



Knox County Government

Department of Finance

Internal Service Fund Reserve Policy

I. Purpose:

Internal Service Funds are used to report activities that provide goods or services to other funds, departments, or agencies of the Knox County primary government and its component units, or to other governments, on a cost-reimbursement basis. These funds are used only when the County is the predominant participant in the activity.

Internal Service Funds are valuable management tools as mechanisms to allocate shared costs. Their use is intended to promote the efficiency and effectiveness of shared activities. As these funds are operated on a cost-recovery basis, they are intended to essentially break even over time. Therefore, the accumulation of large amounts of net position in these funds in excess of expected needs is not intended.

Net Position of the internal service funds measures the net financial resources available to finance expenditures of future periods.

The County desires to maintain a prudent level of available financial resources to help protect users of the shared activities from service disruption in the event of unexpected temporary revenue shortfalls or unpredicted one-time expenses. A reasonable level of reserves in the Internal Service Funds may be accumulated and maintained to provide stability and flexibility to respond to unexpected adversity and/or opportunities.

This policy establishes the amounts the County will plan to maintain in its Internal Service Fund reserves, how these reserves will be funded, and the conditions under which the reserves may be used.

II. Definitions:

- A. Net Position – Net Position is the difference between (a) assets and deferred outflows of resources and (b) liabilities and deferred inflows of resources in a proprietary fund.
- B. Fund Activities - Activities accounted for in the internal service funds include: (1) provision of gasoline and maintenance services for County vehicles, (2) operation of a central mailroom, (3) payment of retiree medical premiums, employee retirement, life insurance and other payroll related expenses, and unemployment

claims, (4) accounting for the payment of workers' compensation and general liability claims, (5) provision of central maintenance for County buildings, (6) providing technical support for electronic data processing functions, and (7) accounting for the payment of employee health insurance claims.

- C. Reserve – Reserve refers only to the portion of net position that is intended to provide stability and respond to unplanned events or opportunities.
- D. Unrestricted Net Position – The difference between total net position in a proprietary fund and its net investment in capital assets and restricted components.

III. Policy:

- A. Reserve Levels – The County intends to maintain, as of each fiscal year ending June 30, a minimum level of unrestricted net position in each Internal Service Fund equivalent to three months or 25 percent of revenues or regular, ongoing operating expenses (including transfers out), whichever is higher. During the course of the year the Department of Finance shall closely monitor the County's revenues and expenses to ensure that reserves are not being used beyond any budgeted planned use, and to measure whether the charges to allocate the expenses for shared activities are appropriate to recover the costs thereof, as intended.

Should the projected year-end net position be less than the minimum reserve amount established by this policy, the projected balance will be reviewed and evaluated for adequacy in accordance with the criteria outlined in this policy.

- B. Funding the Reserve – Funding of Internal Service Fund reserve targets will generally come from excess revenues over expenses, or from one-time revenues.
- C. Conditions for Use of Reserves – It is the intent of the County to use Internal Service Fund reserves to address unanticipated, non-recurring needs. It is intended that reserves should not be used to support recurring annual operating expenses outside of the current fiscal year. Reserves may, however, be used to allow time for the County to restructure its operations in a deliberate manner (as might be required in an economic downturn).
- D. Reserving Net Position – The County Mayor and Senior Director of Finance, collectively, are hereby authorized to reserve net position for specific purposes.

- E. Replenishment of Reserves – In the event reserves are used to provide for temporary funding needs (e.g., natural disaster), the County shall review the adequacy of the balance of the reserves in accordance with the criteria outlined in this policy.
- F. Excess of Reserves – As noted above, internal service funds are intended to operate on a break-even basis over time, and therefore these funds are not intended to have accumulated significant amounts of net position. In the event that reserves exceed the planned balances established by this policy, the excess may be transferred to the County General Fund. Such amounts transferred will be deemed “committed” or “assigned” and will be used for such purposes as the Internal Service Funds provide. The County Mayor and the Senior Director of Finance are authorized to request the transfer of the excess funds and to commit or assign the uses thereof in the General Fund. Such requests will be subject to approval by County Commission.
- G. Periodic Review of the Targets – At a minimum, during the budget process staff shall review the current and projected Reserves to ensure that they are appropriate given the economic and financial risk factors the County is subject to.

IV. Quality Control and Quality Assurance:

It is the responsibility of the Senior Director of Finance to ensure the presence of procedures that provide sufficient guidance to affected County personnel to fulfill the intent of this policy.

These policies will be reviewed at least annually and updated on an as-needed basis.