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## Coates' Canons Blog: Transferring Money from an Enterprise Fund: Authority, Limitations, and Consequences

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As local governments finalize their budgets, many governing boards are wrestling with difficult decisions over how to raise sufficient revenues to cover estimated expenses during the upcoming fiscal year. **G.S. 159-8** requires a governing board to adopt a balanced budget ordinance, whereby estimated revenues plus appropriated fund balances equal appropriations. This balanced budget requirement applies to the general fund and to each of the unit's enterprise funds. **G.S. 159-13(b)(16)**. Governing boards are often reluctant to raise property tax rates to balance the general fund if there are any other available revenue sources. Units sometimes look to transfer excess revenues from an enterprise fund to the general fund in order to balance the latter. North Carolina local governments are authorized to make such transfers, but there are certain limitations and potential consequences of which local officials should be aware. This post defines what it means to "transfer" money from one fund to another and reviews the legal authority to make a transfer from an enterprise fund in North Carolina. It then discusses the potential negative effects of making such a transfer.

### Fund Accounting

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. The Local Government Budget and Fiscal Control Act requires that local governments and public authorities maintain certain funds. See **G.S. 159-26**. Which funds, and how many, depends on the type of government and the activities in which it engages. All local governments are required to maintain a general fund. Most local governments maintain other funds, such as debt service funds, special revenue funds, or trust and agency funds. And any unit that owns or operates a public enterprise must maintain an enterprise fund. (Typically a separate fund is maintained for each enterprise activity, although the law allows a single enterprise fund to account for a consolidated water and sewer system. **G.S. 159-26(b)(4)**.)

### Definition of Transfer

A "transfer" occurs when money is moved from one fund to another. A transfer may take the form of an appropriation (with no expectation of repayment to the initiating fund) or it may be structured as a loan (with an expectation of future repayment to the initiating fund). Some transfers are done for ease of accounting and reporting, such as when money is transferred from the general fund or enterprise fund to a debt service fund to make loan payments. Other transfers, however, involve moving money from one fund to another so that the money may be spent on a purpose that is unrelated to the original fund. Examples of these types of transfers include (1) an appropriation from an electric fund to the general fund to finance a new police officer position; (2) a temporary loan from the sewer fund to the general fund to offset a decrease in sales tax revenues; or (3) an appropriation from the water fund to the public transportation fund to pay for a new bus.

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With respect to the latter examples, it is important to note that a transfer *does not* include an allocation of money from one fund to another to pay legitimate reimbursement costs for services provided to the fund. For example, assume that a local government funds its IT department entirely out of its general fund. Assume also that the IT department provides resources and staff support to the water department. If a local government allocates a proportional share of the IT department's costs to the water (enterprise) fund and moves money from the water fund to the general fund to reimburse the general fund for this expenditure, it is not a transfer. Instead it is a reimbursement and, as explained below, should be labeled as such for budgeting, accounting, and reporting purposes.

### **Legal Authority to Make Transfers From an Enterprise Fund**

Do local governments have legal authority to transfer (appropriate or loan) money from an enterprise fund to another fund in order to pay for an expenditure that is unrelated to the enterprise activity? The answer to this question is generally yes, but there are some significant limitations.

State law confers broad authority on local governments to set fees and penalties (collectively, "rates") for most public enterprise activities. With the exception of solid waste and stormwater enterprises, local governing boards have a lot of leeway in setting schedules of rates. A unit may vary its rates according to different "classes of service," and it may charge different rates for services provided outside its territorial jurisdiction. And, although not explicitly addressed in the statutes, it appears that for most enterprise activities a governing board may set rates such that the revenue generated exceeds the costs of providing the particular service. In *General Textile Printing and Processing Corp. v. City of Rocky Mount*, 908 F. Supp. 1295 (E.D.N.C. 1995), a federal district court held that the city's practice of overcharging customers for water, sewer, electric, and natural gas enterprise services, and using the excessive revenues to fund general fund activities, did not violate state or federal equal protection or due process provisions.

Furthermore, **G.S. 159-13(b)(14)** appears to at least indirectly acknowledge that a local government may generate profits from its enterprise systems. It states that

[n]o appropriation may be made from a utility or public service enterprise fund to any other fund than the appropriate debt service fund unless the total of all other appropriations in the fund equal or exceed the amount that will be required during the fiscal year, as shown by the budget ordinance, to meeting operating expenses, capital outlay, and debt service on outstanding utility or enterprise bonds or notes.

Although structured as a prohibition, this provision actually authorizes a local unit to transfer monies from an enterprise fund to another fund, as long as all of the budgeted expenses (capital, operating, debt service, etc.) for the enterprise activity are covered for the fiscal year. It thus provides a mechanism for a local government to use the extra revenue generated from an enterprise activity for other purposes.

There are some limits to the authority to transfer money from an enterprise fund, though. As explained in a previous **post**, the authority to transfer must be read in conjunction with the authority to set rates for the particular enterprise service. There are a few enterprise activities for which a governing board's ratemaking authority is much more constrained. And those constraints affect the unit's ability to appropriate or loan money from an enterprise fund. For example, solid waste fees must only be used to fund solid waste activities. See **G.S. 160A-314.1**; **G.S. 160A-317** (municipalities); **G.S. 153A-292** (counties). In *Manning v. County of Halifax*, 166 N.C. App. 279 (2004), the North Carolina Court of Appeals held that the county's practice of setting solid waste availability fees such that the aggregate revenue generated exceeded the aggregate costs of operating the county's disposal facilities was unlawful. And the reason the court knew that the fee revenue exceeded the costs of the solid waste program was that the county had transferred the "profit" from the solid waste fund to the general fund and used the money to support general government activities.

In determining whether or not a transfer from an enterprise fund is lawful a unit must first examine any earmarks on the money being transferred. If the money itself may only be spent to support the enterprise activity, it may not be appropriated or loaned to another fund to pay for an unrelated expenditure. Thus solid waste fee revenue may be transferred to the general fund or a debt service fund to make debt service payments on a borrowing incurred for a solid waste project. It may be moved to the general fund to cover legitimate reimbursements for services provided to the solid waste enterprise but financed in the general fund. The revenue, however, may not be appropriated to the transportation fund to purchase a new bus. It may not be appropriated to the general fund to pay for parks improvements. And it may not

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be loaned to the general fund to help balance the budget this year.

In addition to the statutory earmark on solid waste fees, state law requires stormwater fee revenue to be used only for to support stormwater management. See **G.S. 160A-314(a1)(2)** (municipalities); **G.S. 153A-277(a1)(2)** (counties). And transfers from electric funds of certain electricities may not exceed the greater of (1) three percent of the gross capital assets of the electric system, or (2) five percent of the gross annual revenues of the preceding fiscal year. **G.S. 159B-39**. There may also be restrictions imposed on other enterprise revenue by contract, bond covenants, local acts, or grant agreements. None of these restrictions prohibit a local unit from using the enterprise revenue to compensate the general fund for any reasonable overhead expenses allocated to the enterprise activity. But they do constrain a unit's ability to transfer the money from the enterprise fund.

### Consequences of Making a Transfer From an Enterprise Fund

Even if legally allowed, a unit should carefully consider whether a transfer from an enterprise fund (by means of an appropriation or loan) is appropriate. Transfers that occur frequently, or that involve a large amount of money, might be masking a problem with the unit's financial condition. Relying on enterprise ratepayers to fund general government expenditures also may raise issues of equity, fairness, and accountability. This argument resonates particularly in jurisdictions where ratepayers compose only a subset of taxpayers of the unit or where ratepayers come from outside the unit's territorial boundaries. Moreover, this practice could have negative financial implications for the unit, particularly related to issuing debt. Credit rating agencies are likely to look unfavorably upon any effort that destabilizes an enterprise fund.

In recent years the General Assembly has indicated that it strongly disfavors transfers from an enterprise fund. It enacted **G.S. 159G-37(b)** in 2014, which prohibits a local government from receiving loans or grants for water or wastewater purposes from the Clean Water State Revolving Fund (CWSRF), Wastewater Reserve, Drinking Water State Revolving Fund (DWSRF), or Drinking Water Reserve if the unit has transferred money from its water or sewer enterprise fund to the general fund to supplement the resources of the general fund. The prohibition only applies to transfers. It does not apply to legitimate reimbursements of the general fund for "expenses paid from that fund that are reasonably allocable to the regular and ongoing operating of the utility, including, but not limited to, rent and shared facility costs, engineering and design work, plan review, and shared personnel costs."

The North Carolina Department of Environment and Natural Resources has interpreted this provision to apply only to transfers done in the fiscal year immediately preceding the year in which the loan or grant is being requested. (Current (as of June 2015) certification forms are available **here** and **here**.) The statutory language, however, does not contain a specific time period limitation on transfers. Thus it is at least possible that a transfer done this year could affect a unit's ability to receive grants or loans from the state well into the future.

### Links

- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_159/GS\\_159-8.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-8.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_159/GS\\_159-13.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-13.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_159/GS\\_159-26.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-26.html)
- [canons.sog.unc.edu/?p=1110](http://canons.sog.unc.edu/?p=1110)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_160A/GS\\_160A-314.1.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-314.1.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_160A/GS\\_160A-317.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-317.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_153A/GS\\_153A-292.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_153A/GS_153A-292.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_160A/GS\\_160A-314.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-314.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_153A/GS\\_153A-277.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_153A/GS_153A-277.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_159B/GS\\_159B-39.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159B/GS_159B-39.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_159G/GS\\_159G-37.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159G/GS_159G-37.html)
- [portal.ncdenr.org/web/wi/cleanwater/applications](http://portal.ncdenr.org/web/wi/cleanwater/applications)
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