

KENAI PENINSULA BOROUGH POLICY

Unrestricted Fund Balance for Budgetary Calculations for Operating and Capital Project Funds

Purpose:

To establish appropriate fund balance ranges for the Borough and Service Areas' operating and capital funds.

Background:

Fund Balance by definition does not equal cash, nor is it the difference between revenues and expenditures. Rather, Fund Balance is the cumulative difference of all revenues and expenditures from the government's creation. It can also be considered to be the difference between fund assets and fund liabilities, and can be known as fund equity or net position.

The accumulation of fund balance can greatly assist a government's ability to provide services to its residents. Fund balance allows government to provide a stable taxing policy and revenue structure to fund its services. Adequate levels of fund balance enable a government to spread the effect of such items as economic uncertainty and natural disasters over many years. An adequate level of available fund balance is also a major consideration of credit rating agencies during their evaluation of a government's credit worthiness.

Nonspendable and restricted fund balance consists of portions of fund balance that are either legally restricted to a specific future use or are not available for appropriation or expenditure. The portion of fund balance that is not available for appropriation or expenditure represent assets that are not considered "expendable available financial resources." Typical nonspendable and restricted fund balance reserves include:

- Nonspendable
 - Advances to other funds
 - Inventory
 - Prepaid expenses
- Restricted
 - Reserved for debt service, if required by bond documents
 - Grant covenants
 - Service Areas fund balances are shown as restricted for financial statement purposes only. For budgetary fund balance calculation purposes, those funds should be considered as committed.

Unrestricted fund balance represents expendable available financial resources. Unrestricted fund balance can be subdivided into committed, assigned or unassigned, where the only constraint on spending, if any, is imposed by the governmental entity. Typical unrestricted fund balance accounts include:

- Committed fund balance, amounts constrained to specific purposes by a government itself, using its highest level of decision-making authority; to be reported as committed, amounts cannot be used for any other purpose unless the government takes the same highest-level action to remove or change the constraint
 - Outstanding Contracts
 - Purchase orders
 - Special Revenue Funds for budgetary calculations.
- Assigned fund balance, amounts a government intends to use for a specific purpose; intent can be expressed by the governing body or by an official or body to which the governing body delegates the authority
 - Fund balance policy
 - Bond ratings
 - Restricted for specific programs, ie Service Areas
 - Subsequent year expenditures
- Unassigned fund balance amounts that are available for any purpose; these amounts are reported only in the general fund.

Operating Funds

Establishment of fund balance range should include the following:

- Working capital requirements.
- Bond rating and debt service reserve
- Operating contingencies
 - Revenue volatility amount
 - Unexpected expenditure
- Future capital expansion and contingencies

Assignments

Working capital requirements

Working capital provides the amount necessary to cover cash flow requirements and normal variations in revenue and expenditure estimates. Each funds unreserved fund balance shall include an amount equal to at least 10% but not more than 40% of their budget expenditures for working capital. The range shall be determined as follows:

- | | |
|--|------------|
| 1. Funds with expenditure levels in excess of \$10,000,000 | 10% to 15% |
| 2. Funds with expenditure levels from \$7,500,000 to \$9,999,999 | 10% to 20% |
| 3. Funds with expenditure levels from \$2,000,000 to \$7,499,999 | 15% to 25% |
| 4. Funds with expenditure levels from \$500,000 to \$1,999,999 | 20% to 30% |
| 5. Funds with expenditure levels from \$0 to \$499,999 | 25% to 40% |

Bond Rating and debt service reserve

Average annual debt service as a percentage of operating budget	Minimum percentage	Maximum percentage
0% to 5%	15%	25%
6% to 10%	25%	50%
More than 11%	40%	75%

Operating Contingencies

Revenue volatility amount

A revenue volatility factor will provide an amount necessary to offset the sudden decline of significant sources of revenue. Fund balance shall include amount for revenue sources subject to significant declines, as a result of external forces, and constituting a significant portion of a fund’s revenue. The amount designated will be calculated by first calculating the percentage of a funds revenue derived from each revenue source. Secondly a ten year or since fund inception average, which ever is less, annual revenue change will be calculated. Using the percentage of fund revenue and average change, the appropriate volatility factor will be extracted from the following table and multiplied by the prior year’s actual revenue generated by the revenue source. Deviations from this policy may be necessary when changes are made to tax policy such as the \$100,000 personal property tax exemption, the increase in real property exemption from \$20,000 to \$50,000 and the non-prepared food exemption from September 1st to May 31st of each fiscal year.

% Revenue from Source	Low Volatility 0% - 6% Average Volatility Factor	Moderate Volatility 7% - 15% Average Volatility Factor	High Volatility 16%+ Average Volatility Factor
0% to 15%	0%	0% to 10%	10% to 20%
16% to 30%	0%	0% to 15%	20% to 40%
31% to 50%	0%	20% to 40%	30% to 50%
51% to 70%	0%	25% to 50%	60% to 80%
71% to 100%	0%	40% to 75%	75% to 100%

Unexpected Expenditures

From time to time unexpected expenditures will be incurred. Each operating fund shall maintain fund balance to meet these contingencies. The appropriate factor from the following table shall be multiplied by the prior fiscal years total expenditures and operating transfers less transfers. The amount shall be determined as follows:

1. Funds with expenditure levels in excess of \$10,000,000 5%
2. Funds with expenditure levels from \$2,000,000 to \$9,999,999 10%
3. Funds with expenditure levels from \$500,000 to \$1,999,999 15%
4. Funds with expenditure levels from \$0 to \$499,999 25%

Future Capital Expansion and Contingencies:

Operating funds without a related capital projects fund will establish a ten-year financial plan for major capital expansion and maintenance. An amount of fund balance from 10% to 25% of the total expenditures for the ten-year plan shall be designated.

Operating funds having established a capital projects funds for the acquisition of major capital items and scheduled equipment replacement will not have a designation for future capital expansion and contingencies. The fund balance of such capital project funds will be evaluated using the Capital Funds Portion of this policy.

Capital Project Funds

Establishment of fund balance range should include the following:

- Designations for capital requirements.

Designations for capital requirements:

Capital projects funds were established for services areas to accumulate financial resources needed for major maintenance, capital infrastructure expansions or replacement and major equipment. These funds accumulate resources through operating transfers from the service area’s operating fund, interest earnings and grants. Operating transfers from operating funds are intended to be level contributions thus minimizing large variances to operating fund budgets from year to year. The fund balance of these capital projects funds should support the funds ten-year capital replacement and acquisition plan. The service areas update this plan annually.

Each fund’s ten-year average of fund balances shall be no less than 15% but no more than 100% of the average expenditures for the ten-year capital replacement and acquisition plan. The range shall be determined as follows:

Average expenditures for the ten-year capital replacement and acquisitions plan	Minimum percentage	Maximum percentage
\$500,000 +	15%	25%
\$250,000 to \$499,999	25%	50%
\$100,000 to \$249,999	50%	75%
\$0 to \$99,999	50%	100%

Policy

It will be the policy of the Borough to apply the above criteria for annual analysis during its budgeting process. A range of fund balance will be presented to the assembly for approval as part of the annual budgeting process; any deviation from the policy shall be documented and presented at this time. If a fund balance is outside of the established range, the proposed budget must include a three-year plan of action to achieve compliance with the established range.