



POLICY BRIEF

Explaining School Fund Balances:

Are PA Schools, with a \$4.7 Billion Fund Balance, Holding Too Much in Reserve?

An Update for FY 2015-16

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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) formed a consortium to support state legislators, local officials, and education policymakers in a review of options for improving public school finance. CORP has been periodically publishing policy briefs, papers, and studies to support the consortium's mission. This is the fourth annual analysis on school fund balances.

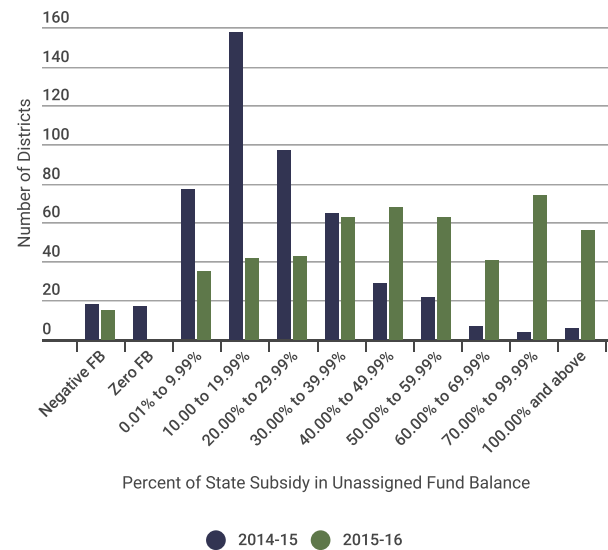
The Pennsylvania Department of Education's annual release of year-end school district fund balances invariably raises questions about the size and distribution of these financial reserves. Namely, one, are school fund balances larger than necessary? And two, are fund balances related to the wealth or poverty of districts? This Policy Brief attempts to shed light on both questions.

Tax increases and an unprecedented 9-month state budget impasse called attention to fund balances (\$4.7 billion) for the 2014-15 year. At the end of the 2015-16 year this amount increased by about \$37 million for the state's 500 school districts, 67 vocational/technical schools (AVTS/CTC), and 175 charter schools. The total fund balance has increased by about \$800 million since 2012-13 (\$3.9 billion). This may suggest to some that these funds are being hoarded by school officials who raise taxes or cut programs unnecessarily or exaggerate their need for additional state aid. In 2014-15 only six districts had a fund balance equal to or greater than their state subsidy. As shown in Figure 1, the number of districts with more than their state subsidy increased to 56. In 2014-15 there were 39 districts with a fund balance that was more than half of the state subsidy. As a result of the extensive state budget delay in 2014-15, the number of districts with a fund balance of more than half of the state subsidy increased to 234 districts in 2015-16.

Why did the fund balance pattern presented in Figure 1 show an increase in fund balances when the state subsidy was so late? First, the districts needed to finalize their

Figure 1

Distribution of Districts by Percent of State Subsidy in Unassigned Fund Balance, 2014-15 and 2015-16



Source: PA Department of Education

budgets well before the state finally settled on a budget - nine months late. Second, many districts adopted budgets for 2015-16 using the assumption that there would be either minimal or no increase in state subsidy. Under the provisions of the School Code, districts have two options when unanticipated revenue is received after the start of

the fiscal year. Option 1, do nothing and allow the funds to roll over for the next year (add to fund balance). Option 2, appropriate the unanticipated revenue. It appears that most districts, based on fund balance increases, chose Option 1 and allowed the funds to roll over into the following year (2016-17).

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 or pensions. 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 divides fund balance into four parts:

- **Restricted** – funds limited by external parties or legislation, e.g. debt covenants
- **Committed** – funds limited by board policy or board action, e.g. planned construction
- **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

Why Maintain a Fund Balance?

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.

A November 1990 research bulletin by the Government Finance Officers Association (GFOA) recommended that an **unassigned fund balance** be retained to guard against an economic downturn. It also advised that an unassigned 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. In 2002, GFOA established a best practice for minimum unassigned fund balance of 5% for large governments may be appropriate. In October 2009, the GFOA revised its best practice in light of GASB Statement 54 to suggest that an appropriate minimum fund balance could be as low as 5% or as high as 15%. The GFOA did not provide a maximum suggested unassigned fund balance.¹

Table 1 - Fund Balance by Type of School, 2015-16

	Number	Committed	Assigned	Unassigned	Total
School District	500	\$1,664,795,902	\$911,666,242	\$1,830,200,202	\$4,406,662,346
Percent of Total		37.78%	20.69%	41.53%	100%
AVTS/CTC	67	\$17,184,926	\$17,514,610	\$20,268,052	\$54,967,588
Percent of Total		31.26%	31.86%	36.87%	100%
Charter School	175	\$103,993,011	\$42,060,775	\$111,618,659	\$257,672,445
Percent of Total		40.36%	16.32%	43.32%	100%
Total All LEAs*	745	\$1,785,973,839	\$971,241,627	\$1,962,086,913	\$4,719,302,379
Percent of Total		37.84%	20.58%	41.58%	100%
Increase Over Prior Year	N/A	\$58,432,254	(\$18,819,186)	(\$2,761,520)	\$36,851,548
Percent of Total		3.38%	(1.90%)	(0.14%)	0.79%

* An LEA is a local education agency that includes school districts, vo-tech, or charter schools.

Source: PA Department of Education, web page, Expenditure Detail - SDs: 1995-96 to 2000-01 | 2001-02 to 2015-16 (Excel), accessed June 7, 2017. <http://www.education.pa.gov/Teachers%20-%20Administrators/School%20Finances/Finances/AFR%20Data%20Summary/Pages/AFR-Data-Detailed-.aspx#.VaageGXD-UI>.

1. Stephen J. Gauthier. 2009. "GFOA Updates Best Practice on Fund Balance." *Government Finance Review* 25(6): 67-68.

Having a positive fund balance benefits the school district when issuing debt. 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.

Fund Balances in PA Schools

In Pennsylvania, fund balances in the 1990s covered school districts when the state failed to make school subsidy payments in a timely manner. The 2014 budgetary impasse was the fourth time this has occurred 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 declined. Beginning in 2010, the state froze funding for repair/renovation, and 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. Additionally, districts have set aside funds to try to minimize or phase in tax increases in individual years to cover pension increases mandated by the Public School Employees’ Retirement System, which operates as a state entity. The budget impasse for the 2015-16 school year resulted in districts relying on the fund balance as a way to meet obligations until state subsidies were available. However, as explained above, the receipt of unanticipated revenue after the start of the fiscal year allowed districts to replenish and even add to the fund balance. This occurred because it was too late in the year to add additional courses/classes and replace things that had been eliminated at the beginning of the year.

Size of Fund Balance

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. Having a fund balance

2. The School Code (24 PS §6-688) provides that a district with expenditures of less than \$19 million may have a fund balance of more than 8%. The sliding scale increases the fund balance by 0.5% for each \$1 million of expenditures below \$20 million. For example, an expenditure of \$19 million would be permitted a fund balance of 8.5% and still be permitted to increase the tax rate. A district with a fund balance of less than \$12 million would be permitted a fund balance of 12.0%.

allows districts the ability to adjust to unusual short-term spending needs thus avoiding the tax rate roller coaster.

As noted above, the financial industry suggests that a government unassigned fund balance should be between 5% and 10% of total operating expenditures and GFOA suggests minimums between 5% and 15%. (A 5% unassigned fund balance would cover a district’s operating costs for about two and a half weeks.) Indeed, Moody’s cited the Commonwealth of Pennsylvania’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 \$19 million if it is going to raise taxes.² Table 1 shows the dollar value of fund balances for the 2015-16 school year.

Even with an increase of \$200 million in state subsidy, the total fund balance only increased by \$36.8 million, or 0.79%. Assigned fund balance increased while unassigned and committed fund balances declined.

The amounts shown in Table 1 include **assigned fund balances**, which are 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 by type of school. As shown in Table 2, the average unassigned fund balance for school districts is 6.5% or below

Table 2 - Unassigned Fund Balance as a Percent of Total Expenditures, 2014-15 and 2015-16

	2014-15	2015-16
School District Total	6.6%	6.5%
AVTS/CTC Total	3.4%	3.5%
Charter School Total	8.1%	6.4%
Total	6.6%	6.4%

Source: PA Department of Education, Expenditure Detail - SDs: 1995-96 to 2000-01 | 2001-02 to 2015-16 (Excel), accessed June 7, 2017. <http://www.education.pa.gov/Teachers%20-%20Administrators/School%20Finances/Finances/AFR%20Data%20Summary/Pages/AFR-Data-Detailed-.aspx#.VaageGXD-UI>.

the School Code limitation. Vocational/technical schools are also below the School Code at 3.5%. Charter schools have a 6.4% 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 (AASE) along with the finance industry 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. The fund balance percent declined by 0.1% for school districts, increased by 0.1% for vo-tech schools and declined by 1.7% for charter schools. The total decline was 0.2% for all entities.

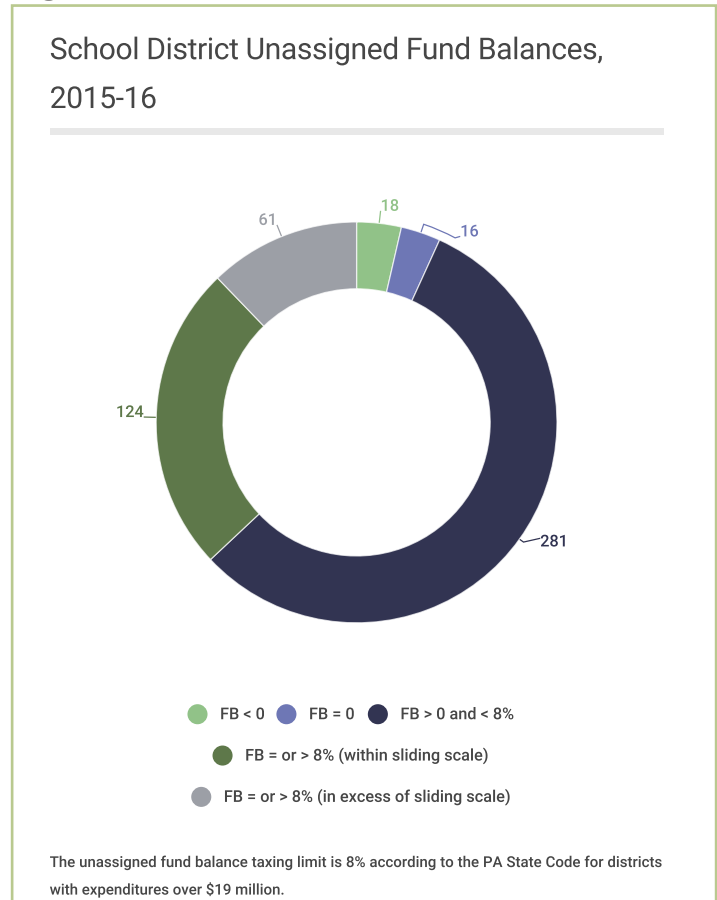
Figure 2 shows that among individual school districts, 16 districts have an unassigned fund balance of zero, and another 18 have an unassigned negative fund balance. There were 281 districts with a fund balance below 8.0%, and 124 districts that are above 8% but within the sliding scale of the School Code. Sixty-one districts had a fund balance in excess of 8% and the sliding scale limit of the School Code.

Is Fund Balance Size Related to District Wealth?

The question may arise as to whether the relative size of unassigned fund balances as a percent of expenditures (see Figure 3) is related to the relative affluence or poverty of school districts. In other words, are wealthy districts likely to have larger fund balances than poor districts, or conversely, are large fund balances an indication that districts are wealthy? CORP ranked all 500 school districts by the percentage that their unassigned fund balances represent of their FY 2015-16 total expenditures. CORP then compared unassigned fund balances to the district's three aid-ratios (the Commonwealth's measure of need) and using widely accepted statistical tests found virtually no correlation.³ Some districts with high fund balances are poor. This may reflect a desire to fund capital projects with savings to avoid borrowing costs or insecurity about their revenue projections or state aid. Many more affluent districts have low unassigned fund balances, reflecting perhaps higher confidence in their tax base and more sophisticated capacity for financial management.

It also needs to be noted that the unassigned fund balance is a point-in-time measure. The fund balance presented is for the school year ended June 30, 2016. Fund balances will usually show a change from the prior year. Some dis-

Figure 2



Source: PA Department of Education

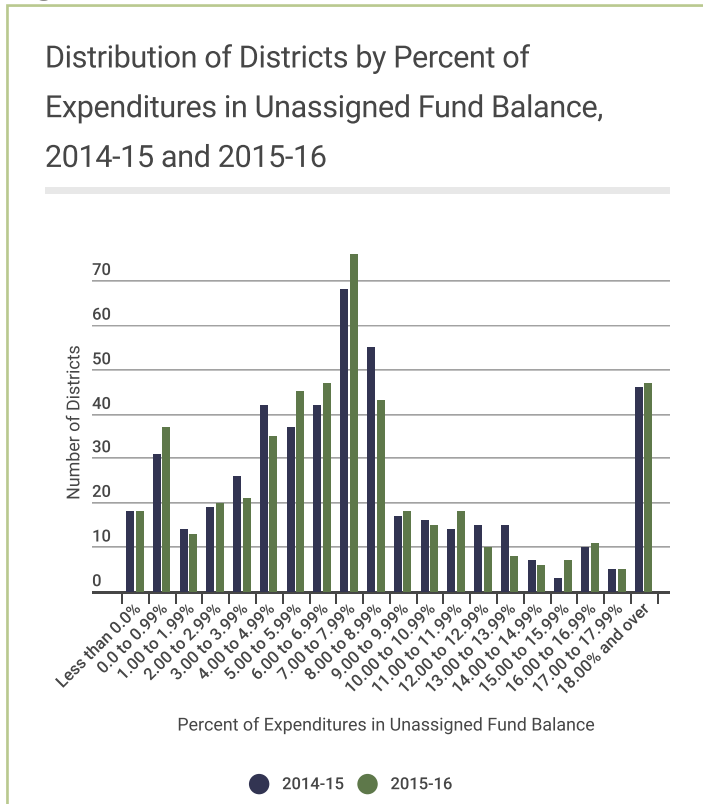
tricts will show an increase and others will show a decline. Current state law only limits unassigned fund balance to 8% of operating expenditures if the district plans on raising taxes.

Summary

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. (A map of PA school districts' unassigned fund balances as percent of expenditures is in Figure 4). Fund balances, like an individual's savings account, are one-time revenues and when used need to be replenished with board approval. Districts should make a periodic review of fund balance amounts and board policy to insure they are still necessary.

3. The rankings and statistical analysis can be found on CORP's website (www.cla.temple.edu/corp/publications/). Caution should be used in interpreting the significance of unassigned fund balances for individual districts based solely on such rankings, as they are highly dependent on unique and sometimes temporary circumstances. The district with the highest percentage fund balance, for example – Bryn Athyn – has fewer than 15 students and operates no schools. Its resources are used to pay other districts for educating Bryn Athyn students.

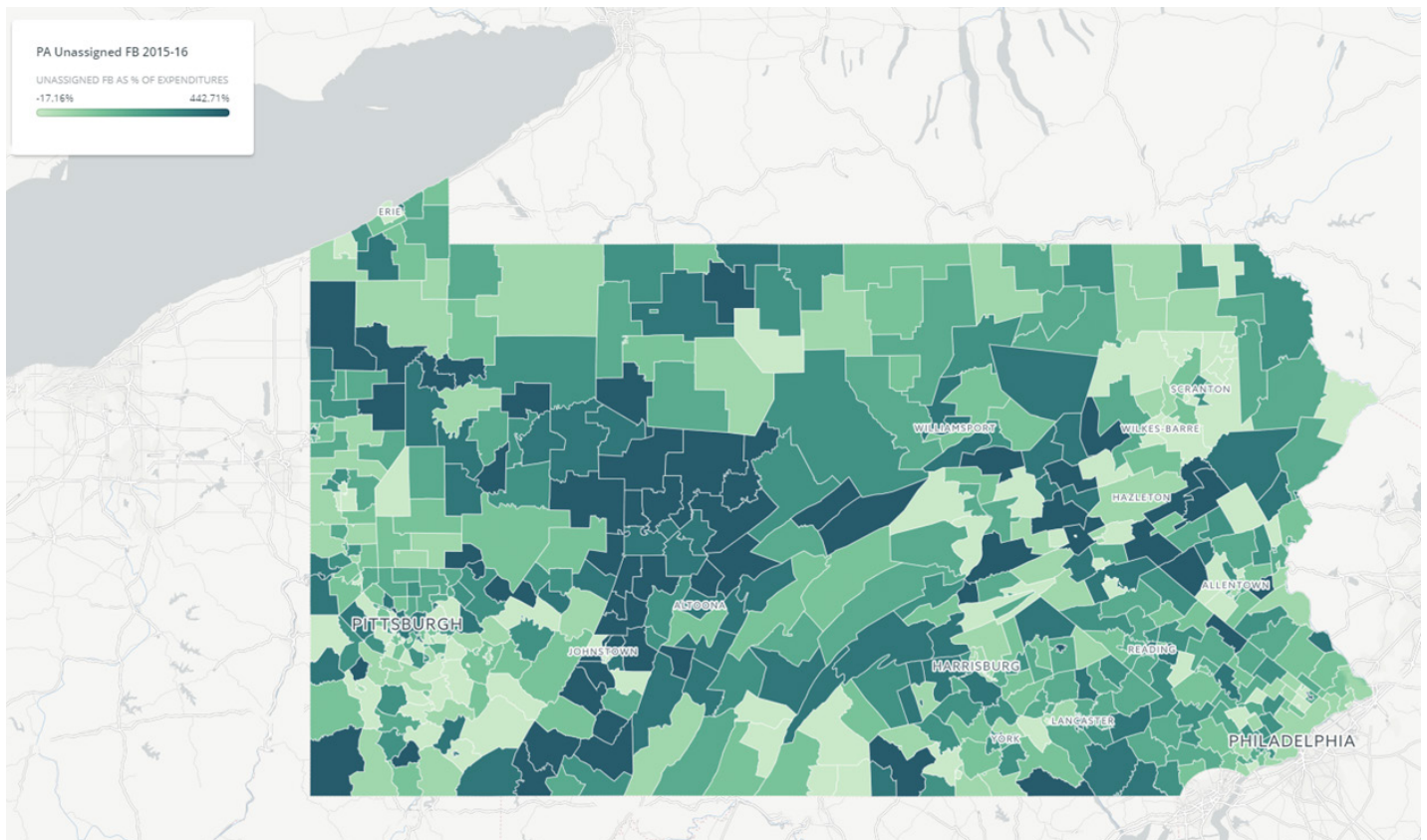
Figure 3



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 responsibilities and resources, including enrollment trends, their obligations for funding pensions, the physical state of their facilities, the reliability and timeliness of future state funding, and the changing economic climate of their communities. 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 although the distribution of fund balances is not systematically related to the wealth or poverty of districts, it is a rough indication of the unequal resources available to schools under Pennsylvania’s system of public education finance. As we have noted in previous editions of this Policy Brief, the amount of fund balances is not necessarily an indication that school districts collectively -- and even individual districts -- are irresponsibly hoarding a pot of gold that could or should be used to avoid tough decisions on how to meet the financial challenges facing our public schools.

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Figure 4 - PA School Districts’ Percent of Expenditures in Unassigned Fund Balance, 2015-16

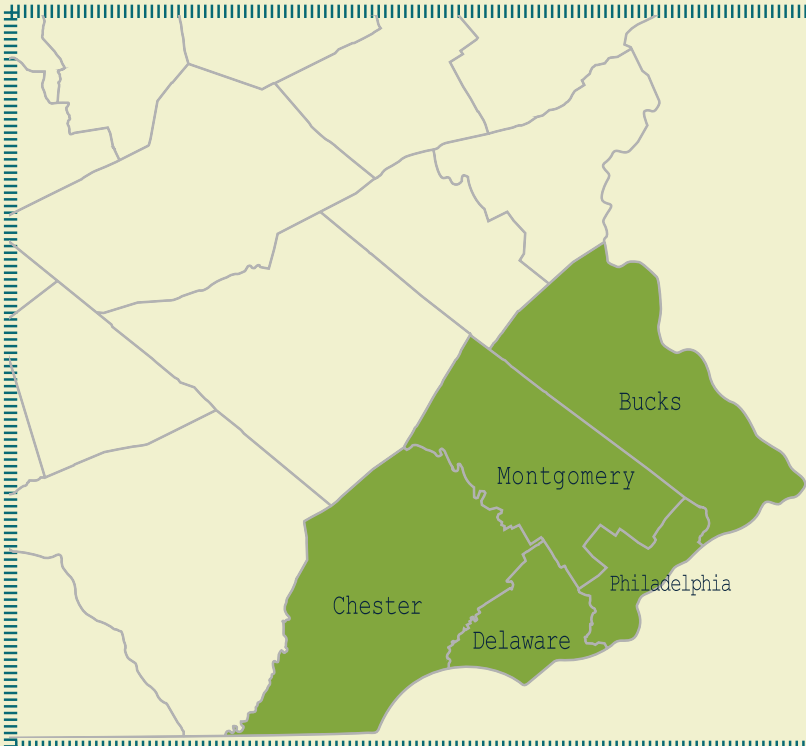


* Find an interactive map, including PA House and Senate districts, of all PA school districts according to the percent of expenditures in the unassigned fund balance at: cla.temple.edu/corp/fundbalance2017/.



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