Budgetary Risk Pooling

A MILE HIGH CASE STUDY

BY SAMUEL MANN

When Kirsten Decker assumed her role as the manager of strategy and evaluation for the Denver Public Library in 2019, she encountered a challenge she hadn't faced before: a persistent and substantial budgetary surplus. Until recently, the Denver Public Library's per-capita funding was among the lowest of its peer institutions. This underinvestment had led to a risk-averse culture and a scarcity mindset among library employees. As a result, of the 54-million-dollar general fund budget annually allocated to Denver's library system, an average of $1 million was left unspent year after year. While many financial officers might gladly trade their organization's deficit for the library system's surplus, this situation concerned Decker for two reasons.

First, because funds were tied up in the wrong places, the library was not maximizing the level of service its budget could provide for Denver's residents. Second, Decker and other members of the budget leadership team were becoming increasingly concerned that end-of-year surpluses and unplanned fourth-quarter spending spikes were allowing room for skepticism about the library's budget planning and management. This dynamic made it challenging for the library to ask elected officials for continued funding at the same level, let alone to request increased investment to expand services.

As Decker considered options for improving this situation, she stumbled upon an unexpected solution while reading an article titled "Don't Go It Alone: Pooling Budgetary Risk to Save Money in Your Budget" in the June 2021 issue of *GFR*.

POOLING BUDGETARY RISK

Knowing that unforeseen and unavoidable expenditures can have a negative impact on a department's work plans, many department heads include some just-in-case funds or padding in their budgetary requests. For example, a library facilities department may request slightly more than their projected costs for building maintenance to account for the possibility that expensive equipment needs to be replaced sooner than expected.

Although this practice is not particularly worrisome in isolation, in aggregate, departmental padding can quickly balloon an organization's total budget. To illustrate this point, we can adapt an example from the *GFR* article. Consider an organization made up of just five departments, each with a ten percent chance of experiencing a $100,000 shock in any given year. If the organization in question fails to pool this risk and each department head requests an extra $100,000 for their budgets, this organization will be including $500,000 of padding in its budget. And yet, the likelihood that all five departments would experience a shock in the same year is extremely low—one in 100,000, to be precise. Alternatively, if this organization were to establish a budgetary risk pool, it could cut that $500,000 in half and still have enough funds to cover more than 99 percent of the situations it would encounter.

Read the June 2021 *GFR* article, "Don't Go It Alone: Pooling Budgetary Risk to Save Money in Your Budget."

gfoa.org/gfr-june-2021

For more information on the Denver Public Library system, see "Strategy and Evaluation Leads to Trust" in the December 2023 issue of *GFR*.

gfoa.org/gfr-december-2023

Founded in 1889, the Denver Public Library system includes the Denver Central Library, located in downtown Denver, as well as 25 branch locations and two bookmobiles.

> "The risk pool gave us an outlet for solving critical and unusual problems."

INTRODUCING A BUDGETARY RISK POOL

Although this tool is less commonly practiced or discussed than it deserves to be, Decker recognized an opportunity to increase the library's fiscal efficiency by pooling risk across departments. At the end of 2021, she began working toward establishing a pooled risk fund to help the library capitalize on its entire budgetary allocation and demonstrate its commitment to strong budgetary management to the city council and the public.

Guided by insights from the *GFR* article and several GFOA best practices, the budget leadership team proposed a three-part solution. First, the library would work to eliminate department-level budgetary padding. Second, it would initially set aside $100,000 to establish a budgetary risk pool, with plans to expand the fund to $200,000, or two percent of its non-personnel budget. Third, the library would implement a policy outlining ways to draw down that pool during years when the library did not experience significant fiscal shocks.

The proposal was adopted at the beginning of the 2022 fiscal year and was remarkably well received. Denver Public Library's Central Operations Manager Megan Hartline shared, "My initial reaction was impersonal approval—I thought, 'Oh, a risk pool sounds like a good idea—for other people!' This strategy reflected a need to meet unforeseen circumstances, which is always wise. The possibility that I would need to call on the risk pool in the course of my work, however, seemed very remote and unlikely. I manage a relatively small budget focused on service delivery, so unforeseen circumstances were not on my radar. That's the sneaky nature of unforeseen circumstances!"

ACCESSING RISK POOL FUNDS

To ensure that the risk pool's resources are allocated wisely, the budget leadership team has defined a qualifying expense as "unplanned, unavoidable spending due to unforeseen circumstances or emergencies that require immediate attention." Departments hoping to draw on the risk pool must complete a concise five-step procedure to determine whether an expense qualifies, based on the above definition.

First, the department must review existing departmental resources to determine whether there is an opportunity to reallocate funds from lower-priority items. If funds aren't available in the department's budget, the second step is to approach the requisite division director and explore the possibility of reallocating funds from another department within the division. If this isn't possible, the affected department must then submit a request form describing the nature of the expense and how the funds will be used if the request is approved. The budget leadership team then reviews the request and asks follow-up questions if necessary. Finally, a decision is rendered within five business days from when the request was submitted.

As a testament to the efficacy of this policy, Allison Barney, youth services manager, described her experience of drawing on the risk pool positively. "It was a very straightforward process. Once I realized the need, I completed the pooled risk request form. There are sections to clarify the amount needed, as well as why it's needed. I submitted it to our budget team, and they responded within a week that the request was approved."

DRAWING DOWN UNUSED FUNDS

Although the Denver Public Library is exploring the possibility of a rolling risk pool, current City of Denver budgetary regulations require that all unspent general fund dollars be returned to the city at the end of each fiscal year. Knowing this, and that unforeseen and unavoidable expenses will not be enough to exhaust the risk pool every year, the budget leadership team also instituted a two-phased procedure outlining how to use any remaining funds. At the end of the third quarter each year, the Finance Department runs a projection to determine how likely it is that the entire remaining balance will be needed during the last three months of the year. Funds above and beyond what is likely to be necessary (up to 75 percent of the original balance) are then

released to purchase "asset investments." The library considers asset investments to be "non-emergency [spending] that may not require immediate intervention but would still benefit from action prior to the next budget year." Such investments might include replacing aging technology or purchasing new ergonomic book carts for branch locations.

The second phase of the library's procedure begins on December 1 of each year, when any unspent or unidentified balance is released to purchase electronic collection material. Electronic assets such as e-books and audiobooks are an excellent investment for the library during that last month of the fiscal year because they can be purchased quickly and are popular enough that the library always has a list of titles they plan to add to the collection.

THE RESULTS

Since it was established in 2022, the Denver Public Library's pooled risk fund has been used three times: once to replace a $25,000 sump pump (a device that pumps water out of a basement to prevent flooding), once to reconstruct a defective service window, and once to fund furniture purchased during the 2022 fiscal year that was incorrectly deducted from the 2023 budget.

In each case, the Denver Public Library's pooled risk fund made a positive impact on the library system and its users while avoiding uncertain reallocation processes or service-level reductions that would have been necessary otherwise. When asked what her department would have done without the risk pool when they discovered that it was necessary to rebuild a service window, Hartline said, "Without the risk pool, we would have tried to shoehorn an immediate need into typical budget processes that stretch out months and years into the future. We also would have been caught between advocating for our primary mission (service delivery) and facilities expenditures that, while essential for service delivery, don't have the same direct connection to customer needs. The risk pool gave us an outlet for solving critical and unusual problems."

CONCLUSION

In addition to providing library departments with timely relief during emergencies, the Denver Public Library's pooled risk fund has all but eliminated the library's persistent surplus. At the end of the 2022 fiscal year, the library had a $100,000 surplus, representing a 90 percent decrease from recent years. As a result, the library's culture has pivoted away from a scarcity mindset, the city council can rest assured in the library's fiscal responsibility, and, most importantly, Denver's residents benefit from a full investment in their library system.

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