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New Rules for Fund Balance: What GASB 54 Means to New Hampshire Municipalities

By Barbara T. Reid

The Government Accounting Standards Board (GASB) recently issued Statement 54, titled “Fund Balance Reporting and Governmental Fund Type Definitions.” A companion article on page 15, authored by Stephen J. Gauthier, director of the technical services center at the Government Finance Officers Association (GFOA), summarizes the significant changes in the focus, classifications and terminology of fund balance. As he rightly notes, few, if any, sections of a municipality’s financial statements draw as much attention as does the fund balance of the general fund. With the changes required under GASB 54, it is essential that finance directors, selectmen, councilors and budget committee members understand the new concepts and components of fund balance, and how the future presentation of fund balance in financial statements will differ from the past.

Comparison of Pre- and Post-GASB 54 Fund Balance

While GASB 54 does not change the amount of fund balance, as explained in Gauthier’s article, it significantly changes how different components of fund balance will be reported. To illustrate these changes, the following exhibits show an example of the components of fund balance both pre- and post-GASB 54 implementation.

March 2010

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Exhibit A, shown on page 12, illustrates the pre-GASB 54 outline of fund balance, as previously published in chapter 5 of the LGC publication, *Basic Financial Policies: A Guide for New Hampshire Cities and Towns*. In Exhibit A, the total fund balance of \$1,000,000 is segregated into two components: “reserved” fund balance and “unreserved” fund balance. The unreserved fund balance is further delineated into the “designated” portions and the “undesignated” portion, resulting in an unreserved undesignated fund balance of \$350,000. Traditionally, this is the amount that is the focus of both a formal fund balance policy as well as the portion of fund balance from which an amount is frequently used to reduce property taxes when annual tax rates are certified by the Department of Revenue Administration.

Exhibit B, shown on page 13, provides a graphic overview of the new GASB 54 rule. The chart illustrates the same amount of fund balance (\$1,000,000), but with the following new classifications:

- Nonspendable
- Restricted
- Committed
- Assigned
- Unassigned

Note that the unassigned fund balance is \$350,000, the same amount as previously reported as unreserved undesignated fund balance. However, there are significant differences in the amounts reported as nonspendable (\$90,000) and spendable (\$910,000) versus the amounts previously reported as reserved (\$360,000) and unreserved (\$640,000). These differences highlight the change in focus in reporting fund balance under GASB 54. Whereas the current focus, illustrated in Exhibit A, is on the amount of fund balance available for *appropriation*, the new focus, illustrated in Exhibit B, will be on the various *spending constraints* imposed upon different elements of fund balance.

Special Considerations

With this comparison of pre- and post-GASB 54 fund balance, several items warrant further discussion. One is the classification of encumbrances. In Exhibit A, the total amount of encumbrances (\$20,000) is reported in the aggregate as reserved fund balance. However, under GASB 54, the classification for encumbrances will vary based upon the resources available to liquidate those encumbrances. Encumbrances may be classified as restricted, committed or assigned fund balance. As footnoted in Exhibit B, this illustration assumes that a portion of the \$20,000 encumbrances will be paid from restricted resources, such as a grant; that a portion will be paid from committed resources, such as an appropriation from a petitioned warrant article; and that a portion will be paid from assigned resources, such as the operating budget. In light of the varying nature in reporting encumbrances under GASB 54, municipalities should determine whether their encumbrance process will readily provide the information necessary to appropriately classify encumbrances under this new reporting requirement. If not, municipalities are advised to enact appropriate procedural changes in that process prior to the implementation of GASB 54.

Also of note is the classification of contingency funds. Similar to encumbrances, contingency funds may be classified in different ways, as either restricted or committed fund balance, depending upon the force of the spending limitation and usage criteria imposed on those funds. For example, a contingency fund to address revenue shortfalls of a specified percentage enacted under a city charter provision may be classified as restricted fund balance, whereas a contingency fund enacted by town meeting for a specific purpose (such as an increase in retirement costs) may be classified as committed fund balance.

Another change in GASB 54 is the clarification of the definition of a special revenue fund. GASB 54 makes clear that, for financial reporting purposes, a special revenue fund may only be established around one or more revenue sources that are restricted or committed to purposes other than capital projects or debt service. In making this change, GASB also broadened the definition of a capital projects fund to encompass all types of capital outlays, not just “major capital facilities,” a change that now aligns the GASB definition with common practice.

Fund Balance Policy Revisions

Municipalities that have adopted a fund balance policy will need to revise that policy to incorporate the new terminology under GASB 54. When determining the appropriate level of fund balance to retain in the general fund, many of the factors discussed in chapter 5 of the Basic Financial Policies guide will still apply under GASB 54, such as:

- size of the municipality;
- diversity and volatility of the revenues and expenditures;
- availability of resources in other funds;
- cashflow needs;
- credit-rating implications;
- political and economic realities; and
- taxpayer acceptance.

Although the GFOA guidelines on the minimum level of fund balance both pre- and post-GASB 54 seem somewhat similar (5 percent to 16 percent of operating revenues or operating expenditures), municipalities will continue to have much leeway in terms of establishing their own formula for computing the appropriate level of fund balance to include in a formal fund balance policy.

Effective Date

Since GASB 54 is effective for financial statement periods beginning after June 15, 2010, many municipalities, and all school districts, will be reporting fund balance under this new standard for the fiscal year that begins July 1, 2010. Other municipalities will report fund balance in accordance with GASB 54 for the fiscal year beginning January 1, 2011.

Additional Resources

It is important that, in addition to those individuals directly responsible for financial operations, elected and non-financial officials gain an understanding of the changed focus in reporting fund balance, and the purpose and concepts of GASB 54. To assist local officials with this understanding, the GFOA has issued a new publication, titled *What Everyone Needs to Know About the New Fund Balance*. This publication, written in a question-and-answer format, explains in non-technical terms the requirements of GASB 54, and is an excellent resource for all local officials involved in budgeting and fiscal policy-making. Copies of this booklet are available for a minimal charge from the [GFOA's e-store](#).

The GASB has also issued a summary of Statement 54 and a fact sheet about the new fund balance reporting. Both of these documents are available on the LGC website. A copy of the entire Statement 54 may be obtained from the GASB website.

Future editions of LGC's *Basic Financial Policies* publication will be updated to include further discussion of the changes in fund balance reporting and will provide examples of fund balance polices adopted under the new requirements of GASB 54.

As local governments nationwide begin to report fund balance in accordance with GASB 54, questions will no doubt arise regarding the proper classification in unique circumstances. It is anticipated that further guidance will be forthcoming from the GASB and the GFOA regarding these circumstances and the implementation of GASB Statement 54.

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