

What If...You Are Starting a Reserve Account

A White Paper For Conservation Districts

Facilitated by:

Donna Fisher, Blair County Conservation District
Ronald Rohall, Westmoreland Conservation District

District Authorities:

Don McNutt and Gerald Heistand, Lancaster County Conservation District
Jim Resh, Indiana County Conservation District
Conrad Donovan, Westmoreland Conservation District

Facilitator notes:

This outline and attendant case studies is the capture of the thoughts and feelings of six district staff and board members on a topic with which they have all had experience. The record herein is meant to set the stage for “What if... You Wanted to Start a Reserve Fund Account.”

The format is meant to be broad brush and then burrow down to more complex and dynamic issues. This is not an exhaustive analysis but merely an attempt to outline some of the implications of taking on the task of “Starting a Reserve Fund Account”.

Disclaimer:

The views expressed in this document are those of six conservation district directors and staff that have experience in creating and maintaining a reserve fund account for their districts. The views and opinions expressed are by no means an exhaustive treatment or the final word on this subject matter. The authors have made every effort to be as thorough as possible, but make no claim as to the completeness of this checklist or document. We do not take any responsibility that your experience will be the same or be successful as a result of using the information contained in this document. We offer this document as a starting point for your explorations and hope it will help in the fiscal management of your conservation district. In addition, this document does not express the official policy or position of the State Conservation Commission, Department of Agriculture, or the Department of Environmental Protection in regards to the establishment, funding or management of reserve fund accounts. Individual state funding sources to conservation districts may limit the use of state funds to certain eligible costs and or reimbursements for work performed.

Overview --The WHY

Many districts have expressed interest in or asked questions about how to put funds aside for expected and unexpected expenses that are not part of the day-to-day operations. This paper will explore those issues most germane to the topic of planning, funding, and maintaining a “reserve fund account.” We have attempted to include as many of the issues as our District authorities have experienced. Reoccurring questions on this issue have led to this exploration of the topic and set the stage for further dialogs. Many of the factors with which Conservation Districts must contend with are addressed here with the caveat that every situation is different and every district is unique.

With the increased complexity of district funding sources, accrued liabilities, and the need to periodically make large expenditures, many districts have found it useful to have a reserve fund account. We have included a list of reasons that would help a District Board of Directors in deciding whether to start a reserve fund account or not. We would suggest that this is only a starting point and more issues will likely surface as Districts establish and manage reserve accounts.

The most important question the board must ask is what are the District’s financial liabilities and can the District meet those liabilities. Thorough questions and honest answers are critical to seeing the District’s true financial position and the ability to have access to the required funds. Another important question to ask is “If a Katrina - type event hit your county, how long can the District provide core services without external funding and/or income?”

When determining to establish a reserve account, Boards should consider the following questions.

Can the district:

- Cover unbudgeted expenses
- Cover cash flow – payroll if reimbursements are late etc.
- Save funds for vehicle repairs or purchase
- Save for anticipated future expenses (capital items)
- Cover Staff turnover expenses accrued liabilities (sick leave, vacation)
- Meet anticipated staff or grant matches (bridge financing)
- Make building repairs (HVAC or roof replacement)
- Eliminate the need for a Line of Credit
- Offset funding (County or other) shortfalls
- Cover insurance deductibles
- Cover debt service
- Manage multiple restricted accounts, pooled accounts

Does the District have a mechanism to:

- Deposit to and save unanticipated revenues for future use.
- Deposit funds collected in one fiscal year to be used in another.

Issues

Reserve accounts can reduce the need to use a line of credit from a bank. Once a reserve account is established and funded, a district can borrow from itself eliminating the expenses that come with borrowing from a line of credit. With appropriate internal controls, there should not be any additional burden on the district’s bookkeeping and accounting staff.

Reserve accounts are not for day-to-day operating expenses. Before establishing a reserve account, a district should calculate its “day’s cash on hand.” Variables for calculating may be very different between districts; an accountant should be involved. One very significant variable is payroll, are the staff paid by the county or the district. A rule of thumb is to keep two to three months of operating funds on hand and consider keeping an additional 2-3 months and up to 6 months of operating funds in a reserve account. Day-to-day operating expenses may fluctuate significantly over the year; careful management may be needed to maintain an adequate fund balance in the checking account.

Reserve accounts should be established to cover accumulated financial liabilities, which include:

- Sick leave and vacation time accumulated by staff.
- Covering the cost of Interim or Temporary employees in the absence of a staff member
- Future purchases – Sinking Fund – replacement of high-ended equipment or vehicles
- Future Major Capital Expenses
- Insurance Deductibles

Before establishing a reserve fund the district should identify all areas of financial exposure and were possible limit and manage that exposure (i.e. capping sick, reviewing insurance policies and deductibles). If a district does not enact reasonable policies to limit known financial exposures, especially related to personnel costs, there may never be a reserve account large enough to cover these unmanaged liabilities

Policy for managing the reserve account should be established by the Board. Well-defined policies identifying the reasons for and how to manage the reserve account are necessary to help protect the account, inform new board members and county officials of why the fund was established, and to demonstrate responsible fiscal management. Clear policy on guidelines for what the fund can and cannot be used for is important to define from the beginning.

Some issues to be considered during policy development include:

- Reasons for the account
- Guidelines for the use of unrestricted funds and restricted funds
- Establish authority and signatory for use and/or transfer of funds
- How and when to put money in the account
- Investment options
 - Board should consider any combination of the following as well as other appropriate options: Market accounts, interest-bearing checking/savings accounts, mutual funds and certificates of deposit (CD's)
- Investment guidelines
 - When and how to invest reserve account funds. How often are investment vehicles examined for their performance and appropriateness? Are the current investments appropriate to meet the cash-flow investments of the District? Are there sources of funds that cannot be pooled and must be kept separate? (i.e. Growing Greener accounts)
- How to allocate interest -- this may vary by the sources of the funds
 - If funds from multiple sources are pooled into a single investment, how is the interest allocated back to the source? Does any or all of the interest become unrestricted funds?
- How to keep track of restricted funds -- this may vary based on the funding source
 - When restricted funds are part of a pooled investment, financial control procedures should be implemented to ensure correct allocations of restricted monies. Financial records should reflect allocations of restricted funds.
- Funding the account. Are there dedicated sources of funds?

- If program funds or reimbursement based funds are the source of funds being put in the reserve account to cover accrued liabilities (e.g. sick leave) the amount should be reasonable and justifiable.
- If and when Board approval is required to draw down the account
- How to be totally transparent

One of the biggest challenges in establishing a reserve is finding the funds to place into the account. Ideas for this include:

- Unanticipated revenues
- Savings from items that come in under budget
- Under budget within line items or purchases
- Dedicated fees
- Capturing depreciation of assets
- Administrative fees
- Portion of vehicle expenses – difference between out-of- pocket cost and reimbursement rate
- Donations
- Awards
- Sales income
- Budget for leave liability annually and if not utilized deposit to a reserve account

Steps to Establish a Reserve Account.

Below we have outlined a general procedure for Boards to follow in establishing a reserve account.

1. The Board of Directors takes official action to establish reserve fund and begin the process
2. Determine “days cash on hand” and establish guidelines for operating the fund
3. Document financial liability
4. Consult your county commissioners and fiscal administrators, explain the need for and how the account will be managed
5. Set policy and guidelines
6. Establish the account
7. Accumulate funds
8. Reevaluate liabilities annually
9. Proactively educate new county commissioners and fiscal administrators and personal as needed

Legal issues, Act 217 under which Districts operate does not prohibit the establishment and use of reserve accounts. However the source of the funds may limit how the funds may be used or

redirected. The district should put in place internal financial controls to insure appropriate use of all funds.

Conclusion

Establishing a reserve account may require significant effort by the Board and management of the District. However, once established with appropriate funding and well-defined policies and guidelines, a reserve account should reduce stress on the Board and financial administrator. It will enable the District to meet anticipated liabilities, cover periods of poor cash flow, and begin new projects knowing the funds are there to get started. Keep your County Commissioners and financial administrators educated on the reserve account, funding sources and purpose.

Don't be afraid to ask for help from those who have gone through the process. One of the greatest strengths of conservation districts is their willingness to help each other.

The following three attached Case Studies are presented to give you insight into how districts of different sizes and needs approached this issue, have met their original needs and may have further evolved the reserve account as the district continued to grow. The District Authorities who authored these Case Studies are available for counsel and welcome you to visit their district.

Lancaster County Conservation District Use of Reserve Accounts

Background and Account Description

The Lancaster County Conservation District has four main reserve accounts. The **Tree Account** with funds generated from the sale of trees was the District’s first reserve account. The largest is the **General Reserve Account** that had most of its initial growth generated with interest money. This account is used to build funds for future capital expenses, as a loan account for district operations, or to be used during a time of extended budgetary shortfall. The **Erosion & Sedimentation Account** is used as a profit/loss account; therefore, a good or bad year in the E&S program does not affect the general operating budget of the District (i.e. the E&S program does not financially support or depend on other programs). The most recent is the reserve **Separation Account** that was set up to take care of the liability (e.g. unused sick leave, vacation leave, etc.) that would occur if a number of employees left employment unexpectedly.

District Policy

The District’s Policy Manual has a **Financial Section** covering anything from acceptable expenditures and management of each District fund, to a policy containing guidelines for the protection of the District and its employees on property and liability insurance coverage issues. The District’s checking account for general operational expenditures pays for expenses out of three separate funds: 1) district activities (containing the tree reserve), 2) other grants (those that don’t have their own account), and 3) general operating. With this type of setup it is rare for the District to ever need to borrow from any of the larger reserve accounts. Another management decision, that has been helpful with cash flow, is that on some District grants we inform the recipients that they will get paid within a week of when we receive the funds from the state.

Funding Reserve Accounts

Erosion & Sedimentation Account

The E&S reserve account is funded with review fees collected along with the historical CDFAP funding. In return, the fund pays for all E&S related expenses (including pro-rated capital and administrative allocated costs). The fund is not expected to pay for overhead costs anytime the account level drops below 75% of the annual salary and benefits cost (the preceding is guideline, not policy). At least 40% of the reserve funds should be kept in fairly liquid interest bearing accounts. There is a separate NPDES account, which has more restrictions than the E&S Account, that is used to accept NPDES fees.

Separation Account

This account was originally funded by means of a transfer from the General Reserve Account. The amount transferred was estimated at 50% of the District’s liability for separation costs. It is maintained by including a line item in the budget for separation costs. At the end of the year, funds not used in this budget category are transferred to the Separation Reserve Account. Conversely, if the budgeted amount is insufficient to pay the separation costs, the balance can be taken from the separation account. If a program has sufficient funds to pay for separation costs, they do not need to be paid from that line item.

General Reserve Account

At the end of the year, the value for budgeted items not expensed can be transferred into the General Reserve Account. (e.g. We budgeted \$10,000 to replace our ten year old network server. By hooking up with the NRCS computer LAN/WAN system, we did not need to spend the \$10,000. It was transferred to the general reserve account and labeled “for future capital costs.” All transfers are noted on the treasurer’s report.)

Tree Account

Funds earned from the sale of trees are put into this account and support the annual banquet, school awards, legislative functions, flowers, and other public/employee relations’ costs.

Lancaster County Contact:

Don McNutt and Gerald Heistand, Lancaster County Conservation District
(717) 299-5361
Don.mcnutt@pa.nacdnet.net

Westmoreland Conservation District Reserve Account

The Westmoreland Conservation District (WCD) currently employs 13 full-time employees, two part-time, one contract employee, and one employee shared with PSU cooperative extension. The district owns three vehicles and leases office space “The Barn” from the County. WCD budget for 2006 is about \$1,290,000

WCD established a reserve account in December 1999 with \$25,000 or 2.5% of the 1999 budget. The process to establish the account began the summer of 1998 as the board prepared the 1999 budget. WCD had been using a line of credit that steadily grew to \$50,000 to meet pay roll because of the lag in state reimbursements. The board and staff at that time worked aggressively to pay down the line of credit, while maintaining three months of operating funds “days cash on hand” in the general fund. By the end of 1999, after about 18 months of aggressive fund management, WCD successfully paid down the line of credit. The district had \$ 25,000 in the general fund that was used to start the reserve account. The reserve account reached the minimum target goal of \$50,000 in 2004. WCD budgets 1% salaries to the reserve account. To date this has allowed WCD to replenish the account when used to pay sick and vacation leave for staff leaving employment with the district. The account is interest bearing and the accrued interest is kept in the account. WCD has also put end of the year carry over funds into the account for special projects.

WCD has had to draw on the reserve account three times since it was established, all three were to pay for accumulated leave time for employees that left district employment. The WCD board must approve the transfer funds from the reserve account to the general fund if anticipated reimbursements from the state or county are not received to meet expenses. Permission must be requested for each transfer and the funds replaced when the reimbursement is received.

One concern WDC had, was that the county’s fiscal managers would view the reserve account as “excess funds”. The District staff and board met with key members of the county commissioner’s staff, explained the reasons for the reserve account and received their buy-in and support. To insure that everyone understood the reason for the reserve account it was defined in WCD’s financial policy statement and is a stand-alone fund.

Capital Reserve Account (this account was set up as a Liability fund of \$50,000 for employee benefits such as vacation and sick leave for staff leaving the employ of the district) Account also holds carry-over funds for special expenses as designated by the board of directors. (This is the A.G. Edwards Account)

WDC has five other accounts: general fund account, clean water fund, special projects account, and two growing greener accounts.

Westmoreland CD Contacts:

Conrad Donovan, 724-694-5145

Ronald Rohall, 724-238-4973, rjrohall@westol.com

Indiana County Conservation District Budgetary Reserve Account

The Indiana County Conservation District currently employs four full-time employees, a part-time clerical position, and a contracted watershed specialist. The district does not own any vehicles and office space is provided through an arrangement with the USDA Natural Resources Conservation Service.

In 1993 our conservation district decided to establish a budgetary reserve account due to cash flow problems related to slow state reimbursements. At that time there were three full-time district employees and payroll was a problem at the beginning of each year and quarter. Prior to implementing the budgetary reserve account we discussed the matter with our county commissioners since the commissioners provide operating funds to the conservation district and the budgetary reserve account would be separate from our general (daily operations) fund. The commissioners felt it was prudent on the district's part to implement this account. The board motioned to establish the account in 1993 with the goal of building an account balance equal to one pay period. The funds would be used to cover staff salaries and the account would be reimbursed once state funds were received. There was no specific method for funding the reserve account, but it was felt that any additional income not anticipated in our general fund would be placed in the reserve account.

In 2000, the reserve account was reviewed. The proposed account balance was increased to 25% of our yearly total employee salaries, benefits and expenses. How the fund could be used was expanded to include the following:

1. To cover cash shortages for payroll and bills while waiting for reimbursements and allocations. The account will be replenished upon receipt of funds.
2. To use as up-front funds, if needed, for grants that do not provide working capital and must be administered on a reimbursement basis. The account will be replenished upon receipt of funds.
3. To hire temporary workers in the event a permanent employee must be off work for an extended period of time.

A new monetary issue facing us today is liability for accumulated sick and annual leave upon termination of employment. Our employee policy manual caps sick leave reimbursement at \$1500/person and employees are permitted to accumulate 240 hours of vacation time. Most employees have reached these caps and the annual leave liability grows yearly as salaries increase. The reserve account is currently yielding money market rates and the interest gained by placing a portion of the funds into higher yielding short term certificate of deposit could help to offset the liability associated with yearly salary increases. These issues will require that the reserve account be open for review and policies for investing and spending the fund revised.

Indiana CD Contact: Jim Resh 724-463-8547 ext4 j.resh@iccdpa.org