

Model Fund Balance Policy

Dear Reader:

The following document was created from the MTAS website ([mtas.tennessee.edu](https://www.mtas.tennessee.edu)). This website is maintained daily by MTAS staff and seeks to represent the most current information regarding issues relative to Tennessee municipal government.

We hope this information will be useful to you; reference to it will assist you with many of the questions that will arise in your tenure with municipal government. However, the *Tennessee Code Annotated* and other relevant laws or regulations should always be consulted before any action is taken based upon the contents of this document.

Please feel free to contact us if you have questions or comments regarding this information or any other MTAS website material.

Sincerely,

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Model Fund Balance Policy

Reference Number: MTAS-582

Model General Fund Fund Balance Policy

The Fund Balance Policy is intended to provide guidelines during the preparation and execution of the annual budget to ensure that sufficient reserves are maintained for unanticipated expenditures or revenue shortfalls. It also is intended to preserve flexibility throughout the fiscal year to make adjustments in funding for programs approved in connection with the annual budget. The Fund Balance Policy should be established based upon a long-term perspective recognizing that stated thresholds are considered minimum balances. The main objective of establishing and maintaining a Fund Balance Policy is for the city to be in a strong fiscal position that will allow for better position to weather negative economic trends.

The Fund Balance consists of five categories: **Non-spendable, Restricted, Committed, Assigned, and Unassigned.**

- **Non-spendable Fund Balance** consists of funds that cannot be spent due to their form (e.g. inventories and pre-pays) or funds that legally or contractually must be maintained intact.
- **Restricted Fund Balance** consists of funds that are mandated for a specific purpose by external parties, constitutional provisions or enabling legislation.
- **Committed Fund Balance** consists of funds that are set aside for a specific purpose by the city's highest level of decision making authority (governing body). Formal action must be taken prior to the end of the fiscal year. The same formal action must be taken to remove or change the limitations placed on the funds.
- **Assigned Fund Balance** consists of funds that are set aside with the intent to be used for a specific purpose by the city's highest level of decision making authority or a body or official that has been given the authority to assign funds. Assigned funds cannot cause a deficit in unassigned fund balance.
- **Unassigned Fund Balance** consists of excess funds that have not been classified in the previous four categories. All funds in this category are considered spendable resources. This category also provides the resources necessary to meet unexpected expenditures and revenue shortfalls.

Non-spendable and Restricted Funds

Non-spendable funds are those funds that cannot be spent because they are either:

- 1) Not in spendable form (e.g. inventories and pre-pays).
- 2) Legally or contractually required to be maintained intact.

It is the responsibility of the finance director to report all non-spendable funds appropriately in the city's financial statements.

Restricted funds are those funds that have constraints placed on their use either:

- 1) Externally by creditors, grantors, contributors, or laws or regulations or other governments.
- 2) By law through constitutional provisions or enabling legislation.

It is the responsibility of the finance director to report all restricted funds appropriately in the city's financial statements. All restricted funds also must be reported to the city's governing body within two months of the end of the fiscal year.

Order of Use of Restricted and Unrestricted Funds

When both restricted and unrestricted funds are available for expenditure, restricted funds should be spent first unless legal requirements disallow it.

When committed, assigned and unassigned funds are available for expenditure, committed funds should be spent first, assigned funds second, and unassigned funds last.

Authority to Commit Funds

The city's governing body has the authority to set aside funds for a specific purpose. Any funds set aside as committed fund balance requires the passage of an ordinance. The passage of an ordinance

must take place prior to June 30 of the applicable fiscal year. If the actual amount of the commitment is not available by June 30, the ordinance must state the process or formula necessary to calculate the actual amount as soon as information is available. In the event the governing body wishes to lift the committed status of funds so that they may be used for general purposes, an ordinance must be passed to do so.

Stabilization Funds

The city's governing body has the authority to establish a financial stabilization account that will be a committed fund balance. A financial stabilization account is established for the purpose of providing funds for an urgent event that affects the safety of the general public (e.g. flood, tornado, etc.). The minimum level for the financial stabilization account is 5 percent of general fund expenditures. The recognition of an urgent event must be established by the governing body or its designee (e.g. chief administrative officer). If established by the governing body's designee, the specific urgent event must be reported to the governing body at its next meeting. A budget amendment must be approved by the city's governing body. In the event that the balance drops below the established minimum level, the city's governing body will develop a plan to replenish the financial stabilization account balance to the established minimum level within four years.

Authority to Assign Funds

Upon passage of the fund balance policy, authority is given to the city's finance director to assign funds for specific purposes in an amount not to exceed per purpose or in total not to exceed . Any funds set aside as assigned fund balance must be reported to the city's governing body at their next regular meeting and recorded in the minutes. The governing body has the authority to remove or change the assignment of the funds with a simple majority vote.

The city's governing body has the authority to set aside funds for the intended use of a specific purpose. Any funds set aside as assigned fund balance requires a simple majority vote and must be recorded in the minutes. The same action is required to change or remove the assignment.

Upon passage of a budget ordinance where fund balance is used as a source to balance the budget, the finance director shall record the amount as assigned fund balance.

Unassigned Fund Balance

Unassigned fund balance is the residual amount of fund balance in the general fund. It represents the resources available for future spending. An appropriate level of unassigned fund balance should be maintained in the general fund in order to cover unexpected expenditures and revenue shortfalls.

Unassigned fund balance may be accessed in the event of unexpected expenditures up to the minimum established level upon approval of a budget amendment by the city's governing body. In the event of projected revenue shortfalls, it is the responsibility of the finance director to report the projections to the city's governing body on a quarterly basis and shall be recorded in the minutes.

Any budget amendment that will result in the unassigned fund balance dropping below the minimum level will require the approval of two-thirds vote of the city's governing body.

The fund balance policy establishes a minimum unassigned fund balance equal to 15 percent of general fund expenditures. In the event that the balance drops below the established minimum level, the city's governing body will develop a plan to replenish the fund balance to the established minimum level within two years.

DISCLAIMER: The letters and publications written by the MTAS consultants were written based upon the law at the time and/or a specific sets of facts. The laws referenced in the letters and publications may have changed and/or the technical advice provided may not be applicable to your city or circumstances. Always consult with your city attorney or an MTAS consultant before taking any action based on information contained in this website.

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