



## POLICY BRIEF

### Explaining School Fund Balances:

### Are PA Local Education Agencies, with a \$4.9 Billion Fund Balance, Holding Too Much in Reserve?

An Update for FY 2016-17

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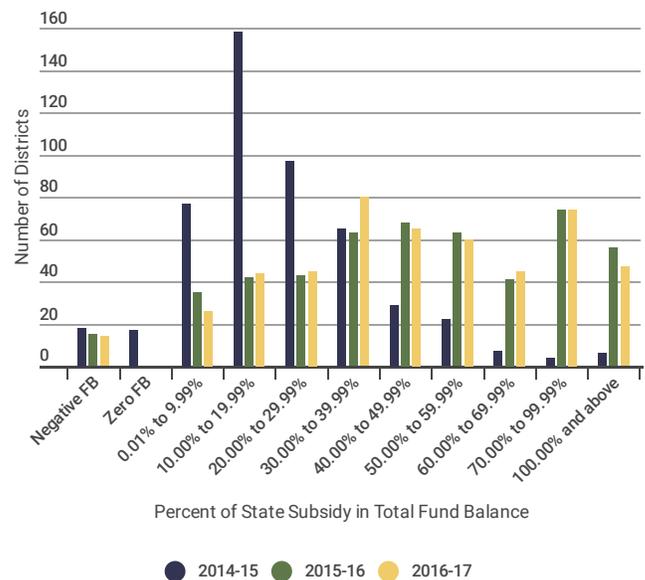
Temple University's Center on Regional Politics (CORP), Penn State's College of Education, the University of Pittsburgh's Center for Metropolitan Studies, and the Pennsylvania Policy Forum (a group of faculty and researchers at 18 public and private colleges and universities) formed a consortium to support 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 fifth 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. First, are school fund balances larger than necessary? Second, are fund balances related to the wealth or poverty of districts? This policy brief attempts to shed light on both questions.

Tax increases and delays in the adoption of a state budget always focus attention on fund balances (\$4.9 billion for the 2016-17 fiscal year). At the end of the 2016-17 year, the total fund balance increased by about \$149.4 million (or 3.1%) over the previous year for the state's 500 school districts, 67 vocational/technical schools (AVTS/CTC), 180 charter schools and 2 joint programs.<sup>1</sup> The total fund balance has increased by about \$591 million since 2012-13 (\$4.277 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 decreased by 9 (from 56 to 47). In 2014-15 there were 39 districts with a fund balance that was more than half of the state subsidy. Probably 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. In 2016-17 the number of districts with a fund balance

Figure 1

Distribution of Districts by Percent of State Subsidy in Total Fund Balance, 2014-15, 2015-16, and 2016-17



Source: PA Department of Education

greater than their state subsidy declined by eight to 226 districts.

1. The term Joint Program is used to identify two programs, one in Lancaster County, the other in York County, that provide a second chance for students who have withdrawn from a traditional high school. These students have a second chance to earn a high school diploma by attending joint programs. These programs operate similarly to an area vo-tech.

Why did the fund balance pattern presented in Figure 1 show an increase in fund balances in 2015-16 when the state subsidy was so late? First, the districts needed to finalize their 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 chose Option 1 and allowed the funds to roll over into the following year (2016-17). Districts appear to have continued a conservative approach to budgeting in 2016-17 with fund balances remaining about the same between 2015-16 and 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 within 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 Statement 54 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

Total fund balance includes all four types of fund balances as appropriate in each district. Most of the discussion in this policy brief will rely on only unassigned fund balance. The fund balance used in the introduction was total fund balance.

**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 payments from the state. In addition, fund balances enable districts to generate investment income which, in turn, helps to keep tax rates lower.

**Table 1 - Fund Balance by Type of School, 2016-17**

	Number	Committed	Assigned	Unassigned	Total
<b>School District</b>	500	\$1,678,570,777	\$966,379,169	\$1,900,540,457	\$4,545,490,403
<b>Percent of Total</b>		36.93%	21.26%	41.81%	
<b>AVTS/CTC</b>	67	\$16,485,880	\$21,669,096	\$18,718,105	\$56,873,081
<b>Percent of Total</b>		28.99%	38.10%	32.91%	
<b>Charter School</b>	180	\$111,348,674	\$45,355,697	\$109,646,814	\$266,351,185
<b>Percent of Total</b>		41.81%	17.03%	41.17%	
<b>Joint Programs</b>	2	--	\$50,336	\$23,920	\$74,256
<b>Percent of Total</b>		0.00%	67.79%	32.21%	
<b>Total All LEAs*</b>	749	\$1,806,405,331	\$1,033,403,962	\$2,028,905,376	\$4,868,714,669
<b>Percent of Total</b>		37.10%	21.23%	41.67%	
<b>Increase over Prior Year</b>	N/A	\$20,431,492	\$62,162,335	\$66,818,463	\$149,412,290
<b>Percent of Total</b>		13.67%	41.60%	44.72%	

\* 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: 2007-08 to 2016-17 (Excel), accessed 6-7-2018. Web site: <http://www.education.pa.gov/Teachers%20-%20Administrators/School%20Finances/Finances/AFR%20Data%20Summary/Pages/AFR-Data-Detailed-.aspx#>. VaageGXD-UI.

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 as a best practice that a minimum unassigned fund balance of 5% for large governments is 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.<sup>2</sup>

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 - and their cost of borrowing - suffer accordingly.

### Fund Balances in PA Schools

In Pennsylvania, school districts have reasons to accumulate larger fund balances when the state budget is delayed, causing concern that their subsidy payments might be reduced or delayed. The 2014-15 budgetary impasse was the tenth since 1992.<sup>3</sup> 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 caused 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.

The 2016-17 appropriation bill was passed by the House and Senate on July 1, 2016. The governor did not sign the bill, and it became law on July 12, 2016 without the governor's signature. School districts adopted their budgets before the end of June, as required by state law, without knowing what the state subsidy would be for 2016-17.

### 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 allows districts 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 a 2016 downgrade of 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.<sup>4</sup> Table I shows the dollar value of fund balances for the 2016-17 school year.

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

3. This count does not include the FY 2003-04 budget as late because the general appropriations act was signed well in advance of the deadline, but only after Governor Rendell vetoed the basic education subsidy, which was not funded until taxes were raised in December 2003. Subsidy payments to school districts were delayed.

4. 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 \$19 million. For example, an expenditure of \$18.9 million would be permitted a fund balance of 8.5% and still be permitted to increase the tax rate. A district with expenditures of less than \$12 million would be permitted a fund balance of 12.0%.

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. **Committed fund balances** are also included in Table 1.

Table 2 shows unassigned fund balance as a percent of total expenditure by type of school. Unassigned fund balance is that portion of fund balance that is not planned for other uses. As shown in Table 2, the average unassigned fund balance for school districts is 6.23% or below the School Code limitation. Vocational/technical schools are also below the School Code at 3.27%. Charter schools have a 5.77% fund balance. All three show a decline in unassigned fund balance as a percent of expenditures from the prior year. 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 unassigned fund balance percent declined by 0.45% for school districts, by 0.38% for vo-tech schools and by 0.66% for charter schools. The total decline was 0.46% for all entities.<sup>5</sup>

Figure 2 and Figure 3 show that among individual school districts 110 have expenditures below \$19 million. Among the total of 110 districts with expenditures below \$19 million, 49 had an unassigned fund balance over 12%. There were almost an equal number of districts (55) with expenditures above \$19 million and a fund balance over 12%. There were 34 districts with expenditures below \$19 million with a fund balance below 8%. Among the districts

**Table 2 - Unassigned Fund Balance as a Percent of Total Expenditures, 2014-15 and 2015-16, and 2016-17**

	2014-15	2015-16	2016-17
<b>School District Total</b>	6.32%	6.68%	6.23%
<b>AVTS/CTC Total</b>	3.44%	3.59%	3.21%
<b>Charter School Total</b>	8.08%	6.43%	5.77%
<b>Total</b>	6.37%	6.61%	6.15%

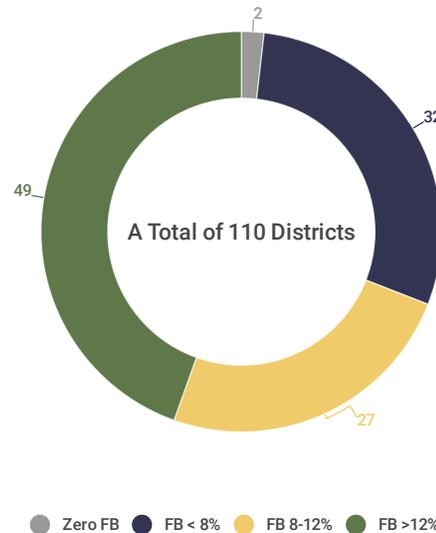
Source: PA Department of Education, Expenditure Detail - SDs: 2007-08 to 2016-17 (Excel), accessed June 7, 2017. <http://www.education.pa.gov/Teachers%20-%20Administrators/School%20Finances/Finances/AFR%20Data%20Summary/Pages/AFR-Data-Detailed-.aspx#.VaageGXD-UI>.

5. These figures differ slightly from the previous report due to calculation errors.

**Figure 2**

**School Districts with Expenditures under \$19 Million Unassigned Fund Balances, 2016-17**

The unassigned fund balance taxing limit is 8% according to the PA Code for districts with expenditures over \$19 million. Districts below this limit are allowed higher unassigned fund balances based on 0.5% increments for each \$1 million less in expenditures while still allowing new taxes.



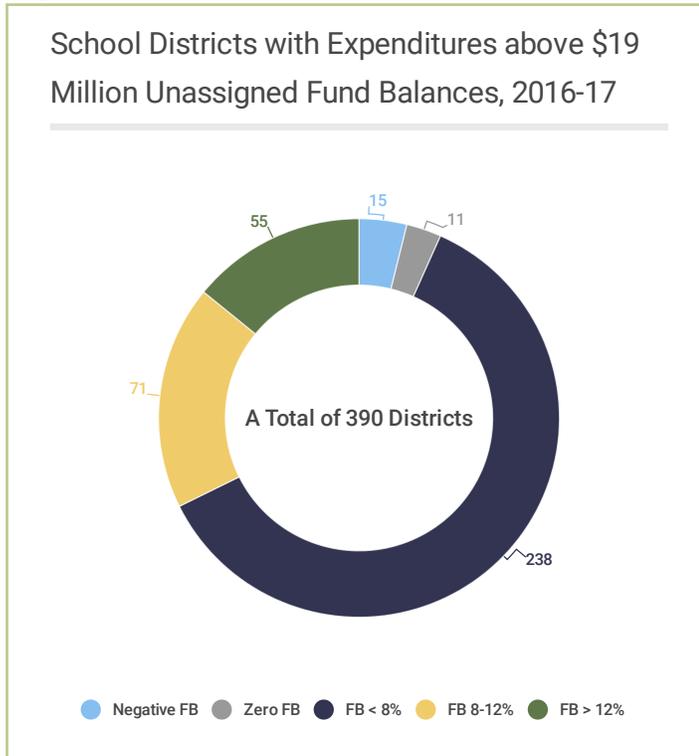
Source: PA Department of Education

with expenditures greater than \$19 million there were 264 districts with a fund balance below 8%. A total of 298 districts had a fund balance below 8%.

Figure 4 shows the distribution of districts by percent of unassigned fund balance. The distribution has varied slightly over the three years presented. However, the variations are relatively small and remain very consistent across all three years.

The distribution of unassigned fund balances (see Figures 2 and 3) also may be a point of interest. The question may arise as to whether the relative size of fund balances 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 their unassigned fund balances represent of their FY 2016-17 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

**Figure 3**



Source: PA Department of Education

statistical tests found virtually no meaningful correlation.<sup>6</sup> 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, 2017. Fund balances will usually show a change from the prior year. Some districts 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.

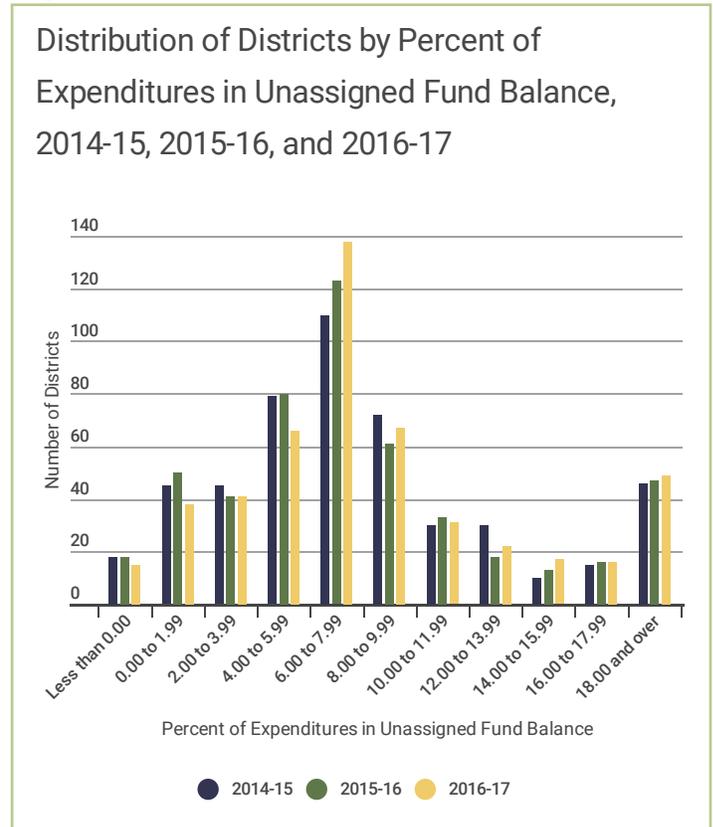
Figure 5 shows a map of the distribution of unassigned fund balances across the 500 Pennsylvania districts.

**Summary**

If the district is going to use its fund balance, it should proceed with caution. The assigned fund balances, if they

6. The rankings and statistical analysis can be found on CORP's website ([www.cla.temple.edu/corp/fundbalances2018/](http://www.cla.temple.edu/corp/fundbalances2018/)). 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 4**



Source: PA Department of Education

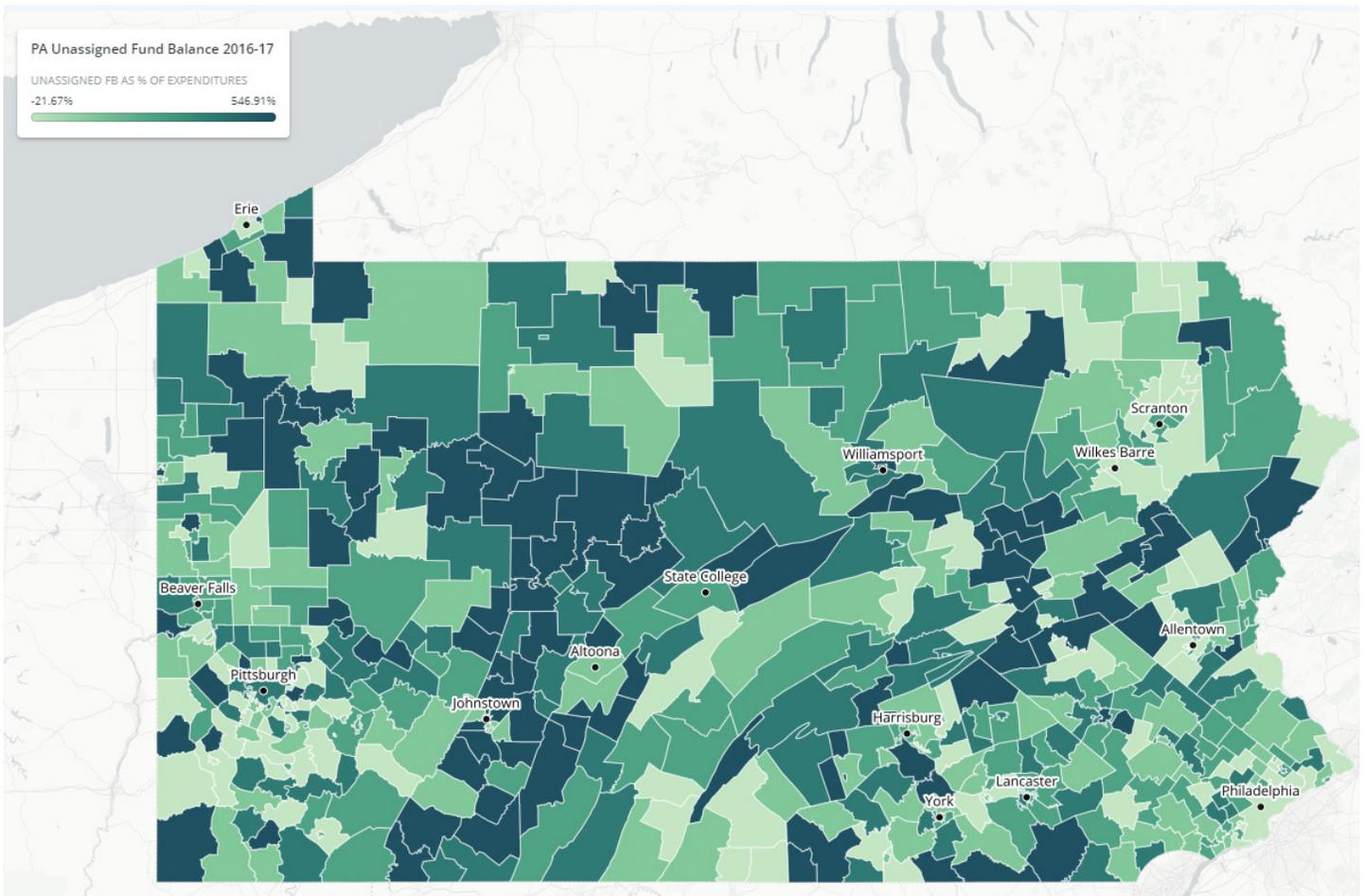
contain federal funds, bond proceeds, or funds in the debt service fund, must be used for their assigned purposes. Committed fund balances should be used first for the purposes for which they were committed. The unassigned fund balance should be used for one-time expenditures. Fund balances, like an individual's savings account, are one-time revenues and when used need to be replenished with board approval. Districts should make a periodic review of fund balance amounts and board policy to insure the amounts are necessary.

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 again, as we have done in previous analyses, 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. The amount of fund balance is neither necessarily an indication that school districts collectively are, in the words of one columnist, irresponsibly "hoarding barrels of money" that

should be sent back to taxpayers. Nor is it sufficient to avoid tough decisions on how to meet the financial challenges facing our public schools.

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**Figure 5 - PA School Districts' Percent of Expenditures in Unassigned Fund Balance, 2016-17**

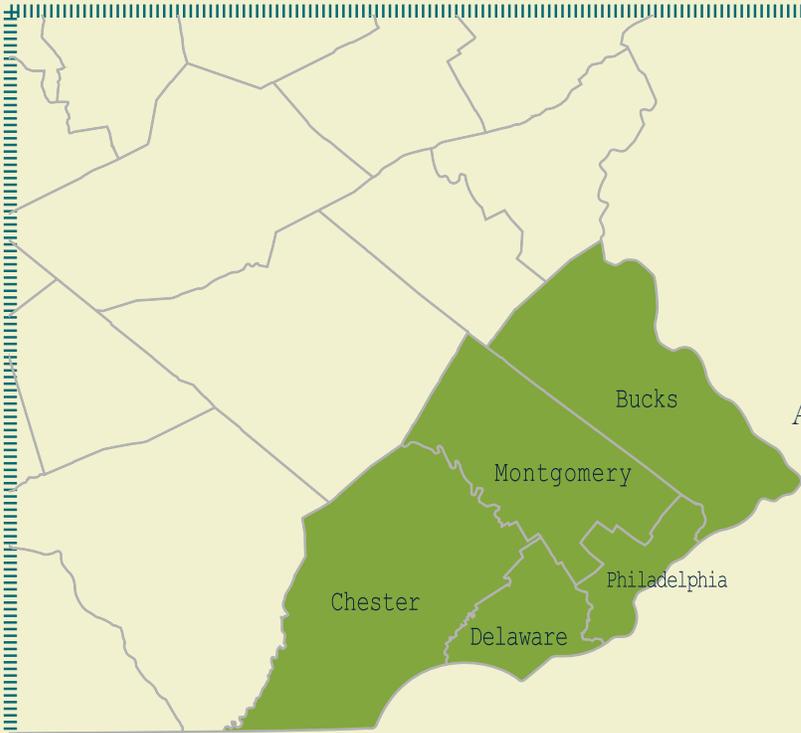


\* Find an interactive map, including PA House and Senate districts, of all PA school districts according to the percent of expenditures in the unassigned fund balance at: [www.cla.temple.edu/corp/fundbalances2018/](http://www.cla.temple.edu/corp/fundbalances2018/).



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