



Best Practices for Managing Fund Balance

WHAT IS FUND BALANCE?

Most simply, fund balance is the difference between assets and liabilities in a governmental fund.

WHY DOES FUND BALANCE MATTER?

Nearly all public entities that have gone through the rating process by a Nationally Recognized Statistical Rating Organization (NRSRO) have fielded questions related to the level of fund balance held in operating funds. During rating calls, financial officers receive questions on fund balance policies and procedures and fund balance minimum or maximum levels. Analysts try to understand previous practice and future plans.

Fund balance, especially cash on hand, is important to public entities with volatile revenue cycles. Numerous Wisconsin school districts have fund balance policies that require fund balance to be at a level that will provide the district with sufficient cash to eliminate the need to cash flow borrow. This is a credit positive from a rating agency perspective, but may not be a perfect solution for all districts.

WHAT DOES THE GOVERNMENT FINANCE OFFICERS ASSOCIATION (GFOA) RECOMMEND?

In its October 2009 Best Practice document *Determining the Appropriate Level of Unrestricted Fund Balance in the General Fund*, GFOA provided the following recommendations:

In establishing a policy governing the level of unrestricted fund balance in the general fund, a government should consider a variety of factors, including:

- The predictability of its revenues and the volatility of its expenditures (i.e., higher levels of unrestricted fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile);
- The perceived exposure to significant one-time outlays (e.g., disasters, immediate capital needs, state budget cuts);
- The potential drain upon general fund resources from other funds as well as the availability of resources in other funds (i.e., deficits in other funds may require that a higher level of unrestricted fund balance be maintained in the general fund, just as the availability of resources in other funds may reduce the amount of unrestricted fund balance needed in the general fund);
- Liquidity (i.e., a disparity between when financial resources actually become available to make payments and the average maturity of related liabilities may require that a higher level of resources be maintained); and
- Commitments and assignments (i.e., governments may wish to maintain higher levels of unrestricted fund balance to compensate for any portion of unrestricted fund balance already committed or assigned by the government for a specific purpose).



WHAT DO THE NRSROs VIEW AS AN APPROPRIATE LEVEL OF FUND BALANCE?

In early 2014, Moody's Investors Service released its new General Obligation rating methodology and along with it, provided benchmarks related to fund balance and cash balance. The new "scorecard" rating system allocates 30% of the weight of the rating to an entity's finances.

SCORECARD FACTOR 2: FINANCES – 30%

	Very Strong	Strong	Moderate	Weak	Poor	Very Poor	
	Aaa	Aa	A	Baa	Ba	B & Below	Weight
Finances (30%)							
Fund Balances as % of Revenues	>30.0% >25.0% for School Districts	30.0% ≥ n > 15.0% 25.0% ≥ n > 10.0% for SD	15.0% ≥ n > 5.0% 10.0% ≥ n > 2.5% for SD	5.0% ≥ n > 0.0% 2.5% ≥ n > 0.0% for SD	0.0% ≥ n > -2.5% 0.0% ≥ n > -2.5% for SD	≤ -2.5% ≤ -2.5% for SD	10%
5-Year Dollar Change in Fund Balance as % of Revenues	>25.0%	25.0% ≥ n > 10.0%	10.0% ≥ n > 0.0%	0.0% ≥ n > -10.0%	-10.0% ≥ n > -18.0%	≤ -18.0%	5%
Cash Balances as % of Revenues	>25.0% >10.0% for School Districts	25.0% ≥ n > 10.0% 10.0% ≥ n > 5.0% for SD	10.0% ≥ n > 5.0% 5.0% ≥ n > 2.5% for SD	5.0% ≥ n > 0.0% 2.5% ≥ n > 0.0% for SD	0.0% ≥ n > -2.5% 0.0% ≥ n > -2.5% for SD	≤ -2.5% ≤ -2.5% for SD	10%
5-Year Dollar Change in Cash Balances as % of Revenues	>25.0%	25.0% ≥ n > 10.0%	10.0% ≥ n > 0.0%	0.0% ≥ n > -10.0%	-10.0% ≥ n > -18.0%	≤ -18.0%	5%

Similarly, Standard and Poor's (S&P) released *U.S. Local Government General Obligation Ratings: Methodology and Assumptions*. The document details the quantitative and qualitative factors that are considered when analyzing an entity's liquidity. S&P puts a focus on available cash as a percentage of total governmental funds expenditures and as a percentage of total government funds debt service.

WHERE CAN I FIND A SAMPLE FUND BALANCE POLICY?

Sample fund balance policies and additional information related to reporting fund balance under GASB 54 are available on the GFOA website at <http://www.gfoa.org/financial-policy-examples-general-fund-reserves>, and from the Wisconsin Department of Public Instruction (DPI) at http://sfs.dpi.wi.gov/sfs_fundbal.

For additional information related to fund balance policies, please contact your WISC Portfolio Advisor at 1-800-783-4273.



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