

KENAI PENINSULA BOROUGH POLICY

Unreserved Portion of Operating and Capital Fund Balances

Purpose:

To establish unreserved fund balance ranges for the Borough's general fund 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. From a practical standpoint, absent significant liabilities, fund equity approximates cash.

A distinction is made between reserved and unreserved fund balance.

Reserved 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." Reserved fund balance is often further broken down into several categories based on the purpose of the assets held. Typical fund balance reserves include:

- Reserved for advances to other funds
- Reserved for debt service
- Reserved for encumbrances
- Reserved for fixed assets held for resale
- Reserved for inventories
- Reserved for prepaid items

Unreserved fund balance represents expendable available financial resources. Unreserved fund balance is often subdivided into designated and undesignated portions. Designated fund balance represents management plans for the future financial resources use. Expressed another way, designations reflect a government's self-imposed limitations on the use of otherwise available expendable financial resources in governmental funds.

Undesignated fund balance represents available financial resources, which have not been designated or obligated to a specific purpose. Typical designated fund balance accounts include:

- Designated for working capital.
- Designated for subsequent years expenditures.
- Designated for future capital expansion.
- Designated for operating contingencies.

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

Operating Funds

Establishment of unreserved fund balance range should include the following:

- Designations for working capital requirements.
- Designations for operating contingencies
 - Revenue volatility amount
 - Unexpected expenditure
- Designated for future capital expansion and contingencies

Designations for 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 \$2,000,000 to \$9,999,999 15% to 25%
3. Funds with expenditure levels from \$500,000 to \$1,999,999 20% to 30%
4. Funds with expenditure levels from \$0 to \$499,999 25% to 40%

Designated for Operating Contingencies:

Revenue volatility amount

A revenue volatility factor will provide an amount necessary to offset the sudden decline of significant sources of revenue. Unreserved 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 years actual revenue generated by the revenue source. Deviations from this policy may be necessary when annual changes are caused by reimbursement of extraordinary, non-recurring expenditures such as Federal Disaster Assistance Funds during the 1995 flooding and changes in taxing practices such as the \$100,000 personal property tax exemption.

	Low Volatility	Moderate Volatility	High Volatility
% Revenue from Source	0% - 5% Average	5% - 8% Average	9%+ Average
	Volatility Factor	Volatility Factor	Volatility Factor
0% to 10%	0%	0%	0% to 25%
11% to 20%	0%	0% to 10%	25% to 75%
21% to 35%	0%	10% to 20%	50% to 100%
36% to 50%	0%	20% to 30%	75% to 125%
51% to 70%	0%	30% to 40%	100% to 150%
71% to 100%	0%	40%to 50%	125%to 175%

Unexpected Expenditures

From time to time unexpected expenditures will be incurred. Each operating fund shall maintain unreserved 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 to capital project funds. The amount shall be determined as follows:

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%

Designated for 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 unreserved 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 unreserved fund balance range should include the following:

- Designations for capital requirements.

Designations for capital requirements:

Equipment replacement capital projects funds were established for services areas to provide for major capital replacement and acquisition. These funds accumulate resources through operating transfers from the service area's operating fund and interest earnings on the balance of the fund. 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

Each fund's ten-year average of undesignated fund balances shall be no less than 25% 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	25%	40%
\$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 five-year plan of action to achieve compliance with the established range.