REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

SUITE 500
525 PARK STREET
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)
(651) 296-4755 (Fax)
state.auditor@state.mn.us (E-mail)
1-800-627-3529 (Relay Service)

September 2009

Article for *Minnesota Counties*

State Budget Deficit and County Unreserved Fund Balances

By Rebecca Otto, State Auditor

Last legislative session I received regular phone calls from reporters, and the question usually was, "Should local governments drain their rainy day funds to do their part for the state budget gap?"

When someone suggests that local governments drain their "rainy day funds" which they equate to the unreserved portion of the General and Special Revenue Funds, they do not understand some very important differences between state and local government budgets.

The state actually has a rainy day fund that they can and have drained. Local governments are a bit different. Unlike state government, which collects income tax withholding and sales tax receipts regularly throughout the year, many counties do not have a constant flow of revenue from which they are able to fund local government operations. Property tax levies, state aid, and property tax credits comprise the majority of county discretionary revenues.

Minnesota laws govern the flow of these major revenue sources into county treasuries:

- The first half of property taxes from property owners is due by May 15 of each year, and is distributed to counties generally by the end of June.
- Counties receive the first half of their state aid and property tax credits from the state on July 20 of each year.
- The second half of property taxes from property owners is due by October 15 of each year, and is distributed to counties generally by the end of November.
- Counties receive the second half of their state aid and property tax credits from the state on December 26 of each year.

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

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

Numerous factors must be considered when determining the level of reserves necessary to avoid short-term borrowing:

- If 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.
- 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 county will determine the minimum fund balance that is necessary for it to operate effectively. Counties may need less reserves in their General and Special Revenue Funds if they have unreserved fund balances in other governmental or proprietary funds from which they may borrow or transfer resources, or if they receive significant revenues from sources other than property taxes and state aid payments (i.e., charges for services). Conversely, 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.

While there are many factors that help determine the minimum fund balance needed to maintain financial health, the Office of the State Auditor recommends that at year-end, local governments maintain unreserved fund balances in their General Fund and Special Revenue Funds of approximately 35 to 50 percent of operating revenues, or no less than five months of operating expenditures. If the local government's Unreserved Fund Balance is less than or greater than this recommendation, the local government should be able to explain the reason for the difference.

So when reporters ask, "When looking at County X's unreserved fund balance, why is it higher than the recommended 35-50%?" or "Why is it lower than the recommended 35-50%?" My response is, "Check with the county, and find out what their policy is for the appropriate level of their unreserved fund balance. If the unreserved fund balance is higher or lower than their stated policy, ask them to explain why the fund balance is higher or lower than their stated policy."

I know that times are difficult for our state and nation. This next legislative session will be challenging for all involved, as the state budget gap may be significant. I will continue to be a voice for prudent fiscal management at the local level as lawmakers and the Governor navigate their way toward a budget solution.