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Fund Balance and Enterprise Fund

Transfer Policies and Procedures

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October 15, 2025



Fund Balance

Advanced Municipal Elected Officials Institute Fall Training



What is Fund Balance?

- Your city's governmental-wide and proprietary fund statements show all assets and liabilities. The difference is net assets.
- Governmental funds (like the General Fund) only show a subset of assets and liabilities. The difference is really more a measurement of liquidity than net worth.



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What is Fund Balance?

- Current Assets - Current Liabilities = Fund Balance
- It's the government's working capital
- A measure of resources immediately available to finance ongoing operations



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Not All Fund Balance Is The Same

- Some portions of Fund Balance are limited in terms of how it can be used
- While other portions of Fund Balance can be used as council sees fit
- So lets distinguish the components...



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Fund Balance Components

- Nonspendable
- Restricted
- Committed
- Assigned
- Unassigned

**RESTRICTED
AREA**

**DO NOT
ENTER**



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Fund Balance Components

Nonspendable – consists of assets that are inherently nonspendable in the current period either because of their form or because they must be maintained intact, including prepaid items, inventories, long-term portions of loans receivable, financial assets held for resale, and principal of endowments



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Fund Balance Components

Restricted – consists of amounts that are subject to externally enforceable legal purpose restrictions imposed by creditors, grantors, contributors, or laws and regulations of other governments; or through constitutional provisions or enabling legislation.



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Fund Balance Components

Committed – consists of amounts that are subject to a purpose constraint imposed by a formal action of the government's highest level of decision-making authority before the end of the fiscal year, and that require the same level of formal action to remove the constraint.



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Fund Balance Components

Assigned – consists of amounts that are subject to a purpose constraint that represents an intended use established by the government's highest level of decision-making authority, or by their designated body or official. The purpose of the assignment must be narrower than the purpose of the general fund, and in funds other than the general fund, assigned fund balance represents the residual amount of fund balance.



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Fund Balance Components

Unassigned – represents the residual classification for the government's general fund, and could report a surplus or deficit. In funds other than the general fund, the unassigned classification should be used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.



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Why Maintain a Fund Balance?

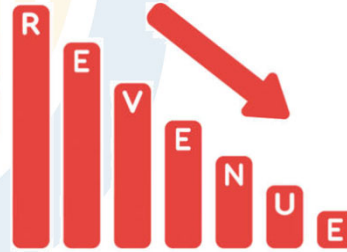
- To smooth cash flow resulting from revenue cycles
- As an alternative to tax anticipation notes and associated expenses
- To maintain a stronger credit rating.



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Why Maintain a Fund Balance?

- To weather revenue shortages (i.e. natural disasters or economic downturns)
- To limit exposure to risk
- To provide flexibility



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How Much is the “Right Amount”?

- There is no “one size fits all” level of fund balance that is appropriate for all cities
- Many factors affect how much a city should maintain in its General Fund
- www.gfoa.org/materials/fund-balance-guidelines-for-the-general-fund



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How to Determine the “Right Amount”

- Analyze the weaknesses, risks, and financial goals of your city or town
- Understand that political beliefs and risk tolerance influence the perception of how much fund balance is too little or too much.



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Factors Affecting Need for Fund Balance

- Starting month of fiscal year relative to timing of major revenues
- Diversity of revenue sources and timing of receipts
- Timing of large expenditures relative to inflow of revenue



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Factors Affecting Need for Fund Balance

- Ratio of personnel expenses to total budget
- Vulnerability to natural disasters and resulting cost
- Desired creditworthiness



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Factors Affecting Need for Fund Balance

- Volatility of revenues and expenditures
 - Dependence on single business or industry
 - Local economic conditions



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What is an adequate level?

- Again, there is no hard fast rule
- GFOA recommends that cities no matter the size maintain an unassigned fund balance (general fund) of at least 2-months operating revenue or expenditures
- www.gfoa.org/materials/fund-balance-guidelines-for-the-general-fund



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What is an adequate level?

- However, a city's particular situation may require a higher level of unassigned fund balance than GFOA's minimum
- Cities that frequently rely on fund balance to meet cash flow or other recurring needs should consider maintaining their fund balance at a higher level



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What is an adequate level?

- Assuming an even proration of revenues and expenditures throughout the year, a minimum fund balance of 17% (2/12th) would be necessary to meet the GFOA's recommendation
- An average city with diverse revenues needs 18-20% of budget in available cash to bridge cash flow gaps from July-November



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Adopt a Fund Balance Policy

- Periodically using fund balance as revenue source is not improper but should be guided by policy
- Developing a formal fund balance policy that is approved by council is important



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A Fund Balance Policy Should State

- When use is appropriate
- Establish a mandatory minimum level of funding
- Define what items can be funded if balance exceeds the minimum



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A Fund Balance Policy Should State

- Establish the minimum funding on factors such as:
 - cash flow
 - disaster potential
 - revenue diversity
 - economic factors
- Tie minimum balance to % of budget so it grows without additional authorization



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The Politics of Fund Balance

- Both internal and external factors influence fund balance policy decisions
- Fund balance size can be controversial because it involves the use of public funds which impacts taxpayers



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The Politics of Fund Balance

- Fund Balance is often misunderstood and sometimes criticized as an unnecessary accumulation of money that could be used to lower taxes and fees
- Critics often don't understand or don't want to understand the complex nature of municipal finance



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The Politics of Fund Balance

- Conversely, staff typically views fund balance as a necessary reserve for cash flow, unexpected expenditures and as an alternative to the cost of borrowing money
- Finding a balance between these two opposing viewpoints can be difficult



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The Politics of Fund Balance

- Therefore, it is important that you evaluate, justify and communicate to council, the public and local businesses the necessity of maintaining an adequate fund balance
- Staff's role is to analyze and prepare a recommendation to council and then council makes the ultimate decision on the city's fund balance policy



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Things to Consider

- Historically how revenues are received and expenditures paid
- The impact of revenue and expenditure patterns on cash flow
- Peak cash flow needs in recent years



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Things to Consider

- On top of that, how much cash do you need for emergencies during peak cash flow needs?
- Assess the risks that could occur during the period of time when your city's need for cash on hand is at its greatest
- Fund Balance level impacts your city's credit rating



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Things to Consider

- The interest cost of borrowing money to maintain positive cash flow in the absence of adequate fund balance
- Potential impact on operations or council's goals if expenditures must be delayed until the inflow of revenue is sufficient



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Things to Consider

- Objective consideration of these factors should enable Council to determine an adequate level of fund balance
- Once that is done, the key is establishing a policy to ensure that the necessary level of fund balance is achieved and maintained



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What's Happening In Your Municipality?

- How many of you believe that your city or town has an adequate fund balance?
- Is the issue controversial in your city?
- How many of you have adopted a fund balance policy?
- How many of you follow the policy?



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Enterprise Fund Transfers

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Enterprise Fund Transfers

- A fund is a separate fiscal and accounting entity with its own self-balancing set of accounts; its own assets, liabilities, and equity; and its own revenues and expenditures.
- An interfund transfer is a budgeted movement of money from one fund to another with the money shown as revenue in the receiving fund and as an expenditure in the fund from which the revenue is transferred



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Enterprise Fund Transfers

- It is common for municipalities that own and operate public utilities to transfer resources from their utility enterprise fund to their general fund.
- In South Carolina, the courts have in the past stated that a municipal utility is a business enterprise that may lawfully be used by the municipality to reduce tax burdens on its residents.



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Enterprise Fund Transfers

- Azar versus City of Columbia (September, 2015)
- www.masc.sc/uptown/03-2016/court-addresses-fund-transfers
- S.C. Code Section 6-1-330
- S.C. Code Section 6-1-440 (Revenue Bond Act)



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Enterprise Fund Transfers

- If you have a public utility transfer in place:
 - Consult legal counsel for guidance
 - Ensure that utility revenues are spent on “related costs”
 - For any “unrelated costs,” document that the expenditures are in fact “surplus” and that the city is in compliance with the Revenue Bond Act



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Enterprise Fund Transfers

- It is common for cities with public utilities to assess a fee in lieu of franchise on their utility and to charge the utility for administrative services provided by the general fund.
- Consult your attorney and make sure that these, or similar, arrangements are adopted by council as a financial policy of the city and that objective formulas and actual expenses are used to calculate amounts transferred.



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QUESTIONS



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