Using Unassigned Funds to Balance the Budget

INTRODUCTION

During the recession and its aftermath, families struggling to make ends meet have had to use their savings to pay bills or buy groceries. Many local governments in South Carolina have had to do likewise during the past few years, using a part of their unrestricted fund balances due to declining revenues and increased costs. In its 2010-2011 State of Local Government Fiscal Conditions research study, the Institute for Public Service and Policy Research at the University of South Carolina expanded the section on use of fund balances in addressing budget issues. The results from the fund balance survey questions are presented below.

The 2009-2010 survey used the term “undesignated, unreserved” fund balance in reference to funds that were available in the general fund for any purpose. Governmental Accounting Standards Board (GASB, n.d.) found that governments interpreted fund balance categories differently and fund balance reporting was inconsistent. This led to the issuance of GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, to address these inconsistencies. Governments were required to implement the new standards for the fiscal year beginning after June 15, 2010. Because some of the local governments participating in the Institute’s survey may not have implemented GASB 54 at the time of completing the survey, the authors used the same “undesignated, unreserved” terminology in the 2010-2011 survey. The intention was to have participants report the “unassigned fund balance” (funds that are available for any purpose and reported only in the general fund) as currently defined by GASB 54.

A total of 70 South Carolina local governments (47 municipalities and 23 counties) responded to the fund balance questions in either the 2009-2010 or the 2010-2011 surveys. Seventy percent (61.7% of the municipalities and 87% of the counties) reported using their unassigned fund balances at least once between FY2008 and FY 2011. Thirty-three of the respondents used their unassigned fund balances at least twice during the four-year period between FY2008 and FY2011.

Respondents were asked why they elected to use the fund balance. Figure 1 summarizes their responses. Some respondents listed multiple reasons. “Other” responses included loss in the local government fund, refund of fire service fee, and using the fund balance instead of issuing bonds or tax anticipation notes. The average amount of the unassigned fund balance used is 11.58%, but the amount used ranges from .95% to 45.88%.
Figure 1

FUND BALANCE POLICIES
While some may view the fund balance as unnecessary and something that should be used to reduce taxes, financial management experts agree that some level of fund balance is needed. The Government Finance Officers Association (GFOA, 2009) recommends that governments establish a fund balance policy and maintain a fund balance of no less than two months (16.67%) of general fund operating expenditures. The International City/County Management Association (ICMA) uses bond-rating firms’ rule-of-thumb figure of maintaining at least five percent of annual operating expenditures as an acceptable fund balance (Fabian & Johnson, 2009).

Forty-nine local governments responded to the question about whether their jurisdiction had a fund balance policy. Twenty-nine (59%) indicated they did have a policy. Of those 29, sixteen jurisdictions had policies that required replenishment of the funds if the balance dropped below the amount required by the policy. Seven jurisdictions reported their fund balances were below the amount required by their policy. A summary of responses regarding fund balance policies is presented below:

<table>
<thead>
<tr>
<th>Reasons for Using Unassigned Fund</th>
<th>Municipalities</th>
<th>Counties</th>
<th>Municipalities</th>
<th>Counties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cover Budget Shortfalls</td>
<td></td>
<td></td>
<td>30</td>
<td></td>
</tr>
<tr>
<td>Capital Projects</td>
<td>14</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grant Matches</td>
<td>3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>COLA/Bonuses</td>
<td>2</td>
<td></td>
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</tr>
</tbody>
</table>

Note - 38 jurisdictions responded. Each jurisdiction could list multiple reasons.
ANALYSIS

Does using part of its fund balance indicate that a city or county is struggling financially? Not necessarily; some local governments use the unassigned fund balance for one-time expenses or to routinely handle uneven revenue flows and avoid using tax anticipation notes or other short-term debt instruments. Using the fund balance to address budget shortfalls may indicate more serious issues caused by declining revenues or increasing expenses. The following analysis will compare the 30 jurisdictions that used their unassigned fund balances to cover budget shortfalls to those local governments that did not use their fund balances at all to see if there are differences in the responses to the survey questions. The following section illustrates some of these differences.

Figure 3 illustrates the local governments that did not use their fund balance during the four year survey period had larger increases in both the size of their budgets and the number of full-time employees.

![Median Budget and FTE Change](image)

Figures 4 and 5 show that municipalities that did use their unassigned fund balances were more dependent on property tax revenues than those jurisdictions that did not use their fund balances. Because of varying revenue sources and a small sample size, counties were not included in this analysis. Although property tax revenues have been the most stable revenue source during the recession, jurisdictions that used their fund balances saw a smaller growth in property tax revenue even though they were more likely to increase property taxes over the four-year survey period (see Figures 6 and 7).
Cities that Used Unassigned Fund to Balance Budget: 2011 Sources of Revenue

- Property Tax: 42%
- Hospitality Tax: 2%
- Accommodations Tax: 7%
- Local Option Sales Tax: 1%
- Permit Fees: 3%
- Business License Fees/ Taxes: 8%
- Other License fees/ Taxes: 8%
- Fines/ Forfeitures: 2%
- User Fees/ Charges for Service: 19%

Cities that Did Not Use Unassigned Fund Balance: 2011 Sources of Revenue

- Property Tax: 30%
- Hospitality Tax: 8%
- Accommodations Tax: 8%
- Local Option Sales Tax: 7%
- Permit Fees: 6%
- Business License Fees/ Taxes: 22%
- Other License fees/ Taxes: 18%
- Fines/ Forfeitures: 3%
- User Fees/ Charges for Service: 3%
- Aide to Local Subdivisions: 1%
Local governments that did not use their fund balance fared better in all revenue sources with the exception of other license fees (Figures 7 and 8). Jurisdictions that used their fund balance were much more likely to increase fees or initiate new ones during the recession (Figure 9).

**Figure 7**

<table>
<thead>
<tr>
<th>Revenue Type</th>
<th>Used fund at least once to balance budget</th>
<th>Did not use fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property Tax Revenue</td>
<td>8.19%</td>
<td>14.55%</td>
</tr>
<tr>
<td>Hospitality Tax Revenue</td>
<td>-3.81%</td>
<td>0.54%</td>
</tr>
<tr>
<td>Accommodation Tax Revenue</td>
<td>-16.22%</td>
<td>-9.95%</td>
</tr>
<tr>
<td>Local Option Sales Tax</td>
<td>-3.94%</td>
<td>0.57%</td>
</tr>
<tr>
<td>Permit Fees</td>
<td>-39.40%</td>
<td>-15.16%</td>
</tr>
</tbody>
</table>

**Figure 6**

*Increase in Property Tax*

- Used Fund at Least Once to Balance Budget
- Did Not Use Fund

<table>
<thead>
<tr>
<th>Year</th>
<th>Increase (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>40.00%</td>
</tr>
<tr>
<td>2009</td>
<td>45.00%</td>
</tr>
<tr>
<td>2010</td>
<td>30.00%</td>
</tr>
<tr>
<td>2011</td>
<td>15.00%</td>
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</tbody>
</table>
While jurisdictions that used their unassigned fund balance to cover budget shortfalls were more likely to take steps to increase their revenue by raising taxes and fees, they also took several other actions at a greater rate than jurisdictions that did not use their fund balances. The survey asked about targeted cuts and reductions in 25 areas. Figure 10 shows the survey results in the five areas in which there were significant differences in response rates. Significant differences were determined by chi square analysis. Differences noted were at the .05 level of significance or greater.
CONCLUSION

Using a portion of the unassigned fund balance is one tool available to address tight budget times, and may be a necessity for local governments struggling with declining revenues and increasing costs. It appears from our survey results that jurisdictions making the decision to use a portion of the unassigned fund balance did so in conjunction with other actions to reduce costs or increase revenues. However, continued dependence on the unassigned fund balance will eventually weaken the financial stability of the jurisdiction. The challenge for these local governments will be to replenish their fund balances if revenues continue to decline and expenses increase.
References


End Notes

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