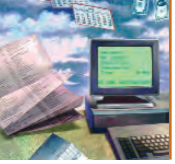

GFOA Updates Best Practice on Fund Balance

By Stephen J. Gauthier

In 2002, the Government Finance Officers Association (GFOA) issued a recommended practice (now a best practice) on *The Appropriate Level of Unreserved Fund Balance in the General Fund*. In 2009, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which replaces the traditional categories of *reserved* and *unreserved* fund balance with five new categories (i.e., *nonspendable*, *restricted*, *committed*, *assigned*, and *unassigned*) that represent a fundamentally different approach to classifying fund balance.

The changes that will result from the implementation of GASB Statement No. 54 led the GFOA to review and "fine tune" certain aspects of its best practice on the appropriate level of fund balance in the general fund.

The changes that will result from the implementation of GASB Statement No. 54 made it necessary, at a minimum, that the GFOA revise its 2002 best practice to reflect the new categories of fund balance. At the same time, the very process of revision created an excellent opportunity for the GFOA to review and "fine tune" certain aspects of its 2002 guidance. Accordingly, the GFOA's Committee on Accounting, Auditing, and Financial Reporting (CAAFR) and the GFOA's Committee on Governmental Budgeting and Fiscal Policy jointly prepared a draft revised version of the 2002 best practice in June, which was subsequently approved by the GFOA's Executive Board at its October 2009 meeting.

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The revised best practice, like its predecessor, deals exclusively with the appropriate level of fund balance in the general fund. The revised best practice also, like its predecessor, focuses on just one portion of fund balance. Prior to GASB Statement No. 54, of course, the focus had been on *unreserved fund balance*. Now that the distinction between *reserved* and *unreserved* fund balance has been eliminated, the focus henceforth will be on unrestricted fund balance, defined as the sum of *committed fund balance*, *assigned fund balance*, and *unassigned fund balance*. The revised best practice goes on to suggest that some governments may wish to focus even more narrowly on just the *unassigned* portion of unrestricted fund balance.

MINIMUM LEVEL

A primary objective of a fund balance policy is to maintain adequate resources to cope with contingencies. As a practical matter, very large governments often are in a much better position to predict contingencies than are smaller governments (for the same reason that an insurance company can more readily predict the number of accidents for a pool of 500,000 drivers than for a pool of fifty). In preparing the original 2002 best practice, the GFOA intended to set a minimum target of approximately two months of operating revenues or expenditures, while at the same time acknowledging that an amount as low as 5 percent could be appropriate for very large governments. Accordingly, the original best practice spoke of a *minimum* target of "no less than 5 to 15 percent" and explained in a footnote that

> In practice, levels of fund balance…typically are less for larger governments than for smaller governments because of the magnitude of the amounts involved and because the diversification of their revenues and expenditures often results in lower degrees of volatility.

Unfortunately, this guidance has sometimes been misinterpreted. Some, for instance, have misunderstood the reference to "no less than 5 to 15 percent" as setting both a *minimum* target (5 percent) and a *maximum* target (15 percent) for unreserved fund balance, whereas the GFOA very much intended that 15 percent be the *minimum* target for most governments. Likewise, the GFOA intended that the "larger government" exception apply to just a few very large governments, whereas it has sometimes been misunderstood to encompass anything "larger" than a small government.

The revised best practice attempts to eliminate the first misunderstanding by clearly stating that:

> GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.

A related footnote goes on to explain that a "significantly lower" level "may be appropriate for *states and America's largest governments* …" (emphasis added) without specifying how low that level might be.

FUTURE DEVELOPMENTS

The GFOA's Executive Board was not content with simply issuing a revised best practice on *The Appropriate Level of Unrestricted Fund Balance in the General Fund*. The board also directed the committees concerned to explore the possibility of developing additional guidance on: 1) appropriate levels of fund balance in governmental fund types other than the general fund, and 2) the appropriate level of working capital that should be maintained in proprietary funds. The committees will likely consider both topics at the upcoming winter committee meetings, which are scheduled for January 2010 in Washington, D.C.

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