

**AGENDA  
LEBANON CITY COUNCIL  
JUNE 19, 2019**

**9. NEW BUSINESS:**

**9.D – ANNUAL REVIEW OF FUND BALANCE POLICY**

**BACKGROUND**

The Fund Balance Policy is reviewed annually by the City Council. Changes are made as warranted. The Policy does not have to be readopted annually (or sooner) as required with the City's Investment Policy (RSA 47:6). The current Fund Balance Policy was adopted by the City Council June 20, 2018.

A fund segregates resources (revenues) and requirements (expenditures) that are legally restricted to specific uses. Budgets are adopted by the City Council on a fund basis. Funds other than the General Fund exist primarily to ensure and demonstrate compliance with limitations on the use of existing resources or as enterprises. The General Fund, as the chief operating fund of the City, has a broader mandate, which may include accumulating sufficient financial resources for contingencies. Accordingly, the Fund Balance Policy is limited to the General Fund.

The purpose of the Policy is to provide adequate financial resources to ensure the continued orderly operation of government and the provision of services to residents and the continued stability of the tax or rate structure that can be threatened by uncertainty emanating from a number of areas including economic uncertainty, unanticipated changes in federal and state policies, imposition of federal and state mandates, unanticipated expenditures resulting from natural disasters or other unforeseen circumstances, errors in estimating expenditures and revenues, potential drain on resources from funds facing financial difficulties, and disparities in timing between revenue collections and expenditures.

**The Fund Balance Policy suggests a range of 19.0% to 24.0% of gross current General Fund budgeted expenditures.** The result is consistent with how the New Hampshire Department of Revenue Administration (DRA) calculates its fund balance retention guidelines (middle ranges) minus the uncertainty of factoring in Net Required County, Local Education and State Education Tax Efforts which are not known until the annual tax rate setting process in October.

**ACTION**

*No action is required at this time, as this is an annual review of the Fund Balance Policy which has not been amended since changes were last incorporated and adopted on June 20, 2018.*

**Included in this Section:**

1. Explanatory memorandum by Greg Colby, Finance Director
2. City Council Policy #CC-101, Fund Balance Policy

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**JUNE 19, 2019**

**BY: GREG COLBY, FINANCE DIRECTOR**

**FUND BALANCE POLICY REVIEW - 2019**

The Fund Balance Policy is reviewed annually by the City Council. Changes are made as warranted. The Policy does not have to be readopted annually (or sooner) as required with the City's Investment Policy (RSA 47:6). The current Fund Balance Policy was adopted by the City Council June 20, 2018.

A fund segregates resources (revenues) and requirements (expenditures) that are legally restricted to specific uses. Budgets are adopted by the City Council on a fund basis.

Funds other than the General Fund exist primarily to ensure and demonstrate compliance with limitations on the use of existing resources or as enterprises. The General fund, as the chief operating fund of the City, has a broader mandate, which may include accumulating sufficient financial resources for contingencies. Accordingly, the Fund Balance Policy is limited to the General Fund. Unassigned Fund Balance (which can be thought of as Spendable Fund Balance) is the residual classification for the City's General Fund.

The purpose of the Policy is to provide adequate financial resources to ensure the continued orderly operation of government and the provision of services to residents and the continued stability of the tax or rate structure that can be threatened by uncertainty emanating from a number of areas including economic uncertainty, unanticipated changes in federal and state policies, imposition of federal and state mandates, unanticipated expenditures resulting from natural disasters or other unforeseen circumstances, errors in estimating expenditures and revenues, potential drain on resources from funds facing financial difficulties, and disparities in timing between revenue collections and expenditures.

Effective May 16, 2012, the objective had been to maintain an Unassigned Fund Balance range of 15.0% to 17.0% of gross current General Fund budgeted expenditures. Since the adoption of the current fund balance policy on June 20, 2018 the policy now suggests a range of 19.0% to 24.0% of gross current General Fund budgeted expenditures.

The accompanying table shows what the DRA references as a range of fund balance retention amounts as provided during the 2017 and 2018 annual tax rate setting process.

DRA - Fund Balance Retention Guidelines

|                                    | <u>2018</u>         | <u>2017</u>         |
|------------------------------------|---------------------|---------------------|
| <b>Current Amount Retained</b>     | <b>\$ 9,445,522</b> | <b>\$ 7,360,828</b> |
| 17% Retained (Maximum Recommended) | \$ 13,762,308       | \$ 12,080,088       |
| 10% Retained                       | \$ 8,095,476        | \$ 7,105,934        |
| 8% Retained                        | \$ 6,476,380        | \$ 5,684,747        |
| 5% Retained (Minimum Recommended)  | \$ 4,047,738        | \$ 3,552,967        |

The DRA recommends utilizing those ranges in determining the adequacy of unrestricted fund balance. The DRA further says, "Retention amounts, as part of the municipality's stabilization fund policy, should be assessed dependent upon your government's own long-term forecasts and special circumstances." And, "...that current best practices published by GFOA recommend, 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.'" The GFOA (Government Finance Officers Association) is a national association; the rub is ascertaining what constitutes General Fund revenues or expenditures in other non-New Hampshire jurisdictions and applying that to New Hampshire circumstances.

The prevalent method of calculation in New Hampshire seems to be establishing a maintenance range based either on a combination of General Fund, School and County appropriations or on General Fund appropriations with the results of each approximating the other.

Appropriate Level of General Fund Unassigned Fund Balance

Unassigned Fund Balance is the residual classification for the City's General Fund and includes all amounts not contained in other fund balance component classifications and therefore not subject to any constraints.

The Unassigned Fund Balance maintenance objective took on added significance in recent years in discussions with the New Hampshire Municipal Bond Bank (NHMBB) and bond counsel about the City's current and projected debt burden. The City's continued commitment to maintaining an appropriate level of Unassigned Fund Balance is very important in the eyes of the NHMBB, credit rating agencies and others who assess the financial position and condition of the City and the commitment of its policymakers toward sound fiscal government.

How Unreserved Fund Balance is managed is also important with respect to Municipal Tax Rate stabilization.

For several budget cycles a special effort has been incorporated into the budget process to project where the Municipal Tax Rate, and its fiscal companion Spendable Fund Balance (Unassigned Fund Balance), may be trending two-years beyond the immediate subsequent budget year.

The following table shows Unassigned Fund Balances for 2014 to 2018 (est.) and related percentages balances are to current General Fund budgeted expenditures.

| <u>Year</u> | <u>General Fund<br/>Budgeted<br/>Expenditures</u> | <u>Unassigned<br/>Fund Balance</u> |          | <u>% of General Fund<br/>Budgeted Expenditures</u> |
|-------------|---|------------------------------------|----------|--|
| 2018        | \$ 30,738,370                                     | \$ 11,676,062                      | Estimate | 37.99%   |
| 2017        | \$ 29,338,760                                     | \$ 10,640,252                      |          | 36.27%   |
| 2016        | \$ 27,924,630                                     | \$ 8,581,538                       |          | 30.73%   |
| 2015        | \$ 27,166,140                                     | \$ 6,501,198                       |          | 23.93%   |
| 2014        | \$ 27,989,723                                     | \$ 5,681,942                       |          | 20.30%   |

For 2020, the Financial Outlook, prepared for the annual Outcomes and Work Plan City Council work sessions, suggests a \$11.58 estimated Municipal Tax Rate -- a \$0.34 or 3.0% increase from the estimated 2019 rate.

For 2021, a \$11.93 estimated Municipal Tax Rate -- a \$0.35 or 3.0% increase from the estimated 2020 rate is suggested.

For 2022, a \$12.29 estimated Municipal Tax Rate -- a \$0.36 or 3.0% increase from the estimated 2021 rate is suggested.

These estimates are taking into account future debt increases which will be partially offset by the use of General Fund Unassigned Fund Balance, with the plan that the above levels will decrease over similar periods to eventually fall within the range of the current policy range of 19-24%.

### Background

The Governmental Accounting Standards Board (GASB) is the independent organization that establishes and improves standards of accounting and financial reporting for U.S. state and local governments. GASB is recognized by governments, the accounting industry, and the capital markets as the official source of generally accepted accounting principles (GAAP) for state and local governments.

In February 2009, the GASB issued Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, which for the City was effective fiscal year ending December 31, 2011. Statement No. 54 substantially altered the focus and terminology used for fund balance reporting. The objective was to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and to clarify existing governmental fund type definitions.

The Fund Balance Policy was compiled based on guidance from the Government Finance Officers Association (best practices), New Hampshire Department of Revenue Administration and the City's independent auditors. New fund balance components focus on "the extent to which the government is bound to honor constraints on the specific purposes for which amounts in the fund can be spent." Previously they focused instead on whether resources were available for appropriation distinguishing Unreserved Fund Balance (available for appropriation) from Reserved Fund Balance (not available for appropriation).

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| <b>COUNCIL POLICY</b>      |                       |                      |                           |
|----------------------------|-----------------------|----------------------|---------------------------|
| <b>Fund Balance Policy</b> |                       |                      |                           |
| <i>Policy Number</i>       | <i>Effective Date</i> | <i>Last Revision</i> | <i>Page No.</i>           |
| <b>CC-101</b>              | 6/20/2018             |                      | Page <b>1</b> of <b>5</b> |
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## **Section 1.0: Purpose**

To provide adequate financial resources to ensure the continued orderly operation of government and the provision of services to residents and the continued stability of the tax or rate structure that can be threatened by uncertainty emanating from a number of areas including economic uncertainty, unanticipated changes in federal and state policies, imposition of federal and state mandates, unanticipated expenditures resulting from natural disasters or other unforeseen circumstances, errors in estimating expenditures and revenues, potential drain on resources from funds facing financial difficulties, and disparities in timing between revenue collections and expenditures.

## **Section 2.0: Scope**

Funds other than the General Fund exist primarily to ensure and demonstrate compliance with limitations on the use of existing resources or as enterprises. The General Fund, as the chief operating fund of the City, has a broader mandate which may include accumulating sufficient financial resources for contingencies. Accordingly, this Policy is limited to the General Fund. Fund balance is a measurement of available financial resources and is the difference between total assets and total liabilities in each fund. Governmental Accounting Standards Board (GASB) Statement No. 54 distinguishes fund balance classified based on the relative strength of the constraints that control the purposes for which specified amounts can be spent.

## **Section 3.0: Definitions**

- 1) *Appropriate* – is a policy decision to set apart from the public revenue a certain sum for a specified public purpose and to authorize the expenditure of that sum for that purpose. The most important policy tool is the annual budget. Policy is *what* is going to be done. The budget is the means of determining *what* will get done because that is where money is allocated to programs, services, projects and facilities.



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Appropriations can be made only by vote of the legislative body. Legislative power is the power to set overall policy, the power to raise and appropriate money (tax and spend) and set the purposes for expenditures. The City Council is the City's legislative body; the county convention, which consists of the state representatives comprising Grafton County, is the county's legislative body (NH RSA 24), acting on budgetary recommendations compiled by the county commissioners; the annual meeting of the Lebanon School District is that entity's legislative body.

- 2) *Assigned Fund Balance* – includes amounts the City intends to be *used for specific purposes but are neither restricted or committed*. In accordance with GASB Statement No. 54, funds that are intended to be used for specific purpose, but have not received the formal approval action at the governing body level (City Council), may be recorded as assigned fund balance. Likewise, redeploying assigned resources to an alternative use does not require formal action by the City Council. GASB Statement No. 54 states that resources can be assigned by the governing body or by another internal body or person whom the governing body gives the authority to do so. Therefore, having considered the requirements to assign fund balance, the City Manager, or the City Manager's designee, shall have the authority to assign fund balance.

Encumbrances (purchase orders), or other contractual commitments, the provision of contingency for assessment abatements and bankruptcy proceedings, special revenue funds and capital project funds are examples of assigned fund balance.

- 3) *Committed Fund Balance* – includes amounts that can be *used only for the specific purposes determined by a vote of the City Council*. Commitments may be rescinded, changed or lifted only by a subsequent vote of the City Council. Included are expendable trust funds (capital reserve funds).
- 4) *Current General Fund Budgeted Expenditures* – are related to the appropriated budget of the current year and not prior year expenditures carried over to the current year as encumbrances or non-budgeted current year expenditure adjustments.
- 5) *Encumbrance* – is a purchase order, a contractual (outstanding) commitment. The process of encumbering budgeted funds is meant to



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ensure budgetary compliance both to prevent overspending appropriations for the year and to detect violations of budgetary authority.

- 6) *Fund* – segregates resources (revenues) and requirements (expenditures) that are legally restricted to specific uses.
- 7) *Non-spendable Fund Balance* – includes amounts *not in spendable form*, such as inventory, or amounts required to be maintained intact legally or contractually such as for inventory, prepaid items, and the nonexpendable portion of permanent trust funds.
- 8) *Restricted Fund Balance* – includes amounts that are subject to externally enforceable legal restrictions and can be spent only for the specific purposes stipulated by law, ordinance or regulation, external resource providers or through enabling legislation. Restrictions applicable to this fund balance may not be changed or lifted by the City without the consent of the resource providers or enabling legislation. Included are library funds, the income balance of permanent funds (trust funds), grant funds and unspent bond proceeds.
- 9) *Unassigned Fund Balance* – is the residual classification for the City's General Fund and includes all amounts not contained in other fund balance component classifications and therefore not subject to any constraints. Appropriation from Unassigned Fund Balance requires approval of the City Council.
- 10) *Unassigned Fund Balance Maintenance Range* – an amount of money, in dollars or as a percentage of a defined base, that is considered a prudent level at which to maintain the unassigned fund balance.
- 11) *Unrestricted Fund Balance* – is total fund balance less nonspendable fund balance and restricted fund balance, which is the total of committed fund balance, assigned fund balance and Unassigned Fund Balance.

#### **Section 4.0: Policy Detail**

- 1) Spending Prioritization:
  - a. When both restricted and unrestricted funds (committed, assigned and unassigned) are available for expenditure, restricted funds should be spent first unless legal requirements disallow it.



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- b. When committed, assigned and unassigned funds are available for expenditure, committed funds should be spent first, assigned funds second, and unassigned funds last.
- 2) Unassigned Fund Balance Maintenance Range:
- a. It is the objective of the City to maintain an Unassigned Fund Balance of 19.0% to 24.0% of gross current General Fund budgeted expenditures.
  - b. The City considers a balance of less than 19.0% to be a cause for concern and, considering factors or circumstances that may require a higher than normal maximum level of Unassigned Fund Balance, a balance of more than 24.0% as excessive.
  - c. In the event Unassigned Fund Balance is less than 19.0%, restorative steps shall be taken in the immediate subsequent fiscal years.
  - d. In the event Unassigned Fund Balance is more than 24.0%, steps should be taken to reduce the excess balance in the immediate subsequent fiscal years, or a plan for doing so over a reasonable period should be prepared, including an explanation of how the excess fund balance will be reduced to an acceptable level. An amount more than 24.0% may be considered to reduce tax levy requirements determined in conjunction with the annual budget process, as a capital improvement funding component, for reservation to accumulate funding for future capital improvements, or for any legal purpose deemed appropriate and desirable by the City Council.
  - e. This Policy is not intended to preclude the administrative application of Unassigned Fund Balance as a companion to the budgeted application of Unassigned Fund Balance as a mitigating utility in setting the annual Municipal Tax Rate.
- 3) This Policy shall be reviewed annually by the City Council and revised as warranted.

### **Section 5.0: References (Charter/Code/State Statues)**

- 1) *Governmental Accounting Standards Board (GASB) Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions.*



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### Section 6.0: Policy & Procedure Revision History

|                   | <b>Section</b> | <b>Revisions</b> | <b>Date</b> |
|-------------------|----------------|------------------|-------------|
| Original Adoption |                |                  | 6/20/18     |
| Amendment         |                |                  |             |
| Amendment         |                |                  |             |
| Amendment         |                |                  |             |

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