

# **Pembroke Trusts, Capital Reserve Funds, and “Fund Balance/Surplus”**



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This document is intended to provide an overview of municipal trust and capital reserve funds, and how such funds, as well as fund balance/surplus, are utilized by the Town of Pembroke and the Pembroke School District.

## Statutory Authority

All Trust and Capital Reserve operations by the Town must be conducted in accordance with [Title 3, Chapter 35](#) of New Hampshire Revised Statutes Annotated.

## Purpose & Scope - Trusts versus Capital Reserves

Although a municipality can create and maintain both trust funds and capital reserves, their purpose and operation are each unique. Generally, both trusts and capital reserves are created to receive funds from either municipal (taxpayer funded) or private sources (donations), for distribution at some future date. Municipal and private funds must not be comingled in the same trust or capital reserve account. Nothing prohibits the investment of trusts or capital reserves created for unique purposes from being jointly invested in a common investment vehicle, such as money markets or treasury securities. Investment decisions are made at the discretion of the Trustees of Trust Funds but may be subject to specific terms of the particular account.

**TRUSTS:** A trust is an account established for a specific purpose and is customarily funded by private donations. All donations to the trust are generally deemed to be unexpendable but may be added to by subsequent private donations, which will also be unexpendable. A trust generally exists in perpetuity and its objective is to create investment returns, kept segregated and recorded separately from the unexpendable balance, which can be drawn upon for periodic expenditure as defined in the trust instrument, which established that trust.

**CAPITAL RESERVES:** A capital reserve is a mechanism used to accumulate funds for a specific future purpose. Capital Reserves differ from trust funds in that a capital reserve lacks any unexpendable component, can be spent in its entirety provided that the expenditure(s) conform with the stipulations included in the creation of that account, and can be discontinued at some future date if its purpose has been satisfied. Trust funds usually include an unexpendable portion which goes on in perpetuity, to earning income, which can subsequently be distributed. Capital reserves can be created via a warrant article at a town or school district meeting in the case of taxpayer funded accounts, or by the Select Board, School Board, Library Trustees, Water Works, or Sewer Commission when private donations or revenues of an enterprise fund are involved. The term "Enterprise fund" refers to entities whose existence is authorized by statute and whose revenue is primarily obtained by user fees.

## Oversight of Trust & Capital Reserve Funds

Trust Funds and Capital Reserves operate under the care and custody of elected Trustees of Trust Funds. There are three Trustees who are each elected to rotating three-year terms of office. A Trustees must be a resident of Pembroke and ideally should have at least a minimal background in accounting, financial reporting, financial investments, and trust laws of the State of New Hampshire.

## Agendas & Minutes

The Trustees of Trust Funds are obligated to conduct as many public meetings as may be necessary to transact business. In Pembroke, at least two meetings should be conducted annually. In a manner identical to every board and commission of the Town, all Trustee of Trust meetings must issue a formal

agenda defining the actions to be taken at the meeting. The meeting must also be properly “noticed” prior to conducting the meeting so that concerned citizens may attend. Meetings should be held in a public place and conducted pursuant to Robert’s Rules of Order. Minutes of each meeting must be taken, and following approval of those minutes at a subsequent meeting of the Trustees, the approved minutes should be posted and become a matter of public record.

## **Recordkeeping & Monthly Account Reconciliations & Transactions**

A separate ledger must be maintained for each trust and capital reserve account and that ledger should correlate precisely to the monthly account statements generated by the financial institution where the funds are deposited. It is the responsibility of the Trustees of Trust Funds to obtain monthly statements from the financial institution, place them on file for review by auditors, and post monthly transactions such as income, fees, new contributions, and authorized distributions to the ledger for each account. Any discrepancy discovered by the Trustees should be remediated with the financial institution as soon as possible. In addition to monthly statements segregated by trust and capital reserve, the Trustees should also obtain listings of all underlying securities producing the investment yield attributed to those accounts. Those listings should also be placed on file for future review by auditors.

Copies of monthly financial statements should systematically be provided to the Town, School District, Sewer Commission, Water Works, and Library Trustees for their records and for ongoing operational purposes.

## **Investment Policy**

State law requires each town to maintain an “Investment Policy” drafted and formally approved by the Trustees of Trust Funds, which details that investment strategy for all Trust and Capital Reserve Funds maintained by the Town. The Investment Policy should be formally reviewed, updated as needed, and ratified annually, with the final version submitted to the Department of Justice, Division of Charitable Trusts. The content of the Investment Policy may vary by town, depending upon the nature of trusts and capital reserves in existence. The policy should include the types of investments being used to achieve the objectives of each account and also address investment reporting deadlines for all managers and custodians under contract with the Trustees, along with the investment return objectives and liquidity needs for each account.

## **Annual Reporting Requirements**

- **Town Report**

The Trustees of Trust Funds should compile and submit statements for the Annual Town Report by mid-January, in accordance with the report production schedule established by the Town. Those reports should include a short narrative addressing any changes in the composition of trusts or capital reserves, along with any material events which occurred during the year, which the Trustees consider to having merit for disclosure. Because the reporting pages serve as a guide for voters at the annual School District and Town meetings, all trusts and capital reserves maintained by the Trustees of Trust Funds should be segregated by School District and Town and consist of the following: (1) A balance sheet of all trusts and capital reserves associated with each grouping, which

total all trust and capital reserve balances as of December 31<sup>st</sup> of the preceding year, and (2) an additional statement which begins with the prior year ending balances, lists all capital contributions resulting from warrant articles approved by voters and subsequently funded, all interest and dividend amounts earned for the year, any realized and unrealized gains or losses on investments, any fees paid to outside service providers, and all withdrawals from trusts or capital reserves. The bottom line of these income statements, when factored into the prior year ending balance must agree with the bottom line of the balance sheet for each grouping, School and Town. Also included in the balance sheet pages of the Town Report is an index of the “Agents to Expend” for each Trust and Capital Reserve for both the Town and School District. The “Agent to Expend” is determined at the time the trust or capital reserve is created. While the agent to expend can be changed after the account is created, a supermajority vote of the body which created the account is required to make such a change.

A special listing of cemetery plots, which have been purchased in the town’s cemeteries inclusive of “perpetual care” should also be included in the town report. Every cemetery plot sold by the town inclusive of perpetual care should be included on that schedule at the amount received in the year the plot was purchased. This is the only way that a record of each plot can be tied back to the town meetings at which the plot sales were approved by the voters. Yes, every plot sale had to appear as a warrant article and be voted in the affirmative at a town meeting or the citizen could not be buried in the town cemetery. It is important to note that this method of plot sales has not been used in Pembroke since 1986, with the revenue from plot sales subsequent to that time going to the town’s general fund as revenue for that particular year. The change in practice was made administratively by the town at that time and is consistent with applicable NH law.

- **Department of Revenue Administration & Department of Justice**

The Trustees of Trust Funds are required by NH Law to file a report with the State Department of Revenue Administration using reporting formats MS-9 and MS-10. These reports must be submitted electronically prior to March 1<sup>st</sup> of each year for data pertaining to the previous calendar year ending December 31<sup>st</sup>. The Department of Revenue Administration shares the MS-9 and MS-10 submissions with the Department of Justice, with whom the Trustees must also file a copy of their most recently ratified investment policy. The Trustees’ reporting obligation is not satisfied until the State has acknowledged receipt of the filing and has subsequently issued an electronic notification that the filing has been accepted.

## **Annual Audit Requirements**

The Town of Pembroke is required to engage the services of an independent auditor to examine the books of the Town annually. The reports and activities of the Trustees of Trust Funds are included as part of the Town’s audit and as such, the Trustees must compile all of the information requested by the auditors and be prepared to authorize those auditors to conduct a check of financial statements directly with the institutions where funds are held. That authorization comes in the form of “Confirmation” authorizations signed by the Trustees for each institution where funds are kept. Failure by the Trustees of Trust Funds to provide the Town’s Auditors with a comprehensive list of all records requested by the auditor by the deadline contained in the audit engagement can result in delays in the audit’s completion and additional audit fees being assessed to the Town, beyond the original quote for audit services.

## Capital Reserves – Specific to Pembroke

Capital reserve accounts in Pembroke exist, at the time this document was written, for the Municipal Town Government, the Pembroke Cemetery Commission, Pembroke Recreation, the Pembroke School District, the Pembroke Sewer Commission, and the Pembroke Town Library. In the past, capital reserves also existed for the Conservation Commission and the Pembroke Water Works, however those accounts were discontinued.

Capital Reserves cannot be created for just any purpose, and the purpose and scope for such funds should be clearly identified in the language of the warrant article, which creates those capital reserves. A [list of allowed purposes](#) is contained in the New Hampshire Statutes RSA 35:1, and each capital reserve account purpose must conform with the list of authorized purposes maintained by the State through administrative rules when the Trustees of Trust Funds report to the State of New Hampshire, DRA & DOJ, annually. The purpose initially assigned to a capital reserve fund can be amended by a warrant article subsequently introduced but requires a super majority vote of the legislative body, (the town or school district meeting) which originated that capital reserve in order to become effective.

At the time this document was written, Pembroke had four capital reserve accounts which were not created with taxpayer funds. They include:

1. The Cemetery Donation Fund, which consisted of residual fundraising by an Eagle Scout who worked with the Cemetery Commission to inventory grave sites in all of Pembroke's cemeteries.
2. The Town Hall Cupola Fund, also funded by private donations, which is restricted to repairs or replacement of a cupola on the Town Hall.
3. The Town Clock Fund, which is used to maintain operation of the Clock Tower and the internal mechanisms of the clock.
4. The Educational Opportunity Fund, which exists to provide funding for any unique educational opportunity, is limited to projects or programs not customarily funded by taxpayer funds. The corpus of this account consists of residual funds of a defunct organization which was called the Pembroke Educational Endowment Fund, (PEEF). When PEEF ceased operations, it had residual funds which were placed under the custody of the New Hampshire Charitable Foundation, with the annual investment proceeds being turned over to the Pembroke Trustees of Trust Funds, with use requests coming from the Pembroke Action League for Schools, (PALS). The Pembroke School Board was an agent to the creation of that capital reserve but retains no authority over expenditures unless PALS should cease to exist. At such time, another organization will need to be identified to replace PALS.

## Trust Funds – Specific to Pembroke

Trust Funds in Pembroke exist, at the time this document was written, for the Pembroke Cemetery Commission, the Pembroke School District, and the Pembroke Town Library. Only an action by NH Probate Court can change the purpose of a trust or allow for its discontinuation.

**Cemetery Trusts:** All cemetery plots sold by the town prior to 1986 have an un-expendable balance in the amount of the sale the principal allocated to perpetual care. Only an action by New Hampshire Probate Courts can authorize the distribution of any portion of an un-expendable trust. Those plots are itemized in the Town's Annual Report and are the reporting obligation of the Trustees of Trust Funds. Earnings for each plot are recorded and can only be distributed for maintenance on that plot. Income

can be carried forward for distribution in subsequent years, but the un-expendable balance cannot be spent without authority of the Probate Court.

**Library Trust:** A single trust known as the Warren Foss Trust was created decades ago by a Pembroke citizen with the investment proceeds to be used for the purchase of library books. Income distribution is restricted to the purchase of books. Only an action by New Hampshire Probate Courts can authorize the distribution of any portion of the principal of the un-expendable trust. In other words, the trust cannot be discontinued simply because it does not raise a meaningful amount of income unless the Probate Court authorizes such action.

**School Trusts:** Two Trust accounts exist which are associated with the Pembroke School District, the School Literacy Trust and the Pembroke Academy Scholarship Trust. Both trust accounts have an un-expendable balance which earns income that accumulates for the purpose for which the trusts were created. The Literacy Trust can only be used to “promote literacy”, and the Pembroke Elementary School Principals are the agents to expend. The Literacy Trust proceeds are restricted to projects not ordinarily funded by taxpayer dollars. Although the restriction makes it difficult for any request to qualify, the purpose for this restriction was to prevent these funds from replacing the educational obligations of the taxpayers.

The **Pembroke Academy Scholarship Trust** was created by the trustees of the former Pembroke Academy, a semi-private high school which was acquired by the Pembroke School District. When the trustees of the school had satisfied all debts and obligations after the sale, the remaining proceeds were used to create the trust. Representatives from the four sending towns to PA and select PA Administrators collect scholarship applications annually, and the Pembroke Trustees of Trust Funds are responsible for determining the total amount to be distributed annually and providing the funds to the headmaster of PA for final distribution to the selected scholarship applicants.

## Fund Balance/Surplus

The operation of municipalities is based upon a budget which is voted into existence by the legislative body of the town (town and school district meetings). The creation and approval of a budget in and of itself does not result in the cash required to pay for budgeted items, it only authorizes such expenditures. Revenues of the town from State and Federal sources and various local tax revenues provide the operating cash required to pay for the town’s financial obligations. A major source of town revenue is property taxes, which Pembroke has elected to assess twice a year. In cases where cash is needed but the timing of revenue receipts do not provide adequate amounts, the town is authorized to borrow money in anticipation of taxes with the issuance of tax anticipation notes, (TANS) which are purchased by local financial institutions. In Pembroke, the practice has been to maintain sufficient cash reserves so that the use of tax anticipation notes is not necessary, thus avoiding the interest expense associated with TANS. Cash balances in excess of the immediate cash flow needs of the municipality constitute the “fund balance”, while amounts in excess of appropriation requirements constitute the “surplus”.

Because Pembroke has, on occasion, when balances were sufficient, used ‘Fund Balance/Surplus’ to fund warrant articles for the town, a brief description of those funds is included here. Fund Balance/Surplus can either directly fund a specific purchase such as new vehicles or equipment, or it can

be used to fund appropriation warrants for capital reserves. It should be noted that when a capital reserve is funded from Fund Balance/Surplus, the contribution to the capital reserve or reserves must be made within 10 business days following passage of the warrant article. This differs from capital reserve funds appropriated from taxes, which must be funded by mid-December of the year in which the warrants are enacted. It should also be noted that Fund Balance/Surplus may not be adequate to fund all or even some capital reserve warrant articles and that funding such articles from end-of-year property tax collections is generally the norm.

The amount of Fund Balance/Surplus allowed is regulated by the State Department of Revenue Administration (DRA), and correlates to the net assessed valuation of the town. If the Fund Balance drops below a certain point, DRA may recommend that the fund balance be increased to accommodate cash flow needs of the town and school district. Conversely, if the Fund Balance becomes too high, DRA may recommend that a portion be used to mitigate property taxes, since it is not an objective of a municipality to raise a fund balance indefinitely.

Cash operations for the Town differ from that of the School District in that a school district is a department of a town and lacks the ability to collect property taxes directly. When other revenue sources of the school district are not adequate to meet cash flow needs for that district, the school district treasurer requests a cash transfer from the town treasurer to meet that need.

School districts may raise and appropriate funds for capital reserves in one of two methods. Such funds can come from either direct taxation through the local property tax or from unexpended appropriations and excess revenues. When a warrant article on the school district warrant appropriates funds as a general tax obligation, it impacts the tax rate for that year. If the district raises and appropriates capital reserve funds from surplus, the tax rate is otherwise unaffected. Any funds appropriated for the school district budget, which are not expended by the end of that fiscal year or otherwise encumbered, become available to fund the capital reserve warrant articles in the order in which they were approved by voters. The district also has a revenue estimate for the fiscal year, which may receive revenues over and above the amounts anticipated when the budget was enacted. Any additional revenues may also be eligible for use to fund capital reserves approved by the voters when unexpended appropriations are inadequate to fund all the capital reserve warrants which the voters approved. All unexpended appropriations and excess revenues beyond the amounts needed to fund warrant articles lapse to reduce the property tax rate for that year. The school district year ends on June 30<sup>th</sup>, and the district has until tax rate setting time, (usually by the end of September) to close its books, determine the amount available to fund capital reserves, and make those payments in cash to the Trustees of Trust Funds by the mid-December statutory deadline.