that are not in a spendable form or are required to be maintained intact. Examples include inventory and prepaid items.
2. **Restricted** fund balance – includes amounts that can be spent only for the specific purposes stipulated by external resource providers either constitutionally or through enabling legislation. Examples include grants and debt proceeds.

3. **Committed** fund balance – includes amounts that can be used only for specific purposes determined by a formal action of the Town’s highest level of decision making authority which is the Board of Commissioners. Commitments may be changed or lifted only by the Board of Commissioners taking the same formal action that imposed the commitment originally.
4. **Assigned** fund balance – comprises amounts intended to be used by the Town for specific purposes. Intent can be expressed by the Board of Commissioners by the approval of a budget appropriation. In governmental funds other than the general fund, assigned fund balance represents the amount that is not restricted or committed. This indicates that resources in other governmental funds are, at a minimum, intended to be used for the purpose of that fund. An example includes funds assigned by the Board of Commissioners for specific capital projects.
5. **Unassigned** fund balance – is the residual classification of the general fund and includes all amounts not contained in other classifications. The Town uses the term available fund balance when referring to unassigned fund balance. Available fund balance (or unassigned fund balance) is the amount that is available for appropriation for public purposes.

Enterprise funds are used to account for utility operations. Enterprise funds are also known as proprietary funds and business-type funds. Enterprise funds have separate terminology for fund balance termed as net position in financial reports. The Town most commonly uses the term fund balance for enterprise funds. The fund balance of all enterprise funds including electric, gas, water, sewer, and storm water is designated as unrestricted fund balance (or unrestricted net position). Restricted fund balance has externally imposed limitations on use from creditors, grantors, laws/regulations, or constitutional provisions. Generally, enterprise funds are business-type funds that do not have those types of restrictions and therefore, the fund balance is termed as unrestricted. However, the fund balance of each enterprise fund is used for the operating purpose of the fund. Appropriations for non-operating purposes and transfers will be clearly indicated in the annual budget and transfers will be subject to applicable statutory restrictions.

**Objectives:**

The Town recognizes that it is essential to maintain adequate unassigned fund balance to mitigate financial risk that can occur from unforeseen revenue

fluctuations, unanticipated expenditures, and similar circumstances. The fund balance also provides cash flow liquidity for the Town's operations.

Fund balance enhances short term and long term financial credit by helping to achieve the highest credit and bond ratings possible.

Fund balance promotes long-term financial stability by establishing clear and consistent guidelines.

Fund balance will provide funding flexibility during unanticipated emergencies and natural disasters.

**Guidelines:**

The Town will maintain reserves required by law, ordinance, and/or bond covenants. The North Carolina Local Government Commission prescribes that a minimum of at least eight (8) percent of annual budgeted expenditures be maintained for unassigned/unreserved fund balance. Higher levels may be set based on the current operating needs of the individual fund and future funding needs. The Town's goal is to have a minimum fund balance of at least ten (10) percent of annual budgeted expenditures for each operating fund.

All expenditures drawn from fund balance will require Board of Commissioners approval unless previously authorized by the Board of Commissioners for expenditure within the Town's annual budget.

**Capital and Reserve Funds:**

The purpose of the Capital and Reserve Fund Policy is to provide guidance with respect to the development, maintenance and use of Reserve Funds. The Town shall strive to develop appropriate reserves to meet future financial obligations with respect to equipment, infrastructure and fiscal needs.

Any fund balance which is not appropriated in the following year's budget for specific expenditures and which is not designated or reserved for specific purposes serves as a general operating reserve for the Town.

The Town will strive to maintain adequate reserves of General Fund balance to insulate General Fund programs and current service levels from large and unanticipated one-time expenditure requirements; revenue reductions due to a change in state or federal legislation or slower revenue growth; adverse litigation or any similar unforeseen action. Reserves should be used for specific circumstances.

Enterprise funds distinguish between current and non-current assets and liabilities. The measure of working capital (i.e., current assets less current liabilities) indicates the relatively liquid portion of total enterprise fund capital, which constitutes a margin for meeting obligations. Working capital is a measure of available margin or buffer in enterprise funds. Enterprise funds should strive to maintain working capital equal to no less than 90 days of operating expenses.

The measure of liquidity helps to assess the ability of the Town to sustain a strong financial position. The ratio of unrestricted cash and short term investments to current liabilities will be used to calculate the liquidity position in Enterprise Funds

The Town will strive to maintain adequate reserves in the Enterprise Fund to ensure stable services and fees; aid in longer term financial and capital planning; ensure creditworthiness or positive economic conditions to ensure the Town maintain a favorable bond rating.

The Town will strive to maintain a liquidity ratio or more than one to one; maintain 90 days' worth of annual operating expenses' and maintain rate models to adequately forecast financial condition.

To establish a capital reserve the Board of Commissioners must adopt an ordinance or resolution which states the following:

1. *The purposes for which the fund is being created.* The Town may accumulate moneys for multiple capital projects within a single capital reserve fund, but it must list each project separately.
2. *The approximate periods of time during which the moneys will be accumulated for each purpose.* The Town must provide a rough estimate when moneys will be expended from the capital reserve fund for each capital project.
3. *The approximate amounts to be accumulated for each purpose.* The Town must provide a rough estimate of the total of the amounts it intends to save for each capital project.
4. *The sources from which moneys for each purpose will be derived.* The Town must indicate the revenue sources it intends to allocate to the capital reserve fund to finance each project (e.g. property tax proceeds, utility fees, local sales and use tax proceeds, grant proceeds, etc.).

Establishing a capital reserve fund affords the Town governing board a more formalized mechanism to save moneys for future capital expenditures. It also provides greater transparency than using fund balance because the board must indicate how it ultimately intends to expend the moneys. Once moneys are

appropriated to a capital reserve fund, they must be used for capital expenditures. The moneys may not be used to fund operating expenses, even in an emergency situation. The Town must list specific capital projects in the capital reserve fund. The board, however, may amend its capital reserve fund at any time to add new capital projects, delete capital projects, or to change the nature of the capital projects.

The board must adopt an ordinance or resolution authorizing the withdrawal of moneys from the fund, the transfer of the moneys to another fund (such as the General Fund or Enterprise fund) and the expenditure of the moneys for one or more of the capital projects or assets identified in the Capital Reserve Fund.

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