Model Fund Balance Policy

+ Guidance

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Like any planning effort, town budgeting involves an element of risk. When preparing and adopting a proposed budget, neither the selectboard nor the voters can precisely predict circumstances during the coming year. A town budget must necessarily be built on certain assumptions and estimates of resource flows, such as revenues and expenditures.

Recognizing this uncertainty, the Government Finance Officers Association (GFOA) recommends that general-purpose governments maintain reserves in their general fund of no less than two months (approximately 17%) of regular operating revenues or expenditures to cover unanticipated shortfalls, unforeseen expenditures, and cash flow needs. In addition, the Vermont Bond Bank (VBB) publishes annual median financial indicators for Vermont municipalities and plans to include fund balance benchmarks in these reports, which may be used alongside national guidance to help towns assess appropriate local targets. GFOA further recommends that governments adopt a formal policy to define appropriate fund balance levels and guide their use. See Fund Balance Guidelines for the General Fund. Governmental Fund fund balance is reported following GASB (Governmental Accounting Standards Board) standards, that classify fund balance according to the constraints on its use. Unassigned fund balance, the most flexible category, appears only in the General Fund and represents spendable resources not otherwise restricted, committed, assigned, or nonspendable.

Fund balance is simply the mathematical difference between assets and liabilities. It increases when inflows exceed outflows and decreases when outflows exceed inflows. Fund balance is sometimes misunderstood as excess money that could be used to reduce taxes or fees. In practice, unassigned fund balance is a long-standing and essential component of town financial reporting and management, used to understand and communicate a town's overall fiscal position. Maintaining an appropriate level of fund balance supports stable and predictable tax rates over time and strengthens a town's ability to manage revenue fluctuations. Adequate fund balance provides flexibility to respond to economic downturns, emergencies, and

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other unanticipated events, while also ensuring sufficient cash flow for ongoing operations. Overall, fund balance helps mitigate both short- and long-term financial risk and contributes to a town's overall fiscal stability. The use of fund balance categories is a standard part of governmental financial statements and reflects how towns have historically assessed financial capacity and risk.

Prior to 2025 and the passing of 24 V.S.A. § 1585, it was unclear, though it was widely practiced, whether Vermont law authorized towns to maintain and carry forward a dollar amount in unassigned fund balance from year to year. With the passage of the new law, selectboards now have the discretion to carry forward or use unexpended voter approved funds, consistent with other applicable laws and local policies. Notably, the selectboard does not require voter approval for expenditure of these funds. Specifically, the law says:

"Monies from a budget approved by the voters at an annual or special meeting that are not expended by the end of a municipality's fiscal year shall be under the control and direction of the legislative body of the municipality and may be carried forward from year to year as an unassigned fund balance. Unassigned fund balances may be invested and reinvested as are other monies received by a town treasurer and may be expended for any public purpose as established by the legislative body of the municipality." 24 V.S.A. § 1585.

Under section 1585, even if selectboards do not technically require voter approval for the use of these funds, state law and best financial practices still require maintaining transparency and accountability. This is best achieved when fund balance activity is properly accounted for and reported (e.g., included in discussion of budget preparation and in the annual audit).

This policy provides guidance to the selectboard on monitoring and managing fund balance, including unassigned fund balance, in a manner consistent with GAAP, GASB

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standards, and Vermont law, while recognizing that fund balance itself exists as the difference between assets and liabilities. Selectboards are encouraged to apply this policy in light of their financial circumstances, long-term plans, and risk tolerance, including defining parameters for target fund balance levels appropriate to local circumstances; conditions for use and replenishment of the fund balance; corrective actions if fund balance falls below the target (such as reducing discretionary expenditures, reallocating resources, or implementing a multi-year recovery plan); and treatment of excess fund balance, such as one-time uses, capital needs, or tax rate stabilization.

Please note that this model policy has been developed for illustrative purposes only. VLCT makes no express or implied endorsement or recommendation of any financial policy, nor does it make any express or implied guarantee of legal enforceability or legal compliance, nor does VLCT represent that any particular policy is appropriate for any particular municipality. Your legal counsel should review any proposed financial policy before adopting it.

As always, please contact the Municipal Operations Support (MOS) if you have questions at mos@vlct.org or 800-649-7915.

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