



POLICY BRIEF

Explaining School Fund Balances:

Are PA Schools, with \$4.3 Billion in Reserve Funds, Really Flush?

Just the (Dry) Facts

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Temple University's Center on Regional Politics (CORP), Penn State's College of Education, the University of Pittsburgh's Center for Metropolitan Studies, and the Pennsylvania Policy Forum (a group of faculty and researchers at 18 public and private colleges and universities) have formed a consortium to support state legislators, local officials, and education policymakers in a review of options for improving public school finance. CORP will periodically publish policy briefs, papers, and studies to support the consortium's mission. Consortium academic leaders and forum members are listed at the end of this brief.

Recent publicity calling attention to the \$4.3 billion in reserve funds accumulated by the state's 500 school districts, 67 vocational/technical schools (AVTS/CTC), and 176 charter schools may suggest to some that these funds are being hoarded by school officials who are raising taxes or cutting services unnecessarily or exaggerating their need for additional state aid.

Here are the (admittedly dry) accounting facts.

Fund balance is the accounting term for the difference between total assets and total liabilities. A fund balance is not all cash. In school accounting, as required by the Pennsylvania Department of Education, assets include money to be received in the 60 days after the close of the fiscal year. Liabilities include only current liabilities and not long-term liabilities such as debt payment. Fund balance generally increases when a district's revenue exceeds its expenditures in a given year. The fund balance declines when the expenditures exceed revenues in a given year.

According to the Accounting Manual for school districts, districts must comply with the Governmental Accounting Standards Board (GASB) statements on accounting for local governmental entities. GASB issued Statement 54, which discusses fund balance as divided into four parts:

Restricted – funds limited by external parties or legislation e.g. debt covenants

Committed – funds limited by board policy or board action

Assigned – funds intended for a particular purpose such as special revenue funds

Unassigned – funds that are available for consumption or not limited in any manner

Just as an individual or family should maintain a savings account for unforeseen expenses or emergencies, school districts should also have funds in reserve to pay for emergency repairs or cover unexpected interruptions in revenues - such as a layoff at a major factory which suddenly affects tax collections. The fund balance can also be used to offset year-to-year variations in local or state cash flow, such as a delay in subsidy payment from the state. In addition, fund balances enable districts to generate investment income which, in turn, helps to keep tax rates lower.

Credit ratings of school districts and other public entities can be affected directly by the level of their fund balances

A November 1990 research bulletin by the Government Finance Officers Association recommended that an unassigned fund balance be retained to guard against an economic downturn. It also advised that a fund balance is necessary to meet emergency situations, which could include: uninsured loss, major repairs to heating systems, and replacement of damaged educational equipment prior to scheduled change.

When a district issues debt, having a positive fund balance benefits the school district. Credit ratings of school districts and other public entities can be affected directly by the level of their fund balances; those with little or no money in reserve are considered to be higher risk and their ratings - along with their cost of borrowing - suffer accordingly.

In Pennsylvania, fund balances in the 1990s covered school districts when the state failed to make school subsidy payments in a timely manner. This has occurred three times since 1992. More recently, fund balances have allowed some districts to maintain services or minimize service cuts or tax increases during the economic downturn when real estate and earned income tax revenues have declined.

Over the last four years, the state has frozen funding for repair/renovation/construction subsidies, which leaves total construction costs to the individual districts. This means that districts either need to set aside funds for repair/renovation/construction or raise taxes for individual projects. The set aside is referred to as an assigned fund balance. The state Department of Education recently reported to the General Assembly that there are 338 projects to fund, requiring \$1.6 billion through the life of the amortization schedules. Additionally, districts have set aside funds to try to minimize the tax increases in individual years to cover pension increases mandated by the Public School Employees' Retirement System, which operates as a state entity.

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The size of a fund balance is dictated by the local circumstances of a school district. For example, a higher fund balance may be appropriate when the local economy and tax base are weak and the district budget either relies heavily on state and federal sources of funding, which can change or be delayed without notice, or when the district is carrying a sizeable debt burden. There are, of course, many other legitimate reasons to hold funds in reserve. School officials may build a fund balance over time, with the intention of using the money for a renovation project or another one-time expenditure, instead of borrowing and repaying a bank with interest.

The financial industry suggests that a government unassigned fund balance should be between 5% and 10% of total operating expenditures. (A 5% unassigned balance would cover a district's operating costs for about two and a half weeks.) Indeed, Moody's cited the Commonwealth's depletion of its reserves as one factor in recently downgrading its bond rating. Simultaneously, Moody's downgraded the Commonwealth's intercept program, which serves as a credit enhancement for school district debt. The Pennsylvania School Code (24 PS 6-688) limits the amount of unassigned fund balance to 8% for a district whose expenditures exceed \$20 million if it is going to raise taxes. Table 1 shows the dollar value of fund balances for the 2012-13 school year.

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The amounts shown in Table 1 include assigned fund balance, which is usually found in special revenue funds such as federal subsidies. Federal funds are received according to the federal fiscal year which overlaps the school fiscal year by 3 months. Another typical assigned balance is for debt service and construction funds. Table 2 shows unassigned fund balance as a percent of total expenditure.

As shown in Table 2, the unassigned fund balance for school districts is 6.7% or below the School Code limitation. Vocational/technical schools are also below the school code at 3.7%. Charter schools have an 8.5% fund balance. In fairness to the charter schools, they operate as not-for-profits, which have a different limitation for fund balance. The American Association of Society Executives (ASAE) recommends a fund balance for not-for-profits of 50% or about 6 months of operating expenditures.

While the total unassigned fund balance is below the school code limit, individual districts and schools will vary.

Table 1 - 2012-13 Fund Balance by Type of School

	Number	Committed	Assigned	Unassigned	Total
School District	500	\$1,484,599,106	\$775,700,543	\$1,723,587,607	\$3,983,887,256
Percent of Total		37%	19%	43%	
AVTS/CTC	67	\$11,557,427	\$21,670,528	\$20,246,495	\$53,474,450
Percent of Total		22%	41%	38%	
Charter School	176	\$76,958,409	\$34,202,683	\$127,207,211	\$238,368,303
Percent of Total		32%	14%	53%	
Total	743	\$1,573,114,942	\$831,573,754	\$1,871,041,313	\$4,275,730,009
Percent of Total		37%	19%	44%	

Source: PA Department of Education, web page, accessed July 22, 2014. http://www.portal.state.pa.us/portal/server.pt/community/summaries_of_annual_financial_report_data/7673/other_financial_information/509049.

Table 2 - 2012-13 Unassigned Fund Balance as a Percent of Total Expenditures

Fund Balance as Percent	
School District Total	6.7%
AVTS/CTC Total	3.7%
Charter School Total	8.5%
Total	6.8%

Source: PA Department of Education, web page, accessed July 22, 2014. http://www.portal.state.pa.us/portal/server.pt/community/summaries_of_annual_financial_report_data/7673/other_financial_information/509049.

Among the school districts, 14 districts have an unassigned fund balance of zero, and another 15 have an unassigned negative fund balance. Among the vocational schools, 34 have a zero unassigned fund balance and two have a negative fund balance. There are 27 charter schools with negative unassigned fund balances and eight with zero unassigned fund balances.

If the district is going to use a fund balance, it should proceed with caution. The assigned fund balances, if they contain federal funds, bond proceeds, or funds in the debt service fund, must be used for their assigned purposes. Committed fund balances should be used first for the

purposes for which they were committed. The unassigned fund balance should be used for one-time expenditures. Fund balances, like an individual's savings account, are one-time revenues and when used need to be replenished with board approval.

The fund balance is an important financial tool for school districts and needs to be considered individually by the districts as they look at their future needs and the changing economic climate. However, they should follow the financial industry recommendation of maintaining a minimum of 5% for an unassigned fund balance.

Given these facts, it seems fair to say that the distribution of fund balances is a rough indication of the unequal resources available to schools under Pennsylvania's system of public education finance but the amount of fund balances is not an indication that school districts collectively -- and even individual districts -- are irresponsibly hoarding a pot of gold that could be used to avoid tough decisions on how to meet the financial challenges facing our public schools.

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