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|  | CITY OF HENDERSONVILLE | Policy Number: | |
| | | Adopted by Resolution Number: | |
| Policy Name: | Fund Balance Policy | Council Date | 06/02/2022 |

SECTION 1. Purpose

The Hendersonville City Council hereby establishes an Available Fund Balance Policy for the purpose of improving and maintaining fiscal responsibility as required under the Local Government Budget and Fiscal Control Act, NC General Statute Chapter 150. This policy defines the level of Available Fund Balance and establishes guidelines for preserving an adequate fund balance in each of the City of Hendersonville (City) major operating funds to sustain financial stability and to provide prudent management of the City's financial reserves.

SECTION 2. Definitions

- 2.1 Fund balance is a measurement of available financial resources and is the difference between total assets and total liabilities in each fund.

- 2.2 An accounting distinction is made between the portions of governmental fund balance that is spendable and nonspendable. Government Accounting Standards Board (GASB) Statement 54 distinguishes fund balance classified based on the relative strength of the constraints that control the purposes for which specified amounts can be spent. Beginning with the most restrictive constraints, fund balance amounts will be reported in the following five categories:
 - a. **Nonspendable** fund balance – includes amounts that are not in a spendable form or are required to be maintained intact. Examples include inventory and prepaid items.

 - b. **Restricted** fund balance – includes amounts that can be spent only for the specific purposes stipulated by external resource providers either constitutionally or through enabling legislation. Examples include grants and debt proceeds.

 - c. **Committed** fund balance – includes amounts that can be used only for specific purposes determined by a formal action of the City's highest level of decision-making authority which is the City Council. Commitments may be changed or lifted only by the City Council taking the same formal action that imposed the commitment originally.

 - d. **Assigned** fund balance – comprises amounts intended to be used by the City for specific purposes. Intent can be expressed by the City Council by the approval of a budget appropriation. In governmental funds other than the General Fund, assigned fund balance represents the amount that is not restricted or committed. This indicates that resources in other governmental funds are, at

a minimum, intended to be used for the purpose of that fund. An example includes funds assigned by City Council for specific capital projects.

- e. **Unassigned** fund balance – is the residual classification of the General Fund and includes all amounts not contained in other classifications. The City often uses the term available fund balance when referring to unassigned fund balance. Unassigned fund balance is the amount that is available for appropriation for public purposes.
- 2.3 The legal definition of available fund balance in North Carolina is defined in the Local Government Budget and Fiscal Control Act (LGBFCA) section 159-8(a). The statute states “appropriated fund balance in any fund shall not exceed the sum of cash and investments minus the sum of liabilities, encumbrances, and deferred revenues arising from cash receipts, as those figures stand at the close of the fiscal year next preceding the budget year.”
- 2.4 Percent available fund balance shall be defined as and match the calculation used by the Local Government Commission (LGC). The calculation is defined as the LGBFCA definition of available fund balance, divided by the total actual operating expenditures plus transfers out minus installment purchases and issuance of capital leases for the fiscal year. This calculation will match the calculation used by the Local Government Commission (LGC) in reporting on local government fund balances.
- 2.5 Enterprise funds are used to account for utility operations. The City's Water and Sewer Fund is an enterprise fund. Enterprise funds are also known as proprietary funds and business-type funds. Enterprise funds have separate terminology for fund balance or retained earnings which is termed as net position in financial reports; however, the City commonly uses the term fund balance for these funds as well. The fund balance or retained earnings of each enterprise fund is to be used for the operating purpose of the fund and used for budgeting on a modified-accrual basis. The Water and Sewer Fund's bond covenant ratio are the most decisive financial indicators for the fund. The City's general trust indenture contains directions on calculating bond covenant ratios.

SECTION 3. Objectives

- 3.1 The City's management and Council recognize that it is essential to maintain adequate available fund balance to mitigate financial risk that can occur from unforeseen revenue fluctuations, unanticipated expenditures, and similar circumstances.
- 3.2 The fund balance also provides cash flow liquidity for the City's operations and increases the potential for investment income.
- 3.3 Ample fund balance enhances short term and long-term financial credit by helping to achieve the highest credit and bond ratings possible to provide the City the ability to borrow at the lowest possible rate.

- 3.4 A fund balance policy promotes long-term financial stability by establishing clear and consistent guidelines.
- 3.5 Adequate available fund balance will provide funding flexibility during unanticipated emergencies and natural disasters.

SECTION 4. Guidelines

- 4.1 The North Carolina Local Government Commission is charged with overseeing the fiscal health of North Carolina cities and counties and recommends that a minimum of at least eight percent (8%) of annual budgeted expenditures be maintained for available fund balance for the purposes of cash flow. They further recommend that local governments maintain an adequate fund. Their meaning of adequate is an available fund balance that can meet operating needs, cash-flow shortfalls, and unforeseen needs and to take advantage of unexpected opportunities. LGC staff consider the average percent available fund of comparable sized NC cities or counties to be a good guide of what is adequate. The percent available fund balance level at 50% of the average percent available fund balance of their respective population group is the guide recommended by the LGC. Additionally, the LGC may send written notices if the percent available falls below this mark or if the percent available drops a large amount in consecutive years. Higher levels may be set based on the current operating needs of the City and the individual fund and future funding needs.
- 4.2 The City commits to maintaining reserves required by law, ordinance, and/or bond covenants. The City Council hereby establishes a goal for the Water and Sewer Fund, maintaining a revenue bond covenant ratio (a) and revenue bond covenant ratio (b) at a minimum of 1.000. The revenue bond covenant ratios are a critical financial indicator which determine capacity to issue revenue bonds and other Water and Sewer Fund indebtedness.
- 4.3 The City Council hereby establishes a goal for percent available fund balance for the General Fund to be at a minimum of 25% of the City's expenditure group as determined by the Local Government Commission. The City is classified by the LGC as a municipality with General Fund expenditures above \$10,000,000. The City will adjust these goals as appropriate based upon the recommendation from the LGC, modifications in North Carolina law, and potential changes in the City's financial outlook.
- 4.4 All expenditures drawn from fund balance will require City Council approval unless previously authorized by the City Council for expenditure within the City's annual budget.
- 4.5 If fund balance falls below the goal levels, the City Manager shall implement a plan to restore percent available fund balance within thirty-six (36) months and include within annual budget the plan to restore fund balance to required levels.

- 4.6 The City Council may, from time to time, appropriate fund balances that will reduce the percent available fund balance below the minimum goal in the General Fund or below the minimum goal for the Water and Sewer Fund for the purpose of a declared fiscal emergency or other such global purpose as to protect the long-term fiscal security of the City. In such circumstances, the City Council will adopt a plan to restore the percent available fund balance to the policy level within thirty-six (36) months from the date of the appropriation. If restoration cannot be accomplished within such time period without severe hardship to the City, then the City Council will establish a different but appropriate time period.
- 4.7 The City Manager is charged to annually monitor and report to City Council during the preparation of the annual operating budget regarding the status and forecast of percent available fund balance and or retained earnings and compliance with the stated range goals.

SECTION 5. Capital Reserves

- 5.1 Under North Carolina General Statute 159-18 the City is authorized to establish and maintain a capital reserve for any purpose for which bonds may be issued. The City of Hendersonville votes to either establish or not establish a capital reserve fund annually in its budget process, following applicable legal procedures. Capital reserve funds are defined annually in the City's budget ordinance.
- 5.2 If the percent available fund balance exceeds five (5) percentage points higher than the stated goal in any fund, the City Manager may choose to transfer remaining spendable fund balance that is not restricted, committed, or assigned to a capital reserve fund or capital projects fund for purposes approved by the City Council.

SECTION 6. Order of Expenditure of Funds

- 6.1 When multiple categories of fund balance are available for expenditure (e.g., a project is being funded partly by a grant, funds set aside by the City Council, and available fund balance), the City will start with the most restricted category and spend those funds first before moving down to the next category with available funds.