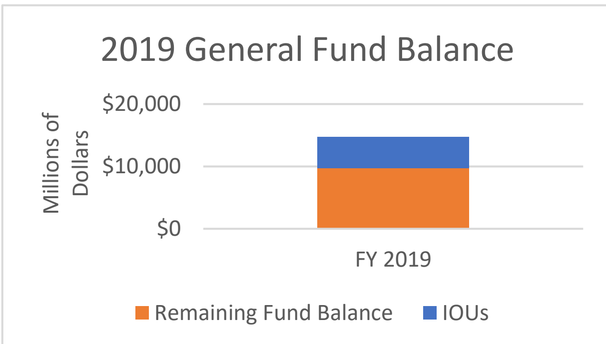
DRAFT FUND BALANCE NOTES

What is fund balance? In simple terms, fund balance is the difference between assets and liabilities in a governmental fund as of the close of the fiscal year.

How much fund balance do school districts have? Texas school districts had a total of $14.7 billion in unrestricted general fund balance as of the close of fiscal year 2019.

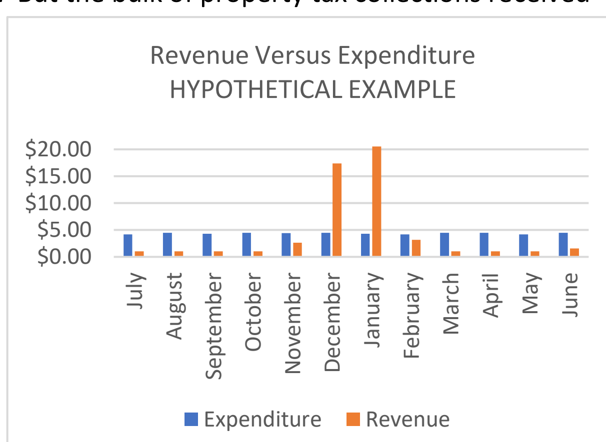
How does fund balance differ from a savings account or a rainy-day fund? Unlike a savings account, a fund balance includes revenues and liabilities anticipated, but not yet realized by a governmental entity. In 2019, for example, roughly $5 billion of school district fund balance was on school district books as an IOU, either from the state or another entity. Also included are longer-term investments and other assets like inventory. Netting against these amounts are accrued but not yet paid liabilities.



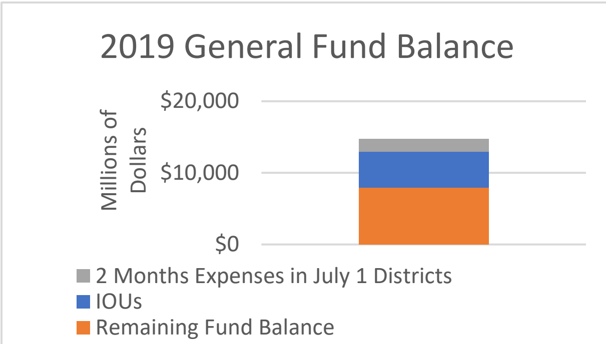
How much fund balance should school districts have? A commonly referenced rule of thumb is for school districts is three months of expenditures should be kept in fund balance. This rule of thumb is included by TEA in the Financial Integrity Ratings System of Texas (FIRST). For example, to receive full points on indicator 7, school districts need 90 days of cash on hand or current investments in the general fund.

However, district need for fund balance can vary greatly depending on cash flow needs and anticipated future costs. Two factors that can impact this need are fiscal year start dates and relative reliance on local property taxes.

Why does reliance on local property taxes matter? In most districts, monthly expenditures are relatively even as staff are paid throughout the year. But the bulk of property tax collections received between December and February. This means that districts that do not receive much state aid need to make sure they end the fiscal year with enough cash on hand to cover them through the first few months of the year, until taxes are paid.



Why does the fiscal year matter? In Texas, school districts have the option of starting the fiscal year on July 1 or September 1. A total of 85 school districts have moved their fiscal year start date to July 1. Many districts prefer this timeline because it allows them to align the start of school purchases with the budget being adopted. In these districts, fund balance needs to last for 5 months



(July through November). Many of these districts may need two additional months of fund balance as compared to districts with a September 1 fiscal year.

Fortunately, when a district moves to a July 1 fiscal year, the fund balance often increases. This is because accounting rules require the district to record 10 months of expenditures in the first year where the change takes place, but a full 12 months of revenues. Two months of expenditures for the districts that have moved their fiscal year accounts for roughly $1.7 billion of the fund balance in Texas school districts.

What are the benefits of having sufficient fund balance? Having sufficient fund balance helps school districts with a number of things. It can prevent districts from facing borrowing costs when they need to cover cash flow deficits. It results in higher bond ratings which results in reduced interest costs. It also allows the district to respond to unforeseen costs without interruptions in service. For example, when Hurricane Harvey hit the Texas coast, school districts used fund balance to cover short term costs while they waited for help from insurance and FEMA. This fund balance allowed for rapid repair of buildings, and minimal service interruption.