

**A Guide to Fund Balances in
the General and Special
Revenue Funds
of the Cities and Counties**

December 31, 1996



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A Guide to Fund Balances in the General and Special Revenue Funds of Cities and Counties as of December 31, 1996

Overview

The Office of the State Auditor has issued reports on the unreserved fund balances in the *General Funds* of Minnesota counties and cities over 2,500 in population since 1991. This year's report includes, for the first time, an analysis of the unreserved fund balances in the *Special Revenue Funds*. The inclusion of Special Revenue Funds is intended to present a more complete picture of the financial condition of counties and cities over 2,500 in population. Throughout this report, whenever the term "fund balance" is used, the reader should note that this is the *combined total* of the unreserved fund balances in the General and Special Revenue Funds.

The unreserved fund balances in the General and Special Revenue Funds of Minnesota cities and counties grew 11.3 percent and 6.3 percent respectively between 1995 and 1996. This report identifies trends in two types of fund balances in Minnesota cities and counties: *unreserved, undesignated*; and *unreserved, designated* General and Special Revenue Fund Balances.¹ The fund balance data in this report are based on 1995 and 1996 city and county audited financial reports.

The unreserved fund balances in the General and Special Revenue Funds of counties and cities over 2,500 in population increased 6.3 percent and 11.3 percent respectively between 1995 and 1996.

Trends in Minnesota City and County Unreserved Fund Balances

Statewide data on the amount of funds available for cities and counties at the end of 1996 indicates continued growth in the unreserved General and Special Revenue Fund Balances of cities and counties.

At the end of 1996, Minnesota's 87 counties had cumulative unreserved General and Special Revenue Fund Balances of \$1.23 billion, which represented an increase of 6.3 percent from the fund balances

¹ Although this report discusses only two types of fund balances, Minnesota cities and counties reporting financial information according to the modified accrual basis of accounting actually report three different classifications of fund balances in the General and Special Revenue Funds. The *unreserved, undesignated fund balances* include all funds remaining at the close of the fiscal year for which no legally-binding commitment has been made, nor has the governing body passed a resolution designating those funds for a specific purpose. The *unreserved, designated fund balances* include all funds remaining at the close of the fiscal year for which no legally-binding commitment has been made; however, these funds have been designated by the governing body for a specific future use. The governing body may pass a subsequent resolution eliminating or changing the designation of those funds and is not legally bound by the initial designation. The *reserved fund balances* include all funds remaining at the close of the fiscal year for which there is a legally-binding external commitment of those funds, such as a signed contract for services or equipment. The reserved fund balances are not discussed in this report.

reported by counties at the end of 1995. No counties reported a negative fund balance at the end of 1996.

Minnesota's 184 medium and large cities reported cumulative unreserved General and Special Revenue Fund Balances of \$683.7 million in 1996, which was an increase of 11.3 percent from the fund balances reported by cities at the end of 1995. Between 1995 and 1996, 133 cities reported an increase in their fund balance and 50 reported a decrease in their fund balance. The City of Grant was a township in 1995 and no information on its fund balances for that year was available.

Table 1A: Trends in City & County Unreserved Fund Balances, 1992 to 1996

Year	City Unreserved Fund Balances *	County Unreserved Fund Balances *
1992	\$ 515.5 million	\$ 928.7 million
1993	\$ 546.3 million	\$ 971.6 million
1994	\$ 550.9 million	\$ 1.05 billion
1995	\$ 614.1 million	\$ 1.16 billion
1996	\$ 683.7 million	\$ 1.23 billion
Percent Change 1992-1996	32.6 percent	32.9 percent

* Figures are not adjusted for inflation.

General and Special Revenue Fund Balances as a Percent of Total Current Expenditures

Comparing city and county unreserved fund balances to their total current expenditures helps place the fund balances in perspective and provides insight on the relative financial health of Minnesota's cities and counties. Cities and counties should have relatively large fund balances at the end of the year because they must rely on them to meet expenses during the first five months of the next fiscal year until they receive the first property tax payments (May) and state aid payments (July).

The unreserved fund balances of cities over 2,500 in population totaled \$683.7 million in 1996, which represented 44.4 percent of total city current expenditures, compared to 1995, in which they represented 42.1 percent of total city current expenditures.

The fund balances of \$1.23 billion reported by counties in 1996 represented 46.0 percent of total county current expenditures, which was slightly less than the 46.3 percent share they represented in 1995.

Statewide Averages Mask Considerable Variation Among Cities and Counties

Although statewide data reflect overall improvement in the financial condition of Minnesota's cities and counties, these trends were not uniformly experienced by all cities and counties across the state. The relative size of the fund balances of individual cities and counties vary dramatically across jurisdictions. There are also significant differences among local governments in the year-to-year changes in fund balances between 1995 and 1996. While many cities and counties reported significant growth in their fund balances, others drew down their fund balances to reduce tax levies and finance operations.

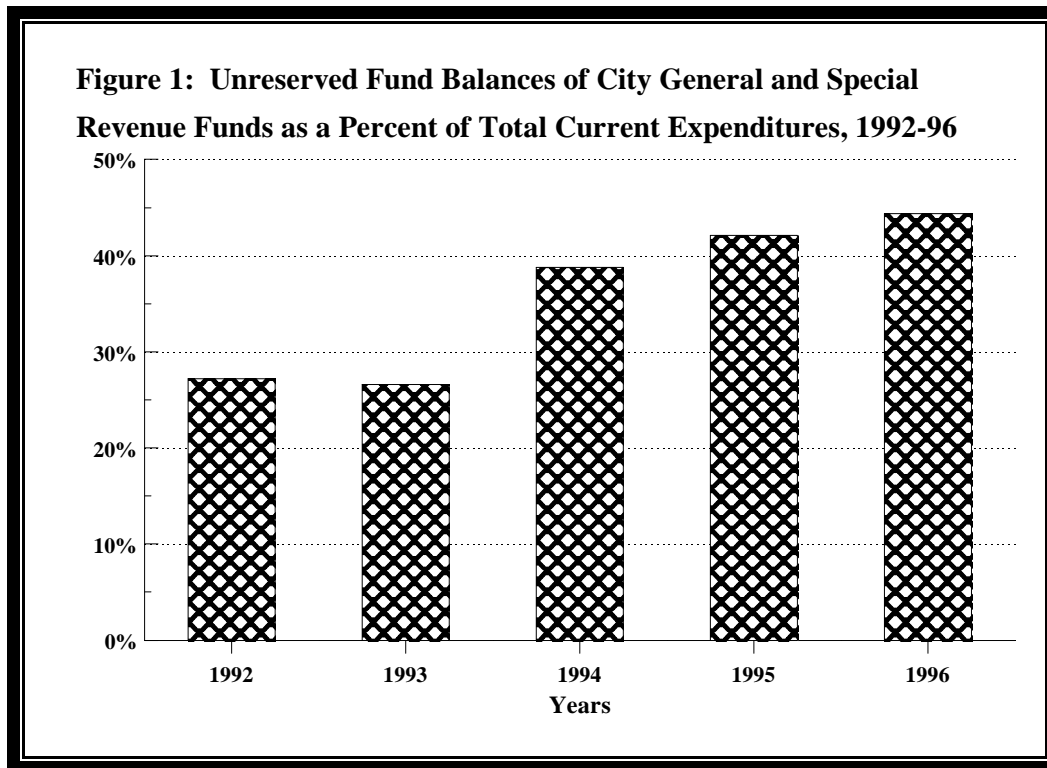
Analysis of Unreserved Fund Balances of City General and Special Revenue Funds

City Unreserved Fund Balances as a Percent of Total Current Expenditures

Three Minnesota cities, Caledonia, North Mankato, and Two Harbors, reported negative unreserved fund balances at the end of 1996. The remaining 181 cities with populations over 2,500 reported 1996 unreserved balances ranging from 1.8 percent of total current expenditures to 297.9 percent of total current expenditures. Statewide, the 1996 city fund balances averaged 44.4 percent of total current expenditures.

- ! 4 cities had fund balances that were between 1.8 and 10.0 percent of total current expenditures;
- ! 69 cities, including Bloomington, Duluth, Minneapolis, and St. Paul, had fund balances between 10 and 50 percent of total current expenditures;
- ! 70 cities had fund balances between 50 and 100 percent of total current expenditures; and,
- ! 38 cities had fund balances in excess of 100 percent of total current expenditures.

Figure 1 on the top of page 4 shows Unreserved Fund Balances of city General and Special Revenue Funds as a percent of total current expenditures for the years 1992 through 1996.



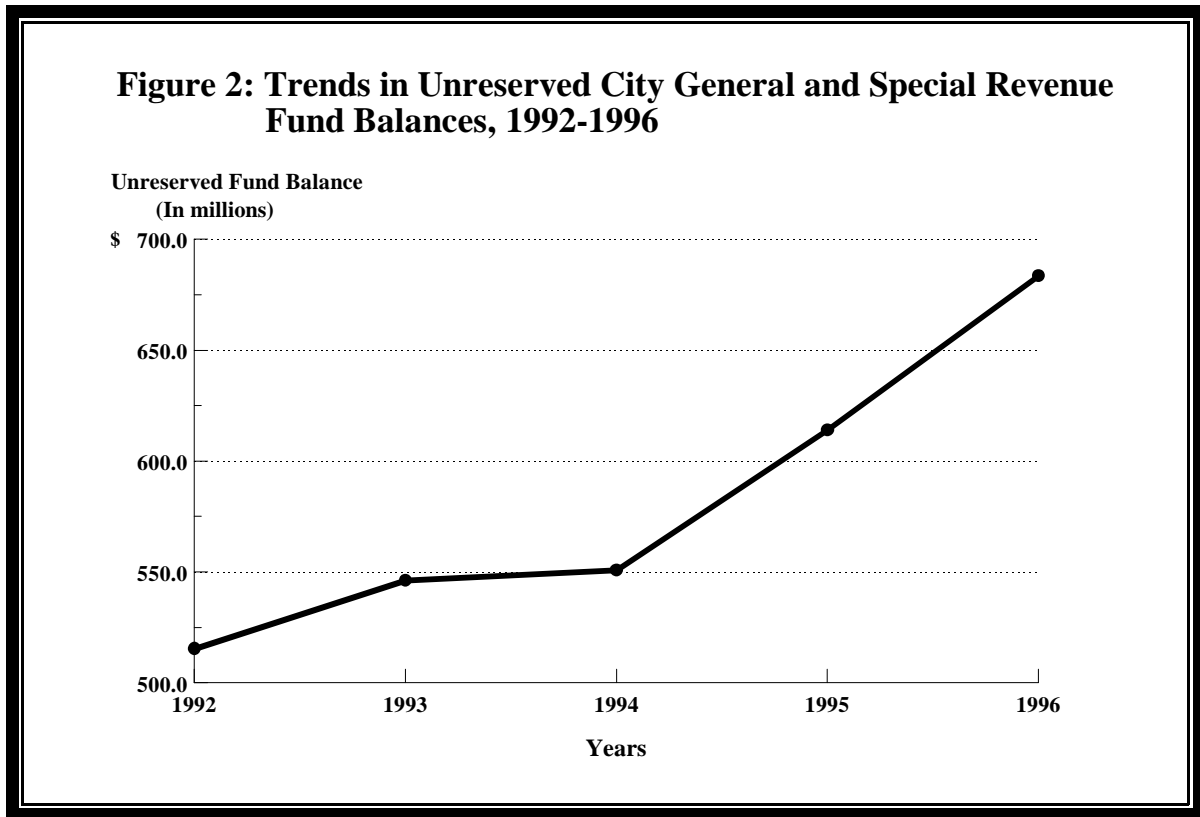
Change in the Unreserved Fund Balances of City General and Special Revenue Funds

In addition to wide variations in the relative size of fund balances among Minnesota cities, there were also significant differences in the year-to-year changes of the fund balances of individual cities. The fund balances of cities grew 11.3 percent in 1996, compared to 11.4 percent in 1995. Of Minnesota's 183 cities over 2,500 in population²:

- ! 48 cities reported decreases in their 1996 fund balance of between 0.1 percent and 100 percent of their 1995 fund balance;
- ! 2 cities reported a decrease in their 1996 fund balance of more than 100 percent from their 1995 fund balance;
- ! 125 cities reported increases in their 1996 fund balance of between 0.1 percent and 100 percent over their 1995 fund balance; and,
- ! 8 cities reported increases in their 1996 fund balance that exceeded 100 percent over their 1995 fund balance.

² The City of Grant is excluded because fund balance data was not available for 1995.

Figure 2 highlights trends in city unreserved fund balances.



Analysis of Unreserved Fund Balances of County General and Special Revenue Funds

County Unreserved Fund Balances as a Percent of Total Current Expenditures

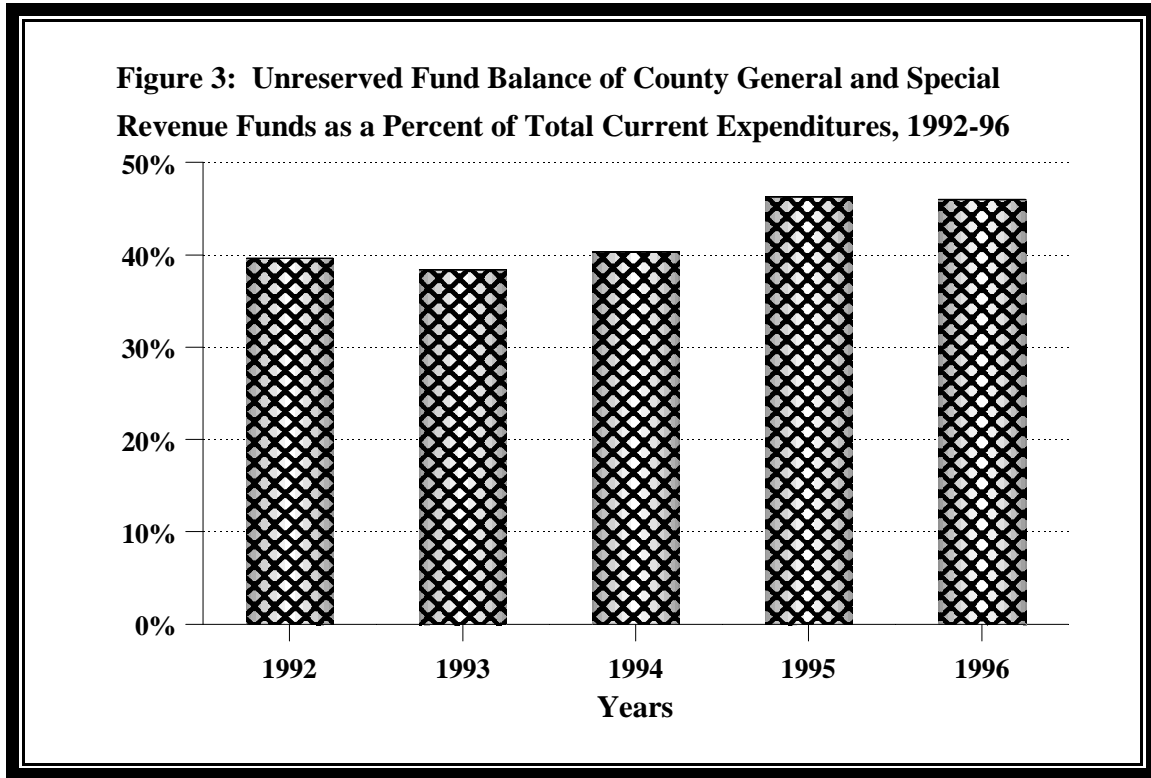
The relative size and change in unreserved fund balances for Minnesota counties vary significantly from county to county. The 1996 county fund balances averaged 46.0 percent of total current expenditures. Fund balances as a percent of total current expenditures ranged from 16.7 percent in St. Louis County to 143.8 percent in Mower County. Of the 87 Minnesota counties:

County unreserved fund balances represented 46.0 percent of Total Current Expenditures in 1996.

- ! 1 county had a fund balance totaling less than 20 percent of current expenditures;
- ! 36 counties had fund balances between 20 and 50 percent of total current expenditures;
- ! 46 counties had fund balances between 50 and 100 percent of total current expenditures;

! 4 counties had fund balances in excess of 100 percent of total current expenditures.

Figure 3 shows the unreserved fund balances in the General and Special Revenue Funds of counties as a percent of total current expenditures for the years 1992 through 1996.



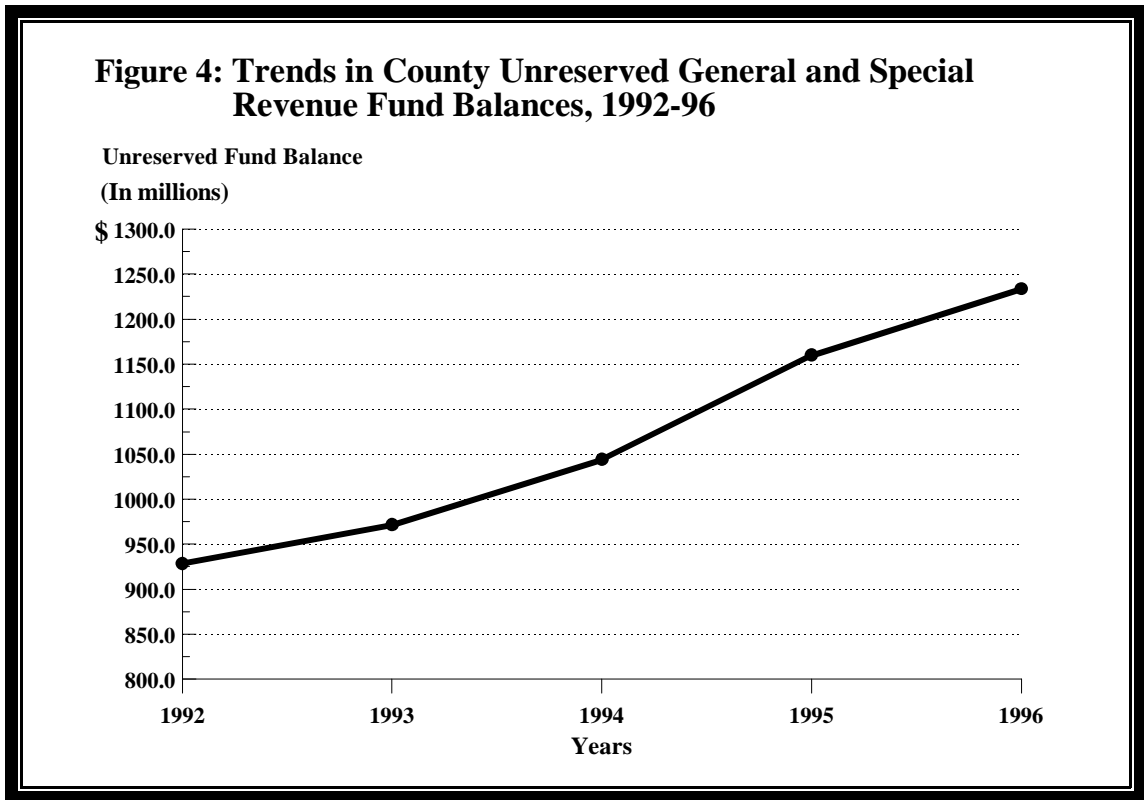
Changes in the Unreserved Fund Balances of County General and Special Revenue Funds

While statewide data for Minnesota counties indicate an increase in unreserved fund balances between 1995 and 1996, many counties reported declines in their fund balances.

! Sixty-three Minnesota counties reported increases in the size of their fund balances between 1995 and 1996. Goodhue County reported a 93.3 percent increase, which was the largest percentage increase of any county. In absolute dollars, Hennepin County reported the largest increase at \$15.9 million.

! Twenty-four counties reported declines in their fund balances between 1995 and 1996. The declines in fund balances ranged from 0.6 percent in Ramsey County to 19.5 percent in Stearns County. In absolute dollars, Scott County reported the largest decrease at \$4.3 million.

Figure 4 shows county unreserved fund balances for the years 1992-96.



Factors to be Considered in Analyzing a Local Government's General and Special Revenue Unreserved Fund Balances

Minnesota cities and counties report their fund balances at the close of their fiscal year (which runs concurrent with the calendar year). This creates an impression that cities and counties have excessive amounts of revenue held in reserve. In reality, city and county fund balances should be relatively large at the end of the year because of local government cash-flow cycles. Cities and counties must rely on their fund balances to meet expenses during the first five months of the next fiscal year, until they receive the first property tax payments (May) and aid payments from the state (July).

Unlike state government, which collects income tax withholding and sales tax receipts regularly throughout the year, Minnesota's cities and counties do not have a constant flow of revenue from which they are able to fund local government operations. Property tax levies, state aid to local governments, and property tax credits comprise the majority of city and county discretionary revenues. Minnesota Statutes govern the flow of these major revenue sources into city and county treasuries.

- ! Minnesota counties receive the first half of property taxes from property owners by May 15 of each year. Counties distribute the cities' share of the first-half property tax levies in late May and early June.
- ! Cities and counties receive the first half of their state aid and property tax credits from the state in July of each year.
- ! Minnesota counties receive the second half of property taxes from property owners by October 15 each year. Counties distribute the cities' share of the second-half property tax levies in late October and early November.
- ! Cities and counties receive the second half of their state aid and property tax credits from the state in December of each year.

Given this state-controlled flow of revenue, city and county fund balances (which are measured on December 31) are the primary source of funds available to cities and counties for their operating expenses during the first five months of the next fiscal year. An adequate fund balance will provide a local government with the cash flow required to finance fund expenditures.

Unique Circumstances of Each Jurisdiction Determine the Size of Fund Balance Needed

While cities and counties must rely on the fund balances for cash flow purposes during the first five months of a year, the unique circumstances of each local government will determine the size of a fund balance that must be maintained to avoid the need for short-term borrowing and to operate effectively.

The unique fiscal characteristics of individual cities and counties make it impossible to apply a single standard for fund balances to all cities and counties. While some cities may require a fund balance equivalent to 40 percent of their total current expenditures, other cities may need a fund balance equal to only 10 percent of their total current expenditures. Numerous factors must be considered in determining the size of a fund balance necessary for a city or county to avoid short-term borrowing.

- ! If cities and counties receive relatively large amounts of revenue from sources such as fees, fines, charges for services, other intergovernmental grants and aids, or interest on investments during the first five months of the calendar year, then they will be less dependent on their fund balances for cash flow purposes.
- ! Cities and counties are often able to delay certain purchases until after the initial property tax and state aid payments are received. While payments for employee salaries, wages and most benefits cannot be delayed during the first five months of the year, purchases of supplies and capital equipment may be delayed.

The individual cash flow needs of a city or county will determine the minimum fund balance that is necessary for a city or county to operate effectively. Cities and counties with the ability to generate significant revenues from sources other than property taxes and state aid payments are often able to minimize the need for large fund balances to support their cash flow requirements. Conversely, cities and counties that rely heavily on property taxes and state aid for the majority of their revenues will need relatively large fund balances to meet their cash flow needs from January 1 through June 1 of every calendar year.