TESTIMONY OF THE

PENNSYLVANIA SCHOOL BOARDS ASSOCIATION

BEFORE THE SENATE EDUCATION COMMITTEE

REGARDING

FUND BALANCES AND BUDGET PREPARATION

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Good afternoon, Chairman Argall, Chairwoman Williams and members of the Senate Education Committee. Thank you for the opportunity for the Pennsylvania School Boards Association (PSBA) to present written testimony regarding fund balances and budget preparation. My name is Mike Gossert, and I am the PSBA Vice President, and I have also served as a school director in the Cumberland Valley School District for over 9 years.

Every year, public education critics are quick to point out the level of school district fund balances. They paint a picture of districts hoarding cash for no clear reason while continuing to increase taxes and complain that their districts are underfunded. But that paints an incomplete, inaccurate, and unfair picture of school district financial management. I would like to take some time today to dispel those myths and take a more balanced look at fund balances.

What is a Fund Balance

I wanted to start by explaining what a fund balance is. Generally, a fund balance is the difference between assets and liabilities in a given fund, in this case a school district's general fund. A fund balance is not just cash in the bank or the equivalent of an individual's savings account. It also includes money owed to or by the district that will be collected, paid and/or used in the current fiscal year. In other words, a fund balance represents the total resources available to meet future obligations.

As required by the Department of Education Manual of Accounting and Governmental Accounting Standards Board (GASB) Statement number 54, fund balance is reported in four categories based on the restrictions placed on their use:

- Restricted fund balances are funds limited by external parties or legislation.
- Committed fund balances have been formally designated by a school board for a specific purpose.
- Assigned fund balances are intended for a specific purpose by a committee of the school board or an individual authorized by the board.
- Unassigned fund balances are available for any purpose.

Why a Fund Balance is Important

The Government Finance Officers Association (GFOA) has said that "[i]t is essential that governments maintain adequate levels of fund balance to mitigate current and future risks and to ensure stable tax rates". In recent testimony before the House Appropriations Committee, some of the other groups testifying here today recognized the importance of the General Assembly maintaining a rainy-day fund yet are quick to criticize school districts for doing the same. And in response to the Governor's recent budget address, members of the Senate Republican Caucus spoke about the importance of increasing the Commonwealth's fund balance beyond its current level of 11% for future rainy days.

School districts will commit or assign fund balance for a variety of reasons. In many instances, they are intended to be used for major anticipated expenses which, in turn, will reduce tax increases resulting from those expenses. For example, funds are often designated for construction, renovation, or repair projects which is especially relevant in light of the lack of state funding for school construction reimbursement in the new PlanCon program. These funds can ease the burden on local taxpayers by either paying for or lowering the amount needed to bond or borrow for the project and allow the district to avoid borrowing and higher interest costs.

The fact that committed or assigned fund balance is not used in one or two fiscal years should not be reason for concern. A new school construction project could be years down the road. Many school districts also have five, ten, or even 20 school buildings that they need to keep up with maintaining and renovating which are part of long-term facilities planning. Without PlanCon, using a capital reserve fund or a committed/assigned fund balance can be critical to making facilities improvements without increasing property taxes. The only other option would be to go to a voter referendum for property tax increases which we have seen are largely not successful.

At Cumberland Valley, our fund balance has been instrumental in the ongoing construction necessitated by the unprecedented growth in enrollment we've been experiencing. Each school year, Cumberland Valley has been adding 300-400 new students. Over the last 5 years, our growth equates to the size of many of the state's smaller school districts. Without maintaining an adequate fund balance, this construction would have been impossible or much more expensive for our taxpayers.

Another prime example of the need to commit or assign money to a fund balance is mandated special education costs. In the last 10 years public schools experienced a $2 billion increase in special education costs. In that same time, state and federal special education funding increased roughly $200 million, leaving school districts to find the remaining funds required to pay these costs. Maintaining an unassigned fund balance can help school districts bear these increased costs without resorting to new property tax increases or reducing the programs and services provided to students.

Further, having a positive unassigned fund balance is essential for:

- Responding to an emergency or other unforeseen event such as a pandemic which requires schools to close and purchase laptops, tablets, WiFi hotspots and other technology needed to convert all instruction to remote learning.
- Unexpected building repairs or upgrades such as purchasing and installing new ventilation systems and plexiglass barriers for school buildings, equipment replacement, or uninsured loss.
- Covering unexpected revenue shortfalls such as the loss of a major employer in the district or other economic disruption which would negatively impact earned income tax and property tax revenues.
- Maintaining good credit ratings which reduce the cost of borrowing or issuing debt.
- Keeping the district running in the event of late or lower than expected state subsidies (for example, a state budget impasse).
- Generating investment revenue which can be used to offset potential tax increases.

Fund Balance Recommendations and Requirements

While there is no set legal requirement related to the size or amount of a school district fund balance there are some recommendations that are useful. First, the GFOA has noted that "[t]he adequacy of [unassigned] fund balance in the general fund should take into account each government's own unique circumstances". For example, a higher fund balance may be appropriate when the local economy and tax base are weak and the district relies heavily on state and federal funding which can be delayed or changed without notice, or when the district has a large debt burden. These circumstances can then be explained to stakeholders and constituents if the district chooses to maintain what may seem like a higher-than-normal level of fund balance that protects taxpayers from an unexpected change in financial condition.

The GFOA also recommends that governments like school districts maintain an unassigned fund balance level of two months of regular general revenue or expenditures. Other financial industry recommendations for unassigned fund balance are for a maximum unassigned fund balance of 10%-15% of the school district's expenditures.

In addition to the limitations on property tax increases imposed by Act 1 of 2006, section 688 of the Public School Code also restricts school districts from increasing property taxes in an upcoming year unless their adopted budget contains an ending unassigned fund balance below a specified percentage of budgeted expenditures. For example, if a school district's budgeted expenditures were $100 million, it could not raise property taxes if the unassigned fund balance at the end of the year is projected to be more than 8% of those expenditures which, in this case, would be $8 million or more.

Even within industry recommendations, evaluating unassigned fund balance levels is a no-win scenario for school leaders. If the unassigned fund balance levels are high, the district's independent financial audit may note this as a finding. However, if the district's unassigned fund balances are too low, the district runs the risk of their credit rating being downgraded. A downgrade which results in just a half percentage point increase in interest rates on a multi-million dollar financing could have a tremendous impact on taxpayers over the course of a 25-30 year loan.

Fund Balance Transparency

Decisions regarding fund balance levels and purposes take place in clear view of the public. Most school boards maintain a board policy that outlines the level of unassigned fund balance that will be maintained. Actions to commit or assign fund balance also take place at open, public meetings. Any district resident or taxpayer has access to any and all information about not only school district fund balance decisions, but also district taxing and spending decisions.

Further, communities are frequently involved in decisions regarding fund balance levels. In at least one of the 12 districts in the recent Auditor General's report, the district had conversations with the community about future school building needs and the community agreed that using tax increases and building a fund balance was necessary and appropriate. This further illustrates that simply looking at tax increases and fund balance levels without context is misguided and that these decisions are best left to locally elected leaders.

The Real Reason for Local Tax Increases

School directors are volunteers who choose to serve in order to benefit their communities. No school director wants to raise taxes on their friends and neighbors yet many are simply forced to for one reason – mandates.

Local property tax increases are a direct result of increases in mandated costs such as pensions, special education and charter school costs as well as the state not adequately funding public education. For example, over the last 10 years, mandated costs for pensions, charter school tuition and special education have increased by more than $6.1 billion while state revenue for those expenses has only increased $2.0 billion, leaving school districts and local taxpayers responsible for the other $4.1 billion. Even if school districts used every dollar of increased Basic Education Funding in that time to help pay those costs, that would still leave a more than $3.7 billion deficit for local taxpayers.

In our annual State of Education report, mandated charter school tuition, pension, and special education costs, along with inadequate state funding have consistently been rated as the top sources of budget pressure facing school districts in each of the seven years that the report has been produced. School leaders reported that those budget pressures lead to property tax increases, cuts to district programs and services, and postponing much needed updates to buildings and curriculum.

Special education costs are also a prime reason why school districts may seek approval for an Act 1 exception. Local taxpayers have been forced to absorb $1.8 billion in unfunded mandated special education costs. Those increases, combined with the long-term predictions that districts are required to make when developing their preliminary budgets, which occur months before the state has even seriously begun budget negotiations, compel school leaders to seek approval to increase taxes beyond the Act 1 index to pay those costs. However, as budget preparation progresses, most districts who receive approval for an exception do not use them or only use a fraction of what had been approved.

And the assertion that school districts aren't controlling their expenses is just plain false. Other than increases in mandatory pension costs and charter tuition payments, increases in school district expenditures were well below the rate of inflation over the last decade.

Local property taxes are only part of the revenue picture for school districts. At Cumberland Valley, property taxes account for roughly 55% of our revenues. Like other forms of local governments, we allocate part of our property taxes towards building a fund balance for long-term facility needs such as major repairs or renovations. We will also seek to utilize any unexpected revenues from large real estate transfers or industries moving into the school district towards building a fund balance. While there are a number of misconceptions out there about the building and use of fund balance, I can assure you that my fellow school directors have the best interests of their students and communities in mind.

Conclusion

Fund balance levels and usage need to be part of a larger discussion about public education funding and mandated expenditures. PSBA and its members stand ready to assist in those discussions and the search for solutions. On behalf of PSBA, I want to thank you for your attention to, and support for, our public schools, and for this opportunity to provide input. I will be happy to take any questions.