A major policy decision required of the Village is the establishment of an appropriate level of undesignated fund balance in the Corporate Fund. The difficulty arose due to a situation where no authoritative guidelines are available to either plan for or use these balances. To this end, the Government Finance Officers Association published a guide entitled *Fund Balance and Net Assets*, which in part discusses this matter and offers some level of guidance for local government.

Research approaches unreserved fund balance from an aspect of both budgetary development and control in periods of economic uncertainty. Essentially, the focus on the use of unreserved fund balance is to provide for operating contingencies. Such unreserved balances can provide for operations and continued tax stability should budgetary short falls develop. However, the development of any policies or guidelines that establish the proper level of unreserved fund balance is a difficult task, especially in light of the fact that there is no uniform standard regarding the appropriate level of unreserved fund balance.

There are several reasons that an unreserved fund balance should be maintained and are generally related to the management of economic uncertainty. Points cited are as follows:

1. Unreserved fund balance can permit the temporary match in revenue to growth in expenditures. The temporary nature of this match relationship is that some permanent revenue enhancement or expenditure controls must be put in place at an early point beyond the period of balance.
2. Balances can be committed within the budgetary period because of the necessary reliance upon certain economically sensitive and therefore at times unpredictable revenue sources such as sales and income taxes along with building fees and licenses.
3. Errors in revenue and expenditure estimation could arise due to the difficulty in identifying the turning point in a given business cycle.
4. A drop in non-recurring, but previously budget supporting, revenues.

The adequacy of an unreserved fund balance depends upon an accurate assessment of what fiscal uncertainty the Village faces from time to time. It should be noted that if an unreserved fund balance is to be maintained, it could become a target for those who will either call for tax reduction or for increased spending, depending upon the particular viewpoint of the observer.

The consensus of the opinion is that local government, as part of its overall policy development, should establish a formal policy regarding the level of unreserved fund balance that is to be held for both contingencies and for any other approved purpose. The policy provides a purpose for maintaining such balances along with the conditions when the balances would be expended or committed. The policy would include, but not be limited to the following:

1. When should resources be set aside for contingencies.
2. Under what circumstances would financial resources be committed to unreserved fund balance.
3. How will balances be used.
4. Determining the appropriate size of the fund balance.

Due to changing fiscal and financial conditions, this policy must and should be dynamic and reflect changes in condition or philosophies.

The key policy determinant is how Unreserved Fund Balance shall be measured and when necessary, used. Several options have been cited:

1. Development of a formula to determine an adequate amount such as a fixed percent of budget.
2. The transfer of any annual surplus into unreserved fund balance as an increment to the base established formula.

The policy should then address how unreserved fund balances shall be utilized. The policy should address under what circumstances resources would be used and who should make the decision regarding that use. The primary reason for this balance is to alleviate unanticipated short-term budgetary problems.

Resource allocation should be grounded in the philosophy of both stabilizing the tax structure and continuing services. The use of unreserved fund balances should not be used to solve long-term budgetary management problems.

The most difficult task in the development of a policy of this type is determining the appropriate fund size. There
appears to be two traditional methods employed in determining the size of unreserved fund balances:

1. Allocating financial resources equal to a percentage of annual operating expenditures.
2. Allocating financial resources equal to a certain number of months operating expenditures.

The Village will continue to follow method one where the goal is to peg fund balance as a percentage a subsequent fiscal year's total approved expenditures. Surprisingly, rating agencies such as Moody's and Standard and Poors view a 5% of expenditures unreserved fund balance as "adequate." However, they both temper their comments on the overall economic sensitivity of the revenue base of the particular community under rating review.

As a word of caution, a standard may not be appropriate in the absolute case. To date, there has been no uniform national standard or rule for use in measuring the amount of resources to set aside since all governments differ to some extent in terms of their economic and financial characteristics. It has been found appropriate for a unit of government to make its own decision about whether to set aside more or less funds based on the perception and assessment of the economic uncertainty facing it. What level should therefore be maintained? The balance relates to the degree of budgetary uncertainty and exposure anticipated to be faced. Government must evaluate the degree of risk it faces on an annual basis and make a decision as to the level of financial resources that it wishes to maintain not only for contingencies but for any transitional budgetary shortfalls. In short, determining the appropriate level of unreserved fund balance is a difficult task.

The ability to recognize an exposure to economic uncertainty as a component of both budget execution and development, and the commitment to sound levels of financial resources in response to such uncertainty will make units of government better able to deal with the realities of slowing or stabilizing economies.

**Village of Buffalo Grove**  
**Corporate Fund Fund Balance**

The Village of Buffalo Grove has analyzed and managed the Corporate Fund Fund Balance as a vehicle for operational stability for the Fund while providing planned resources for capital development, property tax abatement and pension cost stability. While much research has gone on in order to determine what the proper level of Fund Balance should be, any thoughts are tempered knowing that the level must not only follow any set standard(s), but must also consider what is best for Buffalo Grove.

The Corporate Authorities as well as the Village's Finance Committee have reviewed the issue of unreserved Fund Balance in the Corporate Fund. They have discussed the level of Fund Balance, evaluation of what Fund Balance is and should be and the difference between cash and investments and Fund Balance.

Additionally, they have considered the prudent use of cash and investment reserves for purposes that are of a recurring nature while such reserves are theoretically non-recurring. After review and discussion, both the Finance Committee and President and Board of Trustees recommend the following guidelines:

Cash and investment reserves will be maintained at a level equal to 25% of the operational budget beginning as of January 1 of any fiscal period. Unreserved Fund Balance will equal, at a minimum, 25% of the subsequent year’s Corporate Fund budget.

Should the Undesignated Fund Balance drop below 25% of the same year’s Corporate Fund budget, notification will be given to the Village’s Finance Committee. While identified uses of Fund Balance may be proposed that could continue the trend below 25% such uses will be disclosed and approved by the Committee.

Draws for operational (recurring) purposes will be only to cover extraordinary circumstances or to bridge a revenue gap to be resolved by either implementing a new, recurring source of revenue or to permit staff the time to plan an orderly reduction in expenditure levels.

Permanent draws would be for "investment" or capital purposes or to provide some direct tax levy abatement funding for capital-related debt service.

Some resources may be committed to cover pension fund shortfalls in annual funding that are determined at the end of any given calendar accounting period.

These uses of Unreserved Fund Fund Balance are meant to be a guide for direction of identified balances. To effectively manage the intent of this Policy in light of the changing accounting nature of Fund Balance, an annual review of Fund Balance shall be undertaken.
RETAINED EARNINGS-WATER & SEWER FUND

The balance to be maintained as Undesignated Retained Earnings within the Water and Sewer Fund shall be equal to an amount necessary to provide sufficient cash flow for operations as well as providing a reserve accumulation to pay for unanticipated capital replacement and repair.

As a operational goal, cash and investment reserves will be maintained in an amount equal to 25% of the water and sewer operational budgets beginning as of January 1 of any given fiscal period. With this said, the Water and Sewer Fund cash and investment guideline will be:

1. Cash and investment reserves equal to 25% of the operational budget beginning as of January 1 of any fiscal period. Unreserved Retained Earnings would at least equal that amount.

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