School District Snapshot – Understanding Funding, Spending, and Saving

Lots of numbers get tossed around when people talk about money and schools. So do lots of opinions. This article is intended to address the conversation about funding, spending and saving in Pennsylvania's school districts in a way that simply and accurately provides a snapshot of overall fiscal health. The article will attempt to address some common questions, and will provide analysis of the most recent data available from the annual financial reports submitted to Pennsylvania's Department of Education by the commonwealth's 500 school districts.

The following questions will be addressed throughout the article:

1. How are Pennsylvania's public school districts funded?
2. Where does the money for public education come from?
3. How do districts spend money?
4. What types of financial challenges are currently impacting Pennsylvania's public school districts?
5. How much money do districts have in reserve, and how much should they have?

In order to answer these questions, it is important to understand the process. Here in Pennsylvania, each school district is governed by a locally elected team of nine unpaid board members. Boards work closely with the superintendent and other administrators to ensure that schools are able to function efficiently and to provide appropriate educational services to students who live within the district's attendance boundary. Among the many responsibilities of boards is monitoring and maintaining the fiscal health of the district. Maintaining fiscal health includes meeting current financial obligations including costs associated with educational programs and services, as well as planning for future anticipated and unanticipated costs.

Understanding how districts are funded helps with developing an overall picture of fiscal health. Public education money comes from local, state, federal and "other" sources. Federal funding originates from the federal government, often in the form of grants or aid intended to provide services for children with specific needs. Traditionally, federal and "other" funding sources represent a relatively small portion of total education funding. For the most recent school year (2013-2014), combined federal and "other" revenue represented less than 5% of the total education monies received by districts.

Local sources mostly in the form of property taxes represent the largest portion of district revenues. School boards are given the authority to collect these taxes by the Pennsylvania School Code. For the 2013-14 school year, districts generated $15.3 billion to fund public education from local sources. Most of this money came from property and other locally collected taxes.

State funding is often significantly impacted by economic and political forces. 2013-14 revenues from the state totaled $9.5 billion, or just around 37% of total education funding. This compares to an average of about 43% in other states. According to data available from the National Center for Education Statistics (NCES), Pennsylvania ranks 43rd among all 50 states in terms of the amount of state subsidies allocated for elementary and secondary education.

Maintaining fiscal health includes meeting current financial obligations including costs associated with educational programs and services, as well as planning for future anticipated and unanticipated costs.

As you can see in the far right column in the chart below, about 37% (36.55%) of total funding for public education came from state sources for the 2013-2014 school year. This does not mean that all districts received 37% of their total funding from the state. In fact, state funding in individual districts varies widely depending on level of wealth and other factors. For the school year represented in Table 1, the actual amount of state funding received by individual districts represented anywhere from as much as 79% of total funding to as little as 11% of total funding. This wide range results in a difference between the average amount of total revenues in individual districts, and the state's portion of total revenues received by all districts as a whole.

Table 1

	High	Low	Average	Median	Total Distribution of Education Revenues
Local	87.59%	9.80%	53.32%	53.40%	58.59%
State	79.33%	11.28%	42.81%	41.96%	36.55%
Federal	38.83%	0.00%	2.60%	1.93%	3.10%
Other	61.90%	-0.11%	1.28%	0.00%	1.76%

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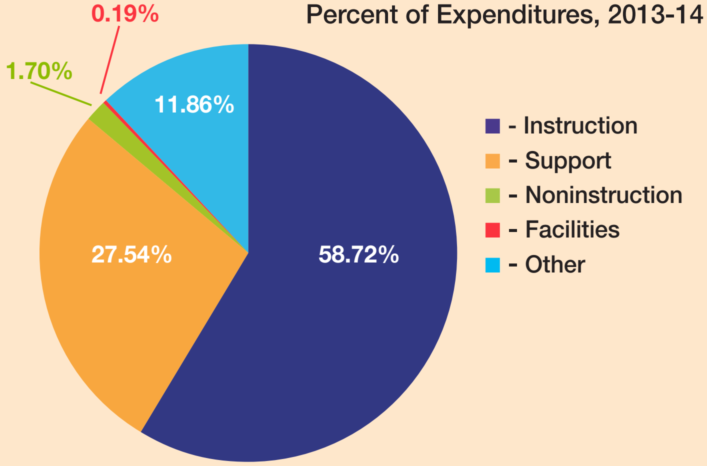
How do districts spend money?

One of the most important annual tasks for Pennsylvania school boards is budgeting. Boards are responsible for developing publically available budgets that cover the costs of providing educational services to children in the district. Essentially, school boards spend the district's money to run schools. Generally speaking, more students means more spending for teacher salaries and pensions, books, transportation, and hundreds of other budgeted items. For accounting purposes, Pennsylvania's school districts divide expenditures into five areas including:

- Instruction,
- Support
- Noninstruction
- Facilities, and
- Other Expenses (including debt service)



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The *Instruction* category includes expenditures that deal with teachers and students. *Instructional* expenditures made up almost 60% of the total amount spent by Pennsylvania school districts for the 2013-14 school year. The largest portion of this amount goes to employee salaries and benefits. In individual districts, the percent of all money spent on *Instructional* costs can vary significantly. In some districts, nearly 90% of the budget goes toward *Instructional* costs. But generally speaking, districts commit around 58% of their budget to this category.

The next largest percent of total expenditures falls into the *Support* category. *Support* services provide administrative, technical, and logistical support to facilitate and enhance instruction. Districts might spend money in this category for things like guidance programs, attendance monitoring, social work, or tax collection. As with the *Instruction* category, spending for *Support* services can vary from district to district.

Pennsylvania public school districts were forced to pay more than $1.4 billion in charter school tuition payments during the 2013-14 school year.

On average, districts spent about 30% of their budgets on *Support* services during the 2013-2014 school year, while as a whole, this category made up 28% of total education spending for the same year. Table 2 shows the distribution of expenditures across all spending categories.

Pennsylvania public school district spending varies greatly from region to region and district to district. Student enrollment is a primary factor in how much districts spend, as is geographic location. But many other factors also help to determine how much districts spend each year. The two largest school districts in Pennsylvania, Philadelphia and Pittsburgh, spent a total of $3.3 billion in 2013-14. That number represents nearly 13% of Pennsylvania's total school district expenditures.

Most districts are able to operate with much more modest budgets. In fact, nineteen districts were able to operate for the 2013-14 school year with expenditures not exceeding $10 million. At the other end of the spectrum, 60 districts spent more than $90 million. The majority of districts spent between $10 million and $50 million, with the largest number of districts (129) spending between $10 million and $20 million. The chart below uses data from PDE's 2013-14 Annual Financial Reports to show the distribution of districts by total expenditures for the school year.

What types of challenges are currently impacting Pennsylvania's public school districts?

Spending for public education can fluctuate from year to year to year according to local needs. In many districts, difficult economic conditions coupled with dramatic cuts in state subsidies have left boards scrambling to cover the costs associated with maintaining appropriate educational programming. Most districts also are faced with growing charter school tuition payments of hundreds of thousands or millions of dollars. In 2013-14, 144 school districts paid tuition payments of greater than $1 million to charter schools around the state. Philadelphia School District by itself paid $701 million, and the payments from all districts totaled more than $1.4 billion.

The biggest financial challenge facing districts today, however, is pension payments for current employees. Pennsylvania's still-developing pension crisis is impacting districts in ways that have not yet fully developed. During the 2009-10 school year, Pennsylvania's school districts contributed $533 million to the Pennsylvania State Education Retirement System (PSERS). That number represented 2.19% of total education spending by public school districts. Because of rising pension contribution rates, that number rose in only five years to $1.8 billion in 2013-14. With an employer contribution rate of 16.93%, Pennsylvania districts were forced to devote almost 7% of

Table 2

	High	Low	Average	Median	% of Total Education Spending
Instruction	89.77%	22.24%	57.48%	57.65%	58.72%
Support	41.09%	10.23%	29.22%	29.34%	27.54%
Noninstruction	6.56%	0.00%	2.14%	2.06%	1.70%
Facilities	29.61%	0.00%	0.31%	0.00%	0.19%
Other	64.60%	0.00%	10.85%	10.02%	11.86%

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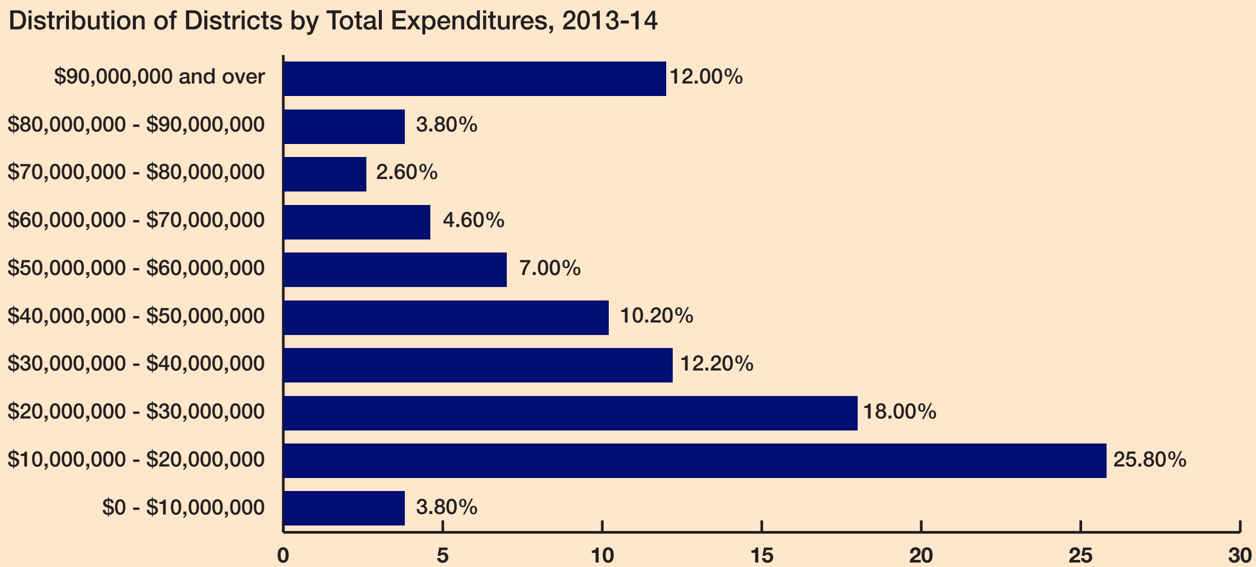

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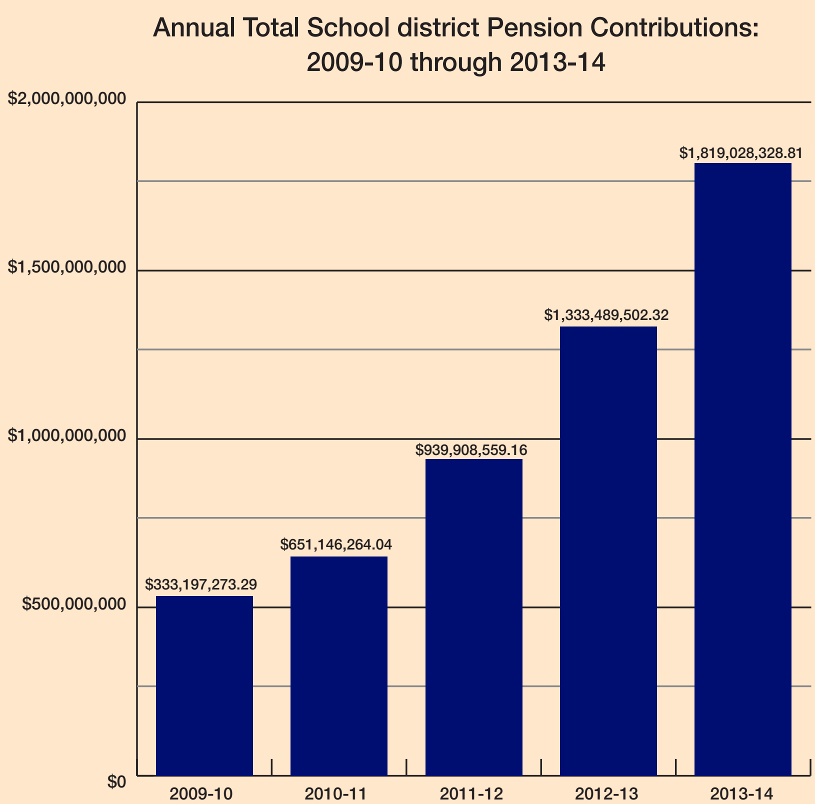
all money spent in 2013-2014 to employee retirement funds. This contribution rate jumped to 21.40% for 2014-15, and will continue to rise until it reaches 33.27%, nearly doubling what districts were required to contribute in 2013-14.

In individual districts, the number is even more concerning. Four hundred and ninety districts saw more than 5% of total expenditures going to PSERS in 2013-14. Some districts saw pension contributions rise to as much as 10% of total expenditures. Pension expenditures in Philadelphia and Pittsburgh combined to total $153 million for the most recent school year. To put that number into perspective, 480 districts operated with a total annual budget of less than $153 million.

Despite financial challenges that have continued to confront Pennsylvania's public schools, many districts are managing to spend less. Sometimes, fiscal responsibility means looking closely at programs and services across the board to see where savings can be made. Around the state there has been a dramatic increase in the number of districts charging fees for participation in athletics, music, and other extracurricular activities. A 2014 report from the Pennsylvania Association of School Business Officials (PASBO) asked districts about the types of difficult choices districts are making in order to save money and meet financial obligations. The PASBO report indicates 90% of responding districts have reduced staffing, and that 64% have increased class size. More than half of responding districts indicated that cuts to academic programs are anticipated.



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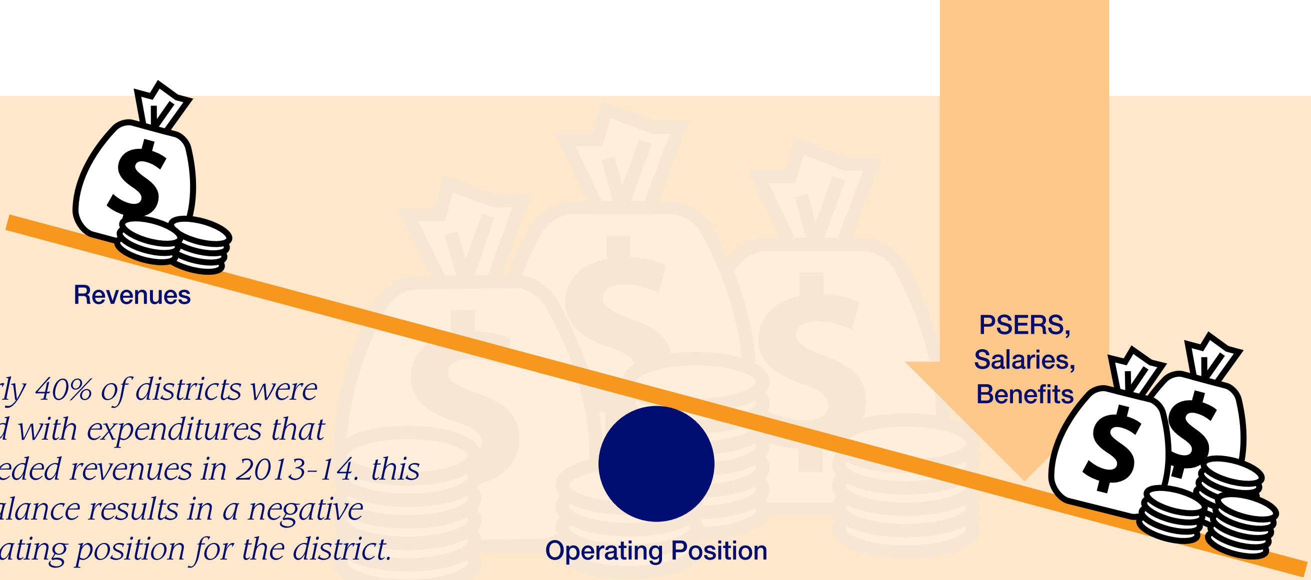
These types of tough decisions have resulted in reduced spending in many districts. Nearly 20% of districts spent less in 2013-14 than they did five years earlier, and nearly as many (92 districts) spent less than they had in the previous year. Collectively, those districts spent $278 million less in 2013-14 than they did in 2009-10.

Still, many districts are finding it increasingly difficult to develop balanced annual budgets. Over the last several years, a growing number of districts have been faced with financial shortfalls. When the district does not bring in enough revenues to cover its expenses, the board is forced to rely on reserves to make up the difference. This can happen for many different reasons, and is not entirely uncommon among districts. However it is important that the board plan carefully so that it is not forced to rely on reserves too often.

Operating position, or the difference between actual revenues and actual expenditures, shows us how many districts are forced to rely on reserves in order to balance the budget. In the 2013-14 school year, 40% of districts (199 districts) were faced with expenditures



Nearly 40% of districts were faced with expenditures that exceeded revenues in 2013-14. this imbalance results in a negative operating position for the district.

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that exceeded revenues. This is a 10% increase over the previous year, and likely is a reflection of the impact of rising PSERS rates for districts.

Industry guidelines recommend that a school district should operate from a positive operating position, where revenues outweigh expenditures. A positive operating position occurs when the district is able to meet financial obligations without using budgetary reserves. Districts that operate with a negative operating position are forced to tap into district reserves to make up the difference. The table below provides a look at the range of operating position among districts for the most recent two school years for which information is available.

Table 3 - Range of Operating Position

Range	2012-2013		2013-2014	
Below 0.00%	137	27.45%	199	40.04%
0.00%-4.99%	288	57.72%	253	50.91%
5.00%-9.99%	57	11.42%	40	8.05%
10.00%-14.99%	13	2.61%	4	0.80%
15.00% & Over	4	0.80%	1	0.20%

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When revenues exceed expenditures, the result is an operating surplus. The majority of school districts in Pennsylvania (253) ended up with an operating position of between 0% and 5% for 2013-14. As a result, most districts were able to set some money aside for future anticipated and unanticipated costs including facilities maintenance and rising pension contributions.

District Fund Balance – Preparing for Anticipated and Unanticipated Costs

Fund balance is a sometimes confusing term used by school districts and other governmental agencies to convey a sense for fiscal preparedness, among other things. It is important to note that a fund balance is a necessary component of a fiscally healthy district. Although the term is often used generally to describe cash on hand, it is more appropriate to think of a fund balance as the difference between assets and liabilities. When assets are greater than liabilities, the district fund balance is positive. A fund balance is not equal to cash and investments. Cash and investments are part of the fund balance. A fund balance also includes money owed to the district, cash value of inventory, and other assets.

Specifically, there are several different types of fund balances that can be viewed as either available for use, or obligated to an assigned or anticipated use. The Governmental Accounting Standards Board (GASB) issued a statement in 2009 (to take effect in 2010) that was intended to address differences in how various local governments and governmental agencies at the time provided and evaluated information related to budgetary reserves. GASB statement # 54 divides fund balances into categories that provide information on how assets are available for use. These categories include:

- *Nonspendable,*
- *Restricted,*
- *Committed,*
- *Assigned, and*
- *Unassigned.*

Nonspendable fund balances are amounts that cannot be spent because they are either in a non-spendable form, or are legally or contractually required to be maintained. Examples might include district inventory that is not liquid, or the principal of a permanent fund. *Restricted* fund balance amounts are constrained for a specific use or purpose as per external parties or legislation. Next, *Committed* fund balances can be viewed as money that the district has available, but that has been designated formally for a specific purpose. In order for funds to be considered *Committed,* the board must take formal action to assign purpose to the money. Fund balance reserves could be *Committed* for Capital Projects, future healthcare payments, or renovations to an existing facility, for instance. The key is that the board must have given purpose to the money via formal action.

Assigned fund balances are intended for a specific use as per committee or individual authorized by the board. This could include anticipated payments for PSERS increases, for instance. *Assigned* fund balances are not considered to be *Restricted* or *Committed* unless they are formally assigned purpose by the governing body – in this case, the school board.

Unassigned fund balances are amounts available for use for any purpose within the General Fund. You can see that there are significant differences between a district's complete spectrum of fund balances and the money that the district actually has available for use in the *Unassigned* category. Generally speaking, *Nonspendable* and *Restricted* fund balances are not tangibly available for use. So for purposes of analysis and comparison, total fund balance includes *Committed, Assigned,* and *Unassigned* fund balances.

Fund balances are important to district health the same way a savings account is important to a family. Just as families should maintain a savings account to deal with emergencies or other unforeseen events, districts should also have funds in reserve to pay for emergency repairs, uninsured losses, or unexpected interruptions to revenues. A new roof for a school building, for instance, can cost in the range of $600,000 to upwards of $900,000. According to the most up-to-date fund balance data available, 11% of districts would not currently have enough *Unassigned* fund balance reserves to pay for an unscheduled roof replacement costing $800,000. This illustrates the importance of planning for unanticipated events.

Fund balances 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. An example of this was particularly evident in 2011-2012 when loss of American Recovery and Reinvestment Act (ARRA) monies combined with lowered state subsidies resulted in nearly $1 billion less in education funding for Pennsylvania. As a result, 217 public school districts were forced to rely on fund balance reserves to develop a balanced budget. *Unassigned* fund balance among these 217 districts was reduced by an average of $1.1 million and a total of $256 million in one year as boards worked to balance budgets hit with significant unexpected reduction in funding. Seven districts did not have enough to make up the difference, and ended up with a negative fund balance for the year.

Fund balances can also enable districts to generate investment income that helps to keep taxes lower. Pennsylvania school districts have generated nearly $230 million in revenues from investments over the past ten years. This is money that can be directly applied to district needs so that in turn, taxes may be kept at a minimum. Conversely, districts that have little money to invest receive little income from investments. Among the sixteen districts with negative *Unassigned* fund balances for 2013-14, the median income from investments was $3,685. Median income from investments among all districts for 2013-14 was $22,813, with a maximum of $2.6 million. 143 districts received investment income of greater than $50,000 in 2013-14.

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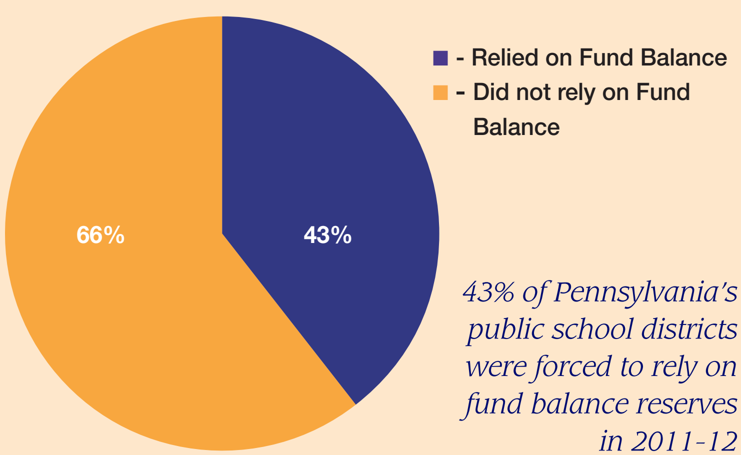
Districts Forced to Rely on Fund Balance Reserves as a Result of Lowered State Funding, 2011-12



43% of Pennsylvania's public school districts were forced to rely on fund balance reserves in 2011-12

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District credit ratings may also be impacted by insufficient or unstable fund balance reserves. Fund balances are one of the important pieces of data reviewed by Standard & Poors or Moody's. A healthy and consistent fund balance can benefit a district when a bond issue is required while a district with little or no fund balance can be considered a higher risk borrower. Lenders like to see total fund balances for public school districts in the five to ten percent of expenditures range. When a district is below that range, or if the district has a history of inconsistent reserves, the credit rating and borrowing power of the district may be limited or adversely affected. A good credit rating may help the district get better rates on loans, and may negate the need for bond insurance when borrowing. These in turn translate to lower taxes for local taxpayers.

How much fund balance should districts have?

There is no easy answer to the question of "what is an appropriate fund balance?" Local agencies including school districts need to walk a fine line between being prepared for a rainy day and being responsible to taxpayers. Local circumstances often combine with economic and other considerations to dictate each district's "appropriate" level of reserves. A weak local economy, a sizeable debt burden, or over-reliance on state funding may impact the need for fund balance reserves. School officials may also build up a fund balance over time in anticipation of future costs associated with construction or payments. In essence, it makes sense for the district to pay itself rather than borrowing and repaying a bank with interest. The Government Finance Officers Association (GFOA) recommends a minimum unreserved fund balance of no less than two months of regular operating expenditures. GFOA also recommends policies be put in place that ensure the appropriate level of fund balance be maintained in the General Fund.

A detailed look at the distribution of total fund balances for all Pennsylvania school districts for 2013-14 shows sixteen districts with a negative fund balance, and more than 300 with a total fund balance greater than 15% of expenditures. Again, the total fund balance includes *Committed, Assigned,* and *Unassigned* fund balances. The school code limits the maximum *Unassigned* fund balance based on a sliding scale to between 8% and 12% of operating expenditures if a district will increase its real estate tax rate.

If the *Unassigned* fund balance in a district exceeds the standards set within the district, excess funds can be used for limited one-time expenditures such as capital equipment, vehicle replacement, or any other non-recurring expense. Alternatively, excess fund balance may be transferred to capital reserve for future building repairs. Excess funds can also be designated for specific future one-time use by the board.

Understanding how Pennsylvania's school districts are funded and how they spend and save money helps to provide a clearer picture of fiscal health. Districts are currently presented with unprecedented financial challenges. School boards across Pennsylvania are facing and preparing for these challenges, making difficult decisions about programs, staffing, and spending in general. The realities of Pennsylvania's public education funding system continue additionally to confront local taxpayers as boards are forced to rely on locally generated taxes as the primary source of district revenue. Even despite these challenges, most districts are able to continue to address budgeting and spending from a balanced perspective that prepares and leaves room for anticipated and unanticipated needs of the future.

Table 4 - Range of Fund Balance, 2013-14

	Total Fund Balance	
Range	**Number**	**Percent**
Below 0.00%	16	3.21%
0.00%-4.99%	24	4.81%
5.00%-9.99%	59	11.82%
10.00%-14.99%	80	16.03%
15.00% & Over	320	64.13%

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