

School District Fund Balance/Cash Reserves

Every June for the last several years, state politicians have had questions about school district fund balances. After watching the UW System, legislators and the Governor deal with fund balance discussions this last year, it appears that school districts should do some communication and school board activities that bring light to the issue and educate everyone as to the purpose and importance of a school district fund balance.

During school budget presentations to the school board and community (budget hearings or otherwise) there should always be a discussion about the June 30 fund balance (especially the cash reserves). A budget presentation should reflect the same thoughtful thinking about fund balance cash reserves that is used for expenses and revenue. School districts should also have a monthly cash flow analysis to explain when revenues come in and when expenditures go out. The presentation should explain that school districts are different than cities and counties in regards to year-end fund balances, cash reserves and cash flow.

Because the UW-System was very quiet about fund balances, legislators were able to say they were surprised about them and cut the System's revenue. The UW will now use its fund balance to operate. Are we running the risk of having the same thing happen to public schools? The operating fund balance for all school districts in the state at the end of the 2012-13 fiscal year was \$2,047,729,849. School administrators, business officials and school board members must make sure their school district fund balance is the result of thoughtful planning that is totally transparent. There should be no political surprises at any political level. Unfortunately, many districts do not have fiscal policies relating to cash reserves. Of those districts that do have fund balance (cash reserve) policies, many are, frankly, not adequate. Let me follow such a wild accusation with what I think are key components needed by school districts in their fund balance cash reserve policy. Then make sure the school administration and board have a thorough and transparent discussion. School districts cannot afford another cut in State or local funding because of inadequate budget planning and communication, including fund balance and cash reserves. There can be no surprises, real or perceived. I have taken the liberty of providing some thoughts about fund balance and cash reserves. I hope it is helpful.

What is a School District Fund Balance?

The fund balance IS NOT: the equivalent of a person's savings or cash accounts. It IS NOT entirely cash that can be used for any purpose.

Fund Balance IS: Assets (What a district owns) less Liabilities (What a district owes).

Fund balance consists of cash, cash equivalents (i.e. investments), and non-cash components (i.e. taxes receivable, payables). Fund balance is often confused as cash. Cash and cash equivalents, also known as financial cash reserves, are only a portion of fund balance. For school district audit purposes, fund balance is measured on June 30, so the amount of fund balance will include significant receivables (August tax receivables, grants receivable, and delayed state aid payments). Policy discussions must concentrate on financial cash reserves that school districts need to operate.

School boards and communities should review monthly cash flow analysis as a part of the proposed budget and how it relates to Fund Balance.

Why is a Sufficient Fund Balance So Important?

School districts need to maintain adequate financial cash reserves in order to demonstrate a strong fiscal position, solid financial planning, and sound fiscal management. The financial cash reserve portion of fund balance should be at a level that supports attaining district long-range goals for the community's children. Reserves should be adjusted to adequately insulate against future instability and/or reduction of revenue. An appropriate amount of financial reserves will enable the district to meet both planned and unplanned short-term cash needs while also setting aside funds for anticipated future needs.

Insufficient fund balance cash reserves will result in a district borrowing to meet cash flow needs. Borrowing will result in additional interest expense borne by taxpayer. An appropriate amount of financial reserves will result in higher credit ratings that will lower district borrowing costs. Taxpayer money that does not go towards interest expenses can then be used for needed educational programs.

Recognized best business practices do not use a percentage or a number as a measure in and of itself for school districts. These do not effectively quantify the numerous factors to be considered when establishing adequate financial reserves. The factors are fluid and fluctuate according to the current and predicted economic environment. They require ongoing analysis. The adequacy of financial reserves should be reviewed annually as part of a school district's budget development process. Bonding agencies, such as Moody's, always review this practice.

Financial reserves provide:

1. Adequate funds for cash flow.
2. Adequate funds for unplanned expenses, planned expenses and planned investments. This provides a way to set money aside for repairs (roof), maintenance (new heating systems, etc.), catastrophic (or near catastrophic) events or major purchases (buses, textbooks, new educational programs).
3. Adequate funds to insulate against revenue loss and instability. This addresses uncertainty about state and federal funding, as well as the myriad of problems posed to school districts in declining enrollment. For the more than 60 percent of Wisconsin school districts currently in declining enrollment, having sufficient fund balance allows these districts to better manage the decline.
4. Adequate mechanisms to accumulate sufficient funds to make designated future purchases or implement new programming initiatives without borrowing or diverting existing and needed program budgets.
5. Adequate funds for contractual and other legal contingencies.

How is a Sufficient Fund Balance Determined?

When establishing appropriate financial reserves, there are many factors to consider. Overall, the

cash flow cycle/pattern of all federal, state and local revenue sources should be evaluated. Analyzing the past, present, and predicted fiscal stability, position, and the economic forecast of these revenue streams will collectively influence appropriate financial reserves. Reserves should be adjusted to adequately insulate against future instability and/or reduction of revenue.

Specific factors to consider when determining appropriate financial reserves include:

1. The district's enrollment pattern and stability, and its impact on the revenue limit.
2. The district's level of local tax collections and the history, as well as the anticipated timing, of future collections.
3. The amount of budget support provided by grants.
4. The district's asset position: Age and condition of district facilities (i.e., roofs, brick, pavement); age and condition of major facility equipment components (i.e., HVAC, electrical, infrastructure). This year's legislation created a new sinking fund. This raises the question of how much of a school district's fund balance from last year might be transferred to the new Fund 46 sinking fund just created by the State.
5. The relationship between operating expenditures, income, cash flow analysis and financial reserves. Insufficient fund balance (cash reserve portion) will result in the district borrowing to meet cash flow needs or require a reduction in needed programs. Borrowing will result in additional interest expense borne by taxpayers. Because of revenue limits, educational programs will need to be reduced.
6. The amount of existing debt obligations (Wisconsin Retirement unfunded prior service liability, OPEB ARC).
7. Anticipated new program implementation.
8. The current and predicted economic environment.
9. A sufficient and stable district fund balance (cash reserve portion) is considered a prudent business practice by the bond rating agencies, resulting in lower district bond borrowing costs for major projects.

When the district attains appropriate financial reserves, or an urgent need arises that requires reserves to be spent, a plan for use of the reserves should already be in place. Use of financial reserves should not be used for operating expenses. It should only be for temporary or one-time expenditures to meet best business practices.

Issues to Consider Related to School District Fund Balances

The School District's fiscal year is not the same as that of municipalities, counties, and other governmental bodies, posing unique issues.

Receivables timing and cash flow circumstances that must be considered include:

1. Most State General Aid payments come very late in the fiscal year and even after the end of the fiscal year. Some General Aid is paid in July but recorded as part of the June 30 Fund Balance. There is no State General Aid income in August, October, November and May.
2. Property taxes start flowing to school districts six months after the fiscal year has started. There is no property tax income in the months of July through December for the current

fiscal year. The August property taxes received are for taxes receivable for the previous year's expenditures. Again, these amounts are part of the June 30 Fund Balance. One cannot use the same thinking or practices that cities and counties use, because the tax collections start immediately at the start of the fiscal year for cities and counties. This does not happen for school districts.

3. School levy credits and first dollar credits are received by the school districts after the fiscal year is over. These payments for the previous school year are received in August. But these amounts are also included in the June 30 Fund Balance.
4. All receivables mentioned above are included in the Unassigned Fund Balance. One cannot pay bills or paychecks with a receivable. The check won't clear the bank.

Recommendations

Each school district operates under unique circumstances and has unique reasons for building a fund balance (financial cash reserve portion). Therefore, general recommendations cannot possibly cover all the individual situations that necessitate an appropriate fund balance. It is recommended that each school district carefully and thoughtfully develop policies, goals and presentations that are transparent, understandable to the community and based on good business practices appropriate for their community. Let's not have any surprises.

The DPI provides a suggested format for the budget document that is voted on by the school board and used for the budget meeting vote on tax levy. One of those accounts that are listed in the budget format is fund balance. Please provide the community and school board the rationale for this account as well as the revenues and expenses. Transparent and active local participation about fund balance cash reserve will make discussing this topic in other venues (i.e. the legislature) more influential and precise in the long run.