



Using Unassigned Funds to Balance the Budget

By William E. Tomes, Anna B. Berger, and Megan E. Bassett

In its most recent *State of Local Government Fiscal Conditions* research survey, The Institute for Public Service looked more closely at how fund balances are used in addressing budget issues.

During the recession and its aftermath, many families struggling to make ends meet have had to use their savings to pay bills or buy groceries. Many local governments across the nation have had to do the same, using a part of their unrestricted fund balances to cover expenses because of declining revenues and increased costs. In 2009, the Institute for Public Service and Policy Research at the University of South Carolina began a longitudinal study of the impact the recession has had on local governments in South Carolina. In its 2010-2011 *State of Local Government Fiscal Conditions* research survey, the institute expanded the section on use of fund balances in addressing budget issues. The results from the fund balance survey questions are presented in this article.

Government financial reports use the term fund balance to describe the difference between financial assets and liabilities. The 2009-2010 institute survey used the term “undesignated, unreserved” fund balance in reference to money available in the general fund for any purpose, that was not restricted, committed, or assigned for any other use. The Governmental Accounting Standards Board found that governments interpreted fund balance categories in different ways and fund balance reporting was inconsistent.¹ This led to the issuance of GASB Statement No. 54, *Fund Balance Reporting and*

Governmental Fund Type Definitions, which addresses these inconsistencies. Governments were required to implement the new standards for the fiscal year beginning after June 15, 2010. Because some of the local governments participating in the institute’s survey may not have implemented GASB Statement No. 54 when they completed the survey, the “undesignated, unreserved” terminology was still used in the 2010-2011 survey. The intention was to have participants report the “unassigned fund balance” (funds that are available for any purpose and reported only in the general fund) as currently defined by GASB 54.

About the Survey

A total of 70 South Carolina local governments (47 municipalities and 23 counties) responded to the fund balance questions in either the 2009-2010 or the 2010-2011 surveys. The surveys requested data from fiscal 2008 through the current fiscal year. Seventy percent (61.7 percent of the municipalities and 87 percent of the counties) reported using their unassigned fund balances at least once between fiscal 2008 and fiscal 2011. Thirty-three of the respondents used their unassigned fund balances at least twice during the four-year period between fiscal 2008 and fiscal 2011.

Exhibit 1: Actual Fund Balance versus Policy Requirement

	Actual Fund Balance		Policy Requirement	
	Municipalities	Counties	Municipalities	Counties
Average	33.82%	30.55%	21.22%	23.41%
Range	2%-100%	5%-58%	10%-35%	10%-47%

When asked why they elected to use the fund balance, respondents said they did so to cover budget shortfalls (30 percent), capital projects (14 percent), grant matches (3 percent) and cost of living adjustments and bonuses (2 percent). Some listed multiple reasons, and some (3 percent) chose “other” — these responses included loss of state aid, refund of fire service fee, and using the fund balance instead of issuing bonds or tax anticipation notes. The average amount of the unassigned fund balance used was 11.58 percent, but the amount used ranged from .95 percent to 45.88 percent.

FUND BALANCE POLICIES

While some may view the fund balance as unnecessary and something that should be used to reduce taxes, financial management experts agree that some level of fund balance is needed. The Government Finance Officers Association recommends that governments establish a fund balance policy and maintain a fund balance of no less than two months (16.67 percent) of general fund operating expenditures.² The GFOA also notes that higher minimum balances should be considered in cases of rapidly growing budgets, disparities in timing between revenue and expenditures, and the possibility of natural disasters such as hurricanes.³ The International City/County Management Association uses bond rating firms’ rule-of-thumb figure of maintaining at least 5 percent of annual

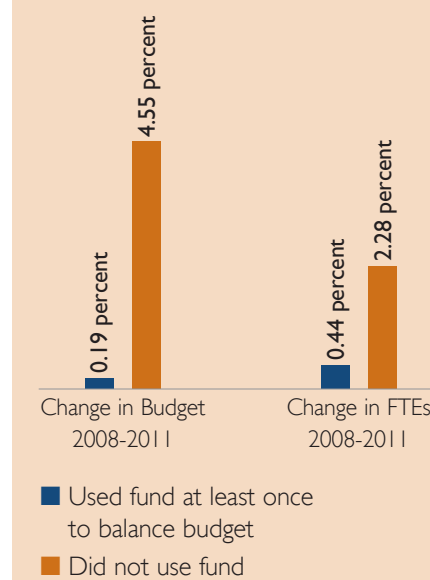
operating expenditures as an acceptable fund balance.⁴

Forty-nine local governments responded to the question about whether their jurisdiction had a fund balance policy. Twenty-nine (59%) indicated that they did, and 16 of those had policies that required replenishment of the funds if the balance dropped below a certain level. Seven jurisdictions reported that their fund balances were lower than the amount required by their policy. Exhibit 1 summarizes responses regarding fund balance policies.

WHAT THE NUMBERS MEAN

Does using part of its fund balance indicate that a city or county is struggling

Exhibit 2: Change in Median Budget and FTEs



financially? Not necessarily; some local governments use unassigned fund balance for one-time expenses or to routinely handle uneven revenue flows so they won’t have to issue tax anticipation notes or other short-term debt. But using the fund balance to address budget shortfalls can indicate more serious issues caused by declining revenues or increasing expenses. The following analysis compares the 30 jurisdictions that used their unassigned fund balances to cover budget shortfalls during the survey period to those that did not use their fund balances at all during the four-year survey period, to see if there are differences in the responses to the survey questions.

Exhibit 3: Cities that Used Unassigned Fund Balance — 2011 Sources of Revenue

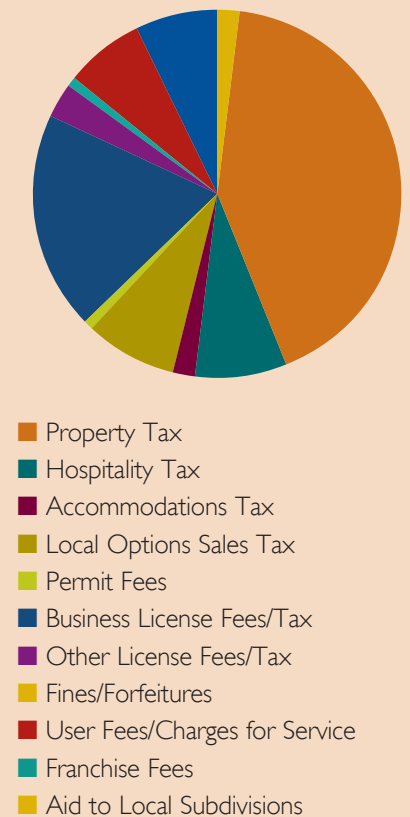


Exhibit 2 illustrates that non-users had larger increases in both the size of their budgets and the number of full-time employees. Exhibits 3 and 4 show that jurisdictions that used fund balance were more dependent on the property tax as their main source of revenue than those that didn't use fund balance. (Because of varying revenue sources and a small sample size, counties were not included in this analysis.) Although property tax revenues have been the most stable revenue source during the recession, jurisdictions that used their fund balances saw a smaller growth in property tax revenue, even though they were more likely to increase property

taxes over the four-year survey period (see Exhibits 5 and 6).

Cities that didn't use fund balance fared better in all revenue sources than those that did, with the exception of "other license fees" (see Exhibits 6 and 7). Cities that used fund balance were much more likely to increase fees or initiate new ones during the recession (see Exhibit 8).

While users were more likely to take steps to increase their revenue by raising taxes and fees, they also took several other actions at a greater rate than non-users. The survey asked about tar-

Exhibit 5: Increase in Property Tax

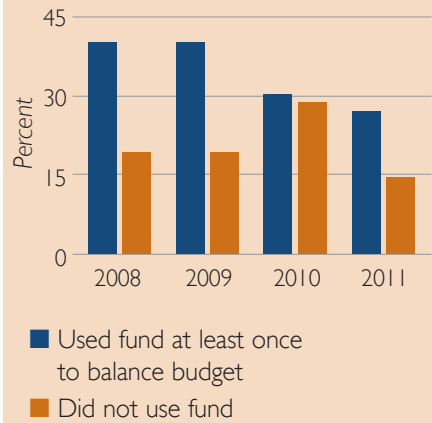
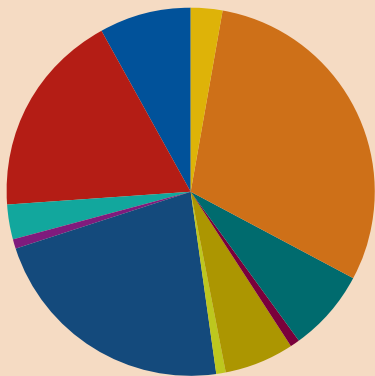


Exhibit 4: Cities that Did Not Use Unassigned Fund Balance — 2011 Sources of Revenue



- Property Tax
- Hospitality Tax
- Accommodations Tax
- Local Options Sales Tax
- Permit Fees
- Business License Fees/Tax
- Other License Fees/Tax
- Fines/Forfeitures
- User Fees/Charges for Service
- Franchise Fees
- Aid to Local Subdivisions

Exhibit 6: Changes in Revenue, Fiscal 2008-Fiscal 2011

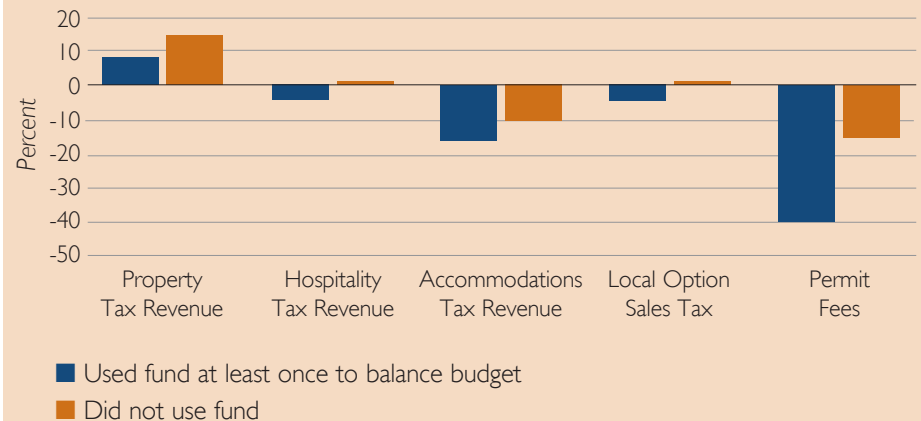


Exhibit 7: Changes in Revenue, Fiscal 2008-Fiscal 2011

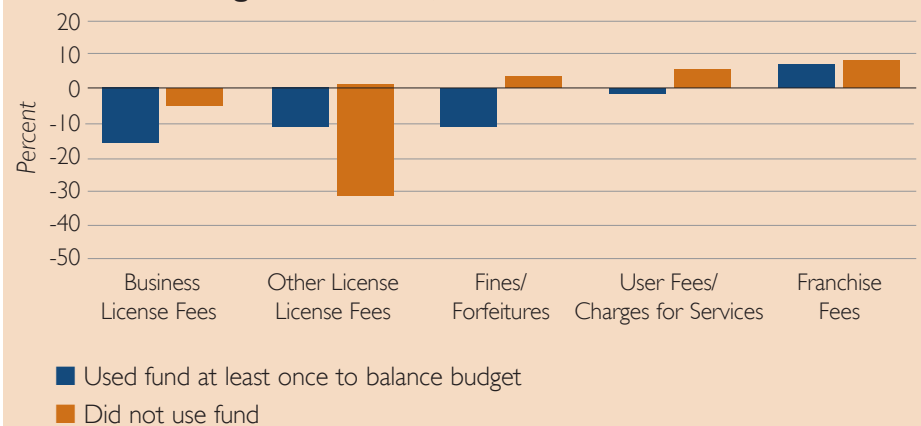


Exhibit 8: Increases in or Additions to User Fees

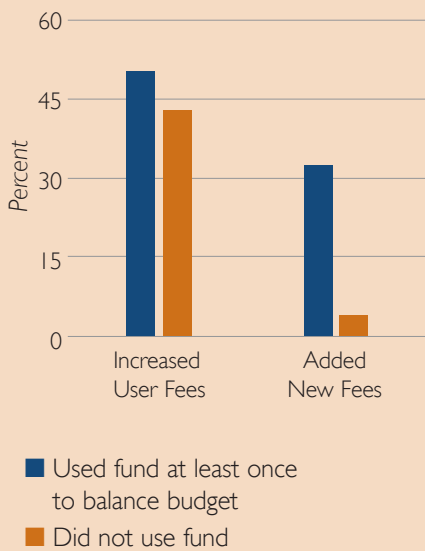
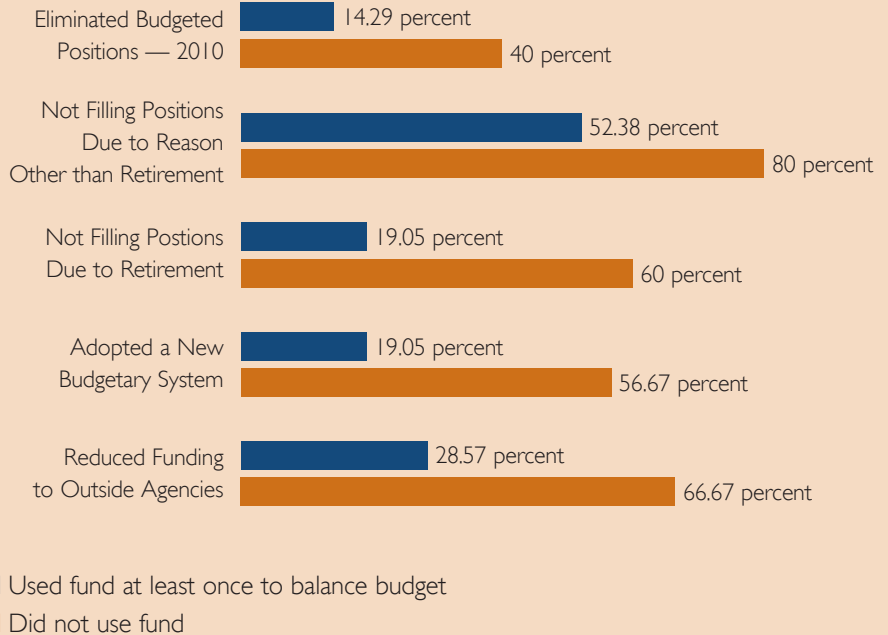


Exhibit 9: Significant Differences in Cuts and Reductions



geted cuts and reductions in 25 areas. Exhibit 9 shows the survey results in the five areas in which there were significant differences in response rates.⁵

Although the differences in response rates were not significant, cities that used unassigned fund balance were twice as likely to terminate employees and eliminate positions. They were also more likely to cut overtime hours and reduce or freeze employee salaries.

There were a few areas in which the cities that did not use fund balance were more likely to make cuts or reductions, although again, the differences were not significant. They were more likely to cut or reduce training expenditures, vacation and holidays, and health-care options. Also, cities that did not use fund balance tapped into their enterprise funds to balance budgets at a greater rate than cities that did use unassigned general fund balance.

CONCLUSIONS

Using a portion of the unassigned fund balance is one tool available for addressing tight budget times and may be a necessity for local governments struggling with declining revenues and increasing costs. Survey results seem to indicate that jurisdictions that made the decision to use a portion of their unassigned fund balance did so in conjunction with other actions to reduce costs or increase revenues. However, continued dependence on the unassigned fund balance will eventually weaken the financial stability of the jurisdiction, as short-term forecasts of local government revenues continue to be dreary. The challenge for these local governments will be to replenish their fund balances if revenues continue to decline and expenses increase. ■

Notes

1. *Fact Sheet about Fund Balance Reporting and Governmental Fund Type Definitions,*

Governmental Accounting Standards Board, www.gasb.org.
 2. *Appropriate Level of Unrestricted Fund Balance in the General Fund*, Government Finance Officers Association best practice, 2009, www.gfoa.org.
 3. Stephen J. Gauthier, *What Everyone Needs to Know about the New Fund Balance* (Chicago: Government Finance Officers Association, 2009).
 4. Jon Johnson and Chris Fabian, "It's All in the Questions: The Manager's Role in Achieving Fiscal Health." *Public Management*, September 2009.
 5. Significant differences were determined by chi square analysis. Differences noted were at the .05 level of significance or greater.

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