

Fund Balance Explainer

What is Fund Balance

“Fund balance” is an accounting term that means the total accumulation of operating surpluses and deficits since the beginning of a local government’s existence. “Fund balance” is not synonymous with unrestricted cash. A common misconception is that fund balance is a cash account, associated with or correlated to a government’s bank account balance. But unlike a personal bank account, a general fund balance is not a “cash-account;” it is a measure of equity between revenues and expenditures. Government fund accounting is unique to the public sector and requires separate self-balancing accounting entries to track each fund’s revenues and expenditures. Fund balance is a government’s total assets less total liabilities.

Fund Balance is an Important Tool

The Government Finance Officers Association (GFOA) recommends that all local governments maintain a fund balance in order to mitigate current and future risks and to ensure stable tax rates.¹ Fund balances are used to:

Smooth Cash Flow Related to Revenue Cycles

A fund balance assists in maintaining enough cash to operate a local government or school district effectively and efficiently so that employees and vendors may be paid timely. Cash balance ebbs and flows throughout a fiscal year. Local governments receive tax revenue cyclically. School districts receive state funding monthly, while federal revenues are received more sporadically. Many grants are given on a reimbursement basis, with reimbursement coming many months after expenses have been paid. Many school districts have a larger than normal payroll on the last school day because of the structure of their employee contracts, and this payment occurs before they receive their final foundation payment for the year.

Local governments and school districts plan and manage their cash flow by establishing a large enough fund balance to tide them through the fiscal year. Money set aside for cash flow is usually included as part of the unassigned fund balance in an operating fund. That is, it is frequently shown as available for general spending when, in fact, availability of these funds must be reviewed against cash flow requirements.

Offset Revenue Shortfalls and Unexpected Expenditures

Establishing and maintaining fund balance is an important financial tool that allows local governments to weather economic downturns and face unforeseen circumstances without requiring immediate major impacts to the budget. Before the introduction of the CARES Act and ARPA, many local governments planned to use fund balance to help offset the immediate and drastic reduction of revenue caused by the Covid-19 pandemic. For school districts, fund balance is frequently a source of funding for unexpected major maintenance, allowing schools to maintain operations without major disruption to classroom instruction. As inflation has caused construction costs to escalate, local governments have relied on fund balance to complete capital projects.

¹ <https://www.gfoa.org/materials/fund-balance-guidelines-for-the-general-fund>

Stabilize Taxes and Maintain Services Without Budget Cutbacks

In the event of permanent changes to a local government's revenue sources, fund balance allows the governing body to create a "glide path" to a smaller budget, meaning constituents would not face immediate cuts to important municipal services or large increases in tax rates. For short-term revenue setbacks, fund balance can be used as temporary revenue replacement to stabilize tax rates.

Improve Long-Term Planning Initiatives

Fund balance is one tool used to develop and amend multi-year capital plans. Funds can be set aside over multiple fiscal years to be used for expenditures not suitable for debt financing or to lower the cost of debt.

Enhance Credit Ratings

Fund balance is a focal point of credit rating agencies and investors; when governments maintain a higher fund balance, they are viewed more favorably and can achieve lower borrowing costs.

Types of Fund Balance

Under the Governmental Accounting Standards Board (GASB) Statement No. 54², fund balances are classified as non-spendable, restricted, committed, assigned or unassigned amounts.

1. ***Non-Spendable*** – Amounts that cannot be spent because they are either in a (a) non-spendable form, including items not expected to be converted to cash (e.g., inventories, prepaid amounts, long-term portion of loans and notes receivable and property acquired for resale), or (b) legally or contractually required to be maintained intact.
2. ***Restricted*** – Amounts constrained to be used for a specific purpose as per external parties (e.g., grant agreements or federal restrictions), constitutional provision, or enabling legislation.
3. ***Committed*** – Amounts constrained to be used for a specific purpose as per action by assembly, council, or school board. Amounts classified as committed are not subject to legal enforceability like restricted resources; however, they cannot be used for any other purpose unless the governing body removes or changes the commitment by taking the same action it employed to impose the commitment.
4. ***Assigned*** – Amounts that are constrained by the government's *intent* to be used for specific purposes but are neither restricted nor committed. The intent shall be expressed by the governing body for a specific purpose. The nature of the actions necessary to remove or modify an assignment is not as rigid as required under a committed fund balance classification.
5. ***Unassigned*** – Amounts available for any purpose (amounts that are not Non-Spendable, Restricted, Committed or Assigned).

School District Fund Balance Reporting

For school districts, fund balance is also regulated by AS 14.17.505 and 4 AAC 09.160. Alaska's regulations have not been updated to conform with GASB 54. This places a significant burden on school administrators, who must comply with current GASB regulations and produce a second set of accounting to meet state requirements. Importantly, the "unreserved fund balance" in state reporting is not the same as the "unassigned fund balance" under GASB 54. State requirements on school district fund balance reporting use the following categories:

² <https://gasb.org/page/PageContent?pageId=/standards-guidance/pronouncements/summary--statement-no-54.html>

1. **Encumbrances** – These funds are for commitments the district has made, for items such as contracts and supplies purchases. This may include funds designated for charter schools. Since these funds have already been committed, they are not available to spend on other items.
2. **Inventory** – This category of fund balance is an accounting entry for the value of non-cash items, typically fuel, gas and other supplies that will be used in the near term to support operations. Since the inventory is not cash, it is not available to spend on other items.
3. **Prepaid Items** – These funds have already been paid for a service or item that will be used in a future fiscal year. For these items, the cash has already been expended, so the funds are not available for other use.
4. **Self-Insurance** – These funds are set aside to pay for self-insurance, which may include health insurance, workers compensation and other types of insurance. The amount set aside in this category is typically determined by a combination of actuarial formula and a review of actual insurance claims. These funds must be reserved to ensure the district can meet its self-insurance commitments under employee agreements and under law.
5. **Federal Impact Aid** – The federal government provides these funds for use in the instructional program or in specific construction programs. Due to the timing of funding, they are set aside for use in the following fiscal year.
6. **Home School Allotments** – This category of reserved balance was added to statute several years ago, to ensure that home school families would have full access to needed resources.
7. **Unreserved Fund Balance** – Total fund balance less the amounts reported in the above categories.

There are other important things to keep in mind when reading DEED's fund balance reports. The timing of reporting requirements, and the non-standard accounting methods mentioned above, necessitate certain assumptions and simplifications. School districts are required to report fund balance as of October 31, just three months into the fiscal year. The timing of the academic school year significantly impacts the timing of school district expenses.

1. **Municipal Appropriations** – Some school districts receive their entire annual appropriation at the beginning of the fiscal year in July, while other districts receive monthly installments. If the entire appropriation is received in July, this will increase the district's operating fund balance when reported on an interim basis.
2. **Federal Impact Aid** – Many school districts will receive the bulk of their federal Impact Aid in January or February.
3. **Payroll** – There is a timing lag between the time that an employee works and when they get paid. This increases a district's interim fund balance until payment (including all related health and retirement benefits) have been paid.
4. **Teacher Salaries** – Many teachers elect to defer a portion of their annual pay so that it is paid during summer months or on the last day of their contract year. This practice results in an increase of fund balance reported on an interim basis.
5. **Paying Bills** – Many times a school district's business office has to wait for a bill even though the expense has been incurred. For example, fuel oil is delivered to a school, but the bill comes on the 5th of the following month. Some districts may encumber this (perhaps for the amount budgeted) while others do not.
6. **Planned Purchases** – A district may plan to make a significant purchase later in the year, especially if the purchase involves considerable public input. They have budgeted for this but have not yet encumbered the money or incurred the expense.

7. ***Student Activities Travel*** – Many student activities involve events away from their local campus that will happen during the winter and spring months. Funds are budgeted for this, but schools have not yet paid for travel.

Fund Balance Policies

GFOA recommends that all local governments adopt formal policies governing the amount of unrestricted fund balance to be maintained, how it can be used, and how it must be paid back. At a minimum, GFOA recommends maintaining the equivalent of two months of either operating expenditures or operating revenues. Local governments vulnerable to risks such as natural disasters, loss of state and/or federal aid, or volatile revenue sources may wish to maintain higher unrestricted fund balances. Policies should also outline the conditions in which unrestricted fund balance should be used, how future budgets will be adjusted to accommodate those conditions, and how and when the fund balance will be replenished.

School district fund balances are strictly regulated by Alaska statute³ and administrative code⁴, and these classifications are carefully audited. School districts are limited to a fund balance no greater than 10% of expenditures for that fiscal year. Several municipalities cap school district fund balances even lower. Significant portions of the fund balances are non-cash, and much of the remaining amount has been designated for important operational purposes. The smaller remaining unreserved balance is critical for districts to maintain, to deal with unexpected events that arise during any operating year.

In some cases, local governments may find that they have accumulated a fund balance larger than their policy calls for. Amounts over the formal policy may reflect a structural trend, in which case the governing body should consider a policy as to how this would be addressed, such as lowering taxes. In no case should these funds be used as a funding source for ongoing recurring expenditures. They may be considered for one-time expenditures that are nonrecurring in nature and which will not require additional future expense outlays for maintenance, additional staffing, or other recurring expenditures.

Best practice dictates that when expenditures are incurred for purposes for which both restricted and unrestricted (committed, assigned, or unassigned) amounts are available, best practice is to use the restricted amounts first as permitted under the law. When an expenditure is incurred for purposes for which amounts in any of the unrestricted fund balance classifications could be used, best practice is to use the committed amounts first, followed by the assigned amounts and then unassigned amounts. Using unassigned amounts last leaves a local government with more options should it face unforeseen expenditures or revenue shortfalls.

Specific Purpose Funds

GASB 54 also outlines other types of funds, besides the general fund, that local governments may have. Local governments use specific purpose funds in different ways, depending on factors like size and services provided. These funds can also accumulate fund balances, subject to the same classifications as above.

1. ***Enterprise Funds*** – An enterprise fund is a separate accounting and financial reporting mechanism for which revenues and expenditures are segregated into a fund with financial statements separate from all other governmental activities. An enterprise fund identifies the total direct and indirect

³ AS 14.17.505

⁴ 4 AAC 09.160

costs to provide a service and the sources and amounts of revenues that support the service for which a fee is charged in exchange for service.

2. **Capital Projects Funds** – These are financial resources that are restricted, committed, or assigned to expenditure for capital outlays, including the acquisition or construction of capital facilities and other capital assets.
3. **Debt Service Funds** – Debt service funds account for payments towards principal or interest, either in the current fiscal year, or resources held for principal and interest maturing in future years.
4. **Permanent Funds** – Permanent funds should be used to account for and report resources that are restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government's programs—that is, for the benefit of the government or its citizenry.

School District Specific Purpose Funds

School districts in Alaska are required to have certain types of funds under DEED's Uniform Chart of Accounts and Account Code Descriptions⁵. Besides the general fund, called the School Operating Fund, Alaska school districts must have the following types of governmental funds:

1. **Special Revenue Funds** – Funds, such as grants, used to account for the proceeds of specific revenue sources (other than trusts or major capital projects) that are legally restricted or committed to expenditure for specified purposes other than debt service or capital projects. More than one special revenue fund may need to be established.
2. **Student Transportation Fund** – This fund accounts for revenues and expenditures for student transportation to and from school and other state-approved student transportation. Revenues include state student transportation revenue and any necessary transfers from the school operating fund.
3. **Community School Fund** – The fund used to account for revenues and expenditures for community schools. Revenues include state grants for community education, and local revenue and matching funds from the School Operating Fund.
4. **Food Service Fund** – The fund used to account for non-instructional food service operations including the National School Lunch and Breakfast programs.
5. **Debt Service Fund** – A fund used to account for financial resources that are restricted, committed, or assigned to expenditures for principal and interest. Debt service funds should be used if legally mandated, as well as for the accumulation of resources for, and the payment of, general long-term debt obligations maturing in future years.

⁵ https://education.alaska.gov/publications/chart_of_accounts.pdf