PICPA Testimony

by

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Good morning, Chair Argall, Chair Williams, and members of the Senate Education Committee. On behalf of the Pennsylvania Institute of Certified Public Accountants (PICPA), thank you for the opportunity to provide testimony on K through 12 school budgeting and fund balances.

My name is Pamela Baker. I am a CPA and the managing partner at Barbacane Thornton & Company. I am responsible for the firm’s adherence to professional standards in the proper planning, supervision and review of compliance and financial audits. I have over 35 years of auditing experience, all of which have been spent almost exclusively auditing and advising the nonprofit and government sectors. I also regularly serve in a consulting capacity assisting organizations in financial accounting and reporting, communicating with board members and the public, hiring finance personnel, and selecting and implementing software systems. In addition, I have been a speaker and participant in numerous courses covering compliance requirements of the Single Audit Act, implementation of FASB and GASB requirements, and other topics unique to the nonprofit and government sectors.

The PICPA was founded in 1897 and is the second oldest and fourth largest CPA organization in the United States. Our membership includes more than 20,000 practitioners in public accounting, business and industry, government, and education. The PICPA seeks to be a nonpartisan technical resource and strategic partner with governors, legislators, and regulatory agencies on a variety of issues. We are proud of this working relationship and believe our contributions have made Pennsylvania a better place to live and operate a business.

Independent auditors and advisers to public school systems are frequently asked by school board members what the fund balance should be and if the school district is financially secure. The role of the independent auditor is to opine as to whether financial statements are fairly presented; that said, our expertise and experience can add to this discussion on budgeting and fund balances. We also would like to introduce to this discussion the accounting principles as promulgated by the Governmental Accounting Standards Board (GASB), which has particular rules for reporting classifications for fund balance that are designed to comprise a hierarchy based primarily on the extent to which a school district is bound to honor constraints on the specific purposes for which amounts in governmental funds can be spent. Specifically, the GASB created five categories of fund balance based on the type and source of constraints on the resources:

- Nonspendable – Resources are in a form that cannot be spent (e.g., inventory).
- Restricted – Resources subject to restrictions are legally enforceable by outside parties (e.g., grantors).
- Committed – Board-level, self-imposed limitations on the use of resources that cannot be reversed without board-level action.
- Assigned – Less formal action to limit how resources can be used. These are approved by the board but can be modified by management.
- Unassigned – Resources that are in spendable form and are neither restricted, committed, nor assigned.

School districts, as taxing entities, are challenged to manage both a short-term perspective (collect annually only enough to pay current expenditures) and a long-term perspective (when will funds be collected to pay expenditures and what unexpected costs will occur that were not planned for, such as COVID, increases in the student population, extreme weather events, etc.).

While there are similarities among Pennsylvania's school districts, there are also significant differences that affect expenditures, including, but not limited to, the need for capital investment, the predictability of revenues, the volatility of expenditures, and the drain on the general fund to support other funds, such as food service. Therefore, districts will not all be in a position to budget in the exact same way. Some may have periods where setting fund balance aside as either committed or assigned will be important. To that end, the fund balance classifications and their use become significant and should not be managed through legislation but rather through reporting. Even when committed or assigned, fund balance classifications must be fully explained and reported in footnotes to financial statements.

It can be helpful to both answer the question of financial security and fund balance through effectively communicating the accounting principles that define how to account for and report fund balance resources. Accounting principles result in transparency with respect to required allocations of respective funds. It can also be helpful to have legislative guidelines in place to assist in communicating responsible budgeting. However, legislative guidelines that are too restrictive can have a potentially negative impact on a district's ability to plan and account for financial activity that is either unexpected or that spans more than one fiscal period.

I would offer that, based on a summary of my comments above, revisions to the existing legislation regarding fund balance limitations are not necessary, will not enhance reporting, nor significantly change annual tax rate determinations.

Thank you for the opportunity to present this testimony. I am happy to answer any questions.