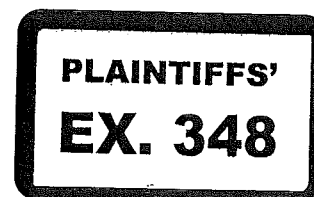




This white paper was created to help readers understand the complex but critical issue of school finance unencumbered cash balances. Developed by Allen, Gibbs & Houlik, L.C. (AGH) to demystify recent debate over school district budgets, this analysis uses plain-English business and accounting concepts to provide context. It is offered in two sections: the first two pages provide a quick overview; the second two pages give a more in-depth look for those who would like a more detailed review of the data. We offer both as a public service and hope they will prove useful to public officials, school districts and members of the community.

The white paper is based on an in-depth analysis of Kansas school districts' budgets and financials conducted by Mark Dick, a certified public accountant and certified fraud examiner with Allen, Gibbs & Houlik, L.C. who has specialized in public sector auditing for more than 40 years. He has testified on school finance for the Kansas Legislature and holds the Certified Government Financial Manager credential from the Association of Government Accountants. Mr. Dick's expertise in not-for-profit and governmental accounting is recognized nationally; he has served as an expert witness in litigation cases across the country.

For more information, please contact Mark Dick at (316) 267-7231 or [mark.dick@aghlc.com](mailto:mark.dick@aghlc.com). For a copy of this white paper, please visit AGH's website at [www.aghlc.com](http://www.aghlc.com).



## ANALYZING SCHOOL DISTRICT UNENCUMBERED CASH BALANCES – AN OVERVIEW

Recent debate over school finance has zeroed in on funds left in school districts' reserves at the end of the June 30 fiscal year, called *unencumbered cash balances*. Based on an extensive study of Kansas school districts' budgets and financials, this white paper does not express an opinion on the "suitable funding" of Kansas schools, but simply provides an accounting context for school districts' unencumbered cash balances at fiscal year-end.

Some observers regard these balances as rationale to cut school district budgets, viewing funds remaining in the reserves on June 30 as evidence of too much spending. It's a flawed argument because it mixes up the very different issues of *cash reserves* and *the determination of "suitable funding" as required by the state constitution*.

Making sure you have enough cash on hand to pay your bills and keep the doors open in between revenue inflows is sound *cash management*. A financially healthy organization – whether commercial or not-for-profit – must maintain enough cash in reserve (sometimes referred to as working capital or operating liquidity) to operate the entity for a period of time until new revenue comes in. The Government Financial Officers Association best practices document recommends that entities maintain, at a minimum, an unrestricted fund balance of no less than two months of general fund operating revenues.

The amount of cash-on-hand at the districts' fiscal year-end reflects the districts' cash-management abilities – not whether the school district has suitable funding. The relevant question for unencumbered cash balances is "How many days of cash-on-hand should the school districts have in their reserves at any given time to pay bills and keep the doors open?" That is a distinctly separate and different question than "Do the school districts have the right amount of funding in their budgets?"

### School District Cash Flow and Your Monthly Finances: An Analogy

This personal-finance analogy illustrates the cash flow timing issues school districts face.

If you worked for a company which paid about half of your salary in two lump-sum payments twice a year – say, in January and June – you would need to watch your cash carefully between those two payday. When you are paid, you're obligated to fund commitments already made, such as your mortgage, car payment and so on. What's left over after that is your expendable income to cover "operating expenses" until the next payday – items such as groceries and gas.

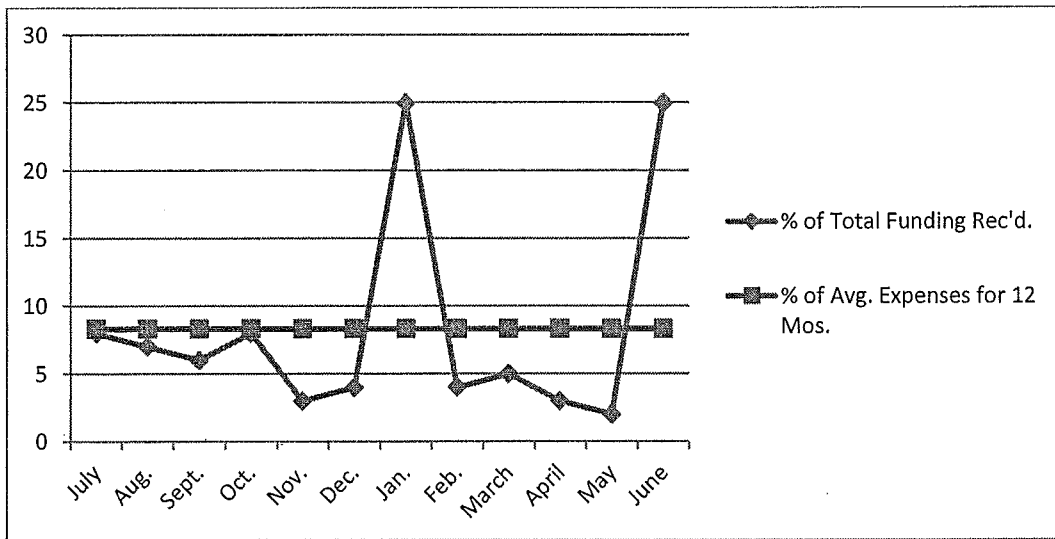
School districts must also conserve cash between "paydays." A review of several representative school districts shows that although their fiscal year ends June 30, districts receive about 25% of their total **unrestricted** funding in January and about 25% in June, with a smaller amount trickling in each month in between. Some federal, state and other funding has restrictions on how it can be spent, and so is not available for ongoing unrestricted operating expenses. Although schools obviously spend more from August through May, significant expenses continue in the summer, including staffing, facilities, and preparation for the next school year.

In brief, school districts must stretch the "payday" of unrestricted funding they receive in June until the next significant funding arrives the following January, long after school begins. By comparison, if the State of Kansas, which receives a major funding infusion in April, had a fiscal year end of April 30, the State would also end its fiscal year with significant unencumbered cash balances.

The following comparison of funding dates compared to year-round expenses illustrates the cash flow of revenues of a typical school district. This chart focuses on unrestricted funding only, since that is the data available.

**SCHOOL DISTRICT CASH FLOW ILLUSTRATION THROUGH A FISCAL YEAR**  
Based on data for unrestricted funds from Kansas school districts for FY 2010

	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	March	April	May	June
% of Total Funding Received	8	7	6	8	3	4	25	4	5	3	2	25
% of Avg. Expenses for 12 Mos.*	8.33	8.33	8.33	8.33	8.33	8.33	8.33	8.33	8.33	8.33	8.33	8.33



\*KSDE data provided did not include monthly expenses, so an average was used.

## IN-DEPTH EXAMINATION OF SCHOOL DISTRICT UNENCUMBERED CASH BALANCES

Some controversy over the unencumbered cash balances school districts hold at their fiscal year-end has arisen in the past two years. Allen, Gibbs & Houlik, L.C. believes the debate has gotten off-track by mixing two key concepts: *cash* reserves and the “suitable funding” of Kansas schools. This in-depth study of school district unencumbered balances was developed to clarify the discussion and provide context.

School district cash balances may be considered from two perspectives. The first could be considered a “moving picture” of the cash balances, which fluctuate daily based on the daily receipts and disbursements of the school. The second perspective is the “snapshot” of the cash balances at any point in time during the year. Comparing the increase or decrease in the cash balances at a specific point sheds light on school districts’ cash management abilities – but not on whether they are suitably funded.

All businesses, including school districts, need working capital. Net working capital is calculated as current assets minus current liabilities which, in the case of school districts, are equal to unencumbered cash balances. Working capital provides operating liquidity and allows the entity to pay bills promptly when they come due.

The Government Finance Officers Association (GFOA) of the United States and Canada has published best-practice recommendations for “appropriate level of unrestricted fund balance in the general fund.” The GFOA states that “it is essential that governments maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. Fund balances are a crucial consideration, too, in long-term financial planning.” While the level of unrestricted fund balance in the general fund should be based on the entity’s specific circumstances, ***GFOA recommends that, “at a minimum ... general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues.”***

One useful way to put working capital into perspective is to calculate the ratio of the ending cash balances to annual expenses. The result is a measurement of the percentage of annual expenditures the entity has in reserve and available to pay ongoing expenses. Providing this measurement of the working capital school districts have at year-end is a meaningful way to help a reader put the cash balances in perspective. School district financial data used to provide this information was studied in the following way:

- All financial data for the fiscal year ended June 30, 2011 was obtained from the Kansas State Department of Education. School districts were placed into five groups based on student enrollment:
  - Group 1 consists of the state’s largest five districts.
  - The remaining districts were placed in quartiles based on student enrollment.
- Each district’s funds were placed into five categories. Each district’s authority over unencumbered cash is limited to two fund categories: unrestricted funds and funds within the Senate Bill 111 category. The remaining categories are subject to State, Federal or capital outlay and debt service restrictions.

Senate Bill 111 allows school districts to transfer ending balances as of June 30, 2012 back to the General fund up to a maximum of \$232 per student excluding special education students. The provisions of Senate Bill 111 are not effective until the end of the current fiscal year which is June 30, 2012. Consequently, this analysis is focused on the unrestricted fund group and all funds excluding capital outlay and debt service type funds.

- **Unrestricted** – The available balance can be used for any legal purpose which includes the general, supplemental general and contingency reserve funds.
  - **Restricted by State Legislation** – Funds whose use is restricted by Kansas law
  - **Federal Restricted** – Funds whose use is restricted by Federal law
  - **Senate Bill 111 Funds** – Funds identified in Senate Bill 111 which, for the fiscal year ending June 30, 2012, enables school districts to transfer ending balances back to the General fund subject to a maximum amount determined by legislators
  - **Capital Outlay and Debt Service** – Funds legally restricted for use in capital improvements and payment of bond principal and interest
- Ending unencumbered cash balances were summarized by school district group and fund categories.
  - Annual expenditures were summarized by school district group and fund categories. Transfers out of the General and Supplemental General funds were eliminated from expenditures to arrive at the operating expenditures of the fund.

Our study revealed some interesting facts and trends.

- The five largest school districts had the smallest percentage of working capital, while the percentage of working capital increased as school district size decreased – suggesting that larger school districts may require lower cash balances, perhaps due to stronger financial controls and budgeting experience.
- The average percentage of working capital in unrestricted funds by school district group ranged from 7.31% to 12.27%. The average for all school districts was 8.89% – enough for approximately one month of operating expenses. The average percentage of working capital for all funds excluding capital outlay and debt service funds was 16.58% – of which a significant portion is not available for unrestricted purposes due to state and federal legislative restrictions.

The combined totals for all school districts' cash balances (excluding capital outlay and debt service funds) was \$872.2 million. Of that total number, the cash balance for unrestricted funds was \$241.3 million; the majority of the other funds had restrictions in place, such as legislative or Federal directives on how the money could be spent.

Seen as a stand-alone number, that's a significant cash balance. Put in perspective using the average daily unrestricted funds operating expenses of the school districts, the \$241.3 million in unrestricted funds would pay the school districts' bills for about 23 days. Would a business owner consider 23 days of working capital adequate cash on hand? **That's a valid question – and one on which AGH does not offer an opinion – but it is a completely separate question than whether school districts are suitably funded.**