

VERNON HILLS FUND BALANCE/NET ASSETS POLICY

April 17, 2012

Purpose

The Vernon Hills Fund Balance/Net Assets Policy establishes a minimum level at which the projected end-of-year fund balance/net assets must observe; as a result of the constraints imposed upon the resources reported by the governmental and proprietary funds. This policy is established to provide financial stability, cash flow for operations, and the assurance that the Village will be able to respond to emergencies with fiscal strength. More detailed fund balance financial reporting and the increased disclosures will aid the user of the financial statements in understanding the availability of resources.

It is the Village's philosophy to support long-term financial strategies, where fiscal sustainability is its first priority, while also building funds for future growth. It is essential to maintain adequate levels of funds balance/net assets to mitigate current and future risks and insulate the Village from revenue fluctuations. Fund balance/net asset levels are also crucial consideration in long-term financial planning. Credit rating agencies carefully monitor levels of fund balance/net assets and unassigned fund balance in the General Fund to evaluate the Village's continued creditworthiness.

Definitions

Governmental Funds

The fund balance will be composed of three primary categories:

- 1) Nonspendable Fund Balance – portion of a Governmental Fund's fund balance that are not available to be spent, either in the short-term or long-term, or through legal restrictions (e.g., inventories, prepaid items, land held for resale and endowments).
- 2) Restricted Fund Balance – portion of a Governmental Fund's fund balance that are subject to external enforceable legal restrictions.
- 3) Unrestricted Fund Balance – is made up of three components:
 - A) Committed Fund Balance – the portion of a Governmental Fund's fund balance with self-imposed constraints or limitations that have been placed at the highest level of decision making through formal Board action. The same action is required to remove the commitment of fund balance.
 - B) Assigned Fund Balance – the portion of a Governmental Fund's fund balance to denote an intended use of resources but with no formal Board action.
 - C) Unassigned Fund Balance – available expendable financial resources in a governmental fund that is not the object of tentative management plan.

Some funds are funded by a variety of resources, including both restricted and unrestricted (committed, assigned and unassigned). The Government assumes that the order of spending fund balance is as follows: restricted, committed, assigned, unassigned.

Definitions – Continued

Proprietary Funds

Proprietary funds include enterprise and internal service funds. The net assets will be composed of three primary categories:

- 1) Invested in Capital Assets, Net of Related Debt – portion of a proprietary fund's net assets that reflects the fund's net investment in capital assets less any amount of outstanding debt related to the purchase/acquisition of said capital assets. Related debt, for this purpose, includes the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of capital assets of the Government.
- 2) Restricted Net Assets – portion of a proprietary fund's net assets that are subject to external enforceable legal restrictions.
- 3) Unrestricted Net Assets – portion of a proprietary fund's net assets that is neither restricted nor invested in capital assets (net of related debt).

Authority

Governmental Funds

Committed Fund Balance – A self-imposed constraint on spending the fund balance must be approved by ordinance or resolution of the Board. Any modifications or removal of the self-imposed constraint must use the same action used to commit the fund balance. Formal action to commit fund balance must occur before the end of the fiscal year. The dollar amount of the commitment can be determined after year end.

Assigned Fund Balance – A self-imposed constraint on spending the fund balance based on the Village's intent to use fund balance for a specific purpose. The authority is delegated to members of the management team by the Board through the annual budget approval process.

Minimum Unrestricted Fund Balance Levels

Governmental Funds

General Fund

Purpose – It is a major fund and the general operating fund of the Village. It is used to account for all activities that are not accounted for in another fund.

Fund Balance – Unrestricted fund balance targets should represent no less than 67% of annual operating and debt service expenditures. Within the General Fund, certain balances are restricted to Drug Forfeiture, Emergency Telephone 911, DUI Fines and RTA Metra Parking as established by Illinois State law or Intergovernmental agreement. Also within the General Fund certain Summer Celebration balances are committed through the budgetary process.

Minimum Unrestricted Fund Balance Levels – Continued

Motor Fuel Tax Special Revenue Fund

Purpose - Used to account for and report the proceeds of specific revenue sources that are legally restricted to expenditures for road maintenance purposes as specified under Illinois State law for the lawful use of Motor Fuel Tax receipts.

Financing – Special revenue funds are provided by a restricted and/or committed revenue source. Financing may be received from Motor Fuel Tax as well as from other State transportation revenues that share the same restrictions.

Fund Balance – Derived from Motor Fuel Taxes and other State transportation revenues that share the same restrictions; is therefore, legally restricted. The fund balance amount will be targeted at a minimum level of 67% of an annual budgeted road program. This will be adjusted annually with the adoption of the annual budget.

Tax Increment Special Revenue Fund

Purpose - Used to account for and report the proceeds of Tax Increment Revenues that are legally restricted to expenditures for prescribed purposes within the Tax Incremental Financing District of the Village of Vernon Hills, and further restricted by bond covenants established by Tax Increment Bonds.

Financing – The Tax Increment Special Revenue Fund is funded by the Tax Increment generated within the Tax Incremental Financing District of the Village of Vernon Hills and the required General Fund ten percent match.

Fund Balance – Tax Increment Revenues and the required General Fund ten percent match are legally restricted by the ordinances establishing the Tax Increment District and they are further restricted by bond covenants established by Tax Increment Bonds. The fund balance amounts are restricted to levels set in the Tax Increment Bond covenants.

Vernon Hills Athletic Complex Special Revenue Fund

Purpose - Used to account for and report the proceeds of the repayment of Community High School District 128's \$1,300,000 Taxable Debt Certificates, Series 2001 issued for the purpose of constructing the Vernon Hills Athletic Complex. The Village is using those loan payment proceeds to continue making capital improvements related to the Vernon Hills Athletic Complex.

Financing – Special revenue funds are provided by a committed source of funds, which is the proceeds of the repayment of Community High School District 128's \$1,300,000 Taxable Debt Certificates, Series 2001 issued for the purpose of constructing the Vernon Hills Athletic Complex.

Fund Balance – Derived from the proceeds of the repayment of Community High School District 128's \$1,300,000 Taxable Debt Certificates, Series 2001 issued for the purpose of constructing the Vernon Hills Athletic Complex. The remaining fund balance amount

will be used for making capital improvements related to the Vernon Hills Athletic Complex until the fund balance is exhausted.

Minimum Unrestricted Fund Balance Levels – Continued

Proprietary Funds

Golf Course Enterprise Fund

Purpose - Established to account for and report financial resources that are invested in the Vernon Hills Golf Course capital assets, net of related debt, restricted, or unrestricted for future spending related to the fund. The focus of enterprise fund measurement is upon determination of operating income, changes in net assets, financial position, and cash flows. The generally accepted accounting principles applicable are those similar to businesses in the private sector. The Golf Course Enterprise Fund is required to account for operations for which a fee is charged to external users for goods or services and the activity (a) is financed with debt that is solely secured by a pledge of the net revenues or (b) establishes fees and charges based on a pricing policy designed to recover similar costs.

Financing – User fees or debt financing are used to finance operations, capital outlay and improvements, and debt service retirements of the Golf Course.

Net Assets – Considered invested in capital assets net of related debt for amounts capitalized as capital assets, less the outstanding debt related to the acquisition of said assets. Unrestricted net asset targets should represent no less than three months of operating expenses (excluding debt service and capitalized asset expenses) at the end of the Golf season.

Equipment Replacement Internal Service Fund

Purpose - Established to account for and report financial resources at are invested in capital assets, net of related debt, restricted, or unrestricted for future spending related to the fund. The focus of internal service fund measurement is upon determination of operating income, changes in net assets, financial position, and cash flows. The generally accepted accounting principles applicable are those similar to businesses in the private sector. Equipment Replacement Internal Service Funds is used to account for the financing of non information technology equipment purchases with a cost of over \$15,000 and a life of at least six years. The Fund provides this equipment by activity to other departments of the Village on a cost-reimbursement basis.

Financing – User fees charged to other departments are used to finance capital outlay.

Net Assets – Considered invested in capital assets net of related debt (for amounts capitalized as capital assets, less the outstanding debt related to the acquisition of said assets. Restricted net assets relate to bond covenant reserves as outlined in the bond ordinance. Unrestricted net asset targets should represent appropriate twelve months of fund activity, subject to discretion of the Board and management (excluding debt service and capitalized asset expenses).

Other Considerations

In establishing the above policies for unrestricted fund balance/net asset levels, the Village considered the following factors:

- The predictability of the Village's revenues and the volatility of its expenditures (i.e., higher levels of unrestricted fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile)
- The Village's perceived exposure to significant one-time outlays (e.g., economic fluctuations, state budget cuts, immediate capital needs, state budget cuts and disasters)
- The potential drain upon General Fund resources from other funds as well as the availability of resources in other funds (i.e., deficits in other funds may require a higher level of unrestricted fund balance be maintained in the General Fund, just as, the availability of resources in other funds may reduce the amount of unrestricted fund balance needed in the General Fund)
- Liquidity (i.e., a disparity between when financial resources actually become available to make payments and the average maturity of related liabilities may require that a higher level of resources be maintained)
- Commitments and assignments (i.e., governments may wish to maintain higher levels of unrestricted fund balance to compensate for any portion of unrestricted fund balance already committed or assigned by the government for a specific purpose)

If any of the above factors change, the Village should readdress current unrestricted fund balance/net asset levels to ensure amounts are appropriate.