# Fund Balance and Related Issues

This is to inform you of the Michigan School Business Officials (MSBO) recommendations and position on the establishment and use of what is commonly referred to as a “fund balance” or fund equity.

One must be careful in generalizing about fund balances because, although there are some commonalities, circumstances vary from district to district that may affect what a fund balance represents and/or how much of a fund balance is necessary for the financial stability of a school district.

A typical fund balance in a school district is composed of three components:

1) Cash on hand – these funds may be in short term, highly liquid investments or in a checking or savings account. These funds are available for district use.

2) Accounts receivable – because of a timing difference between a school district’s fiscal year (which ends June 30) and the state’s fiscal year (which ends September 30) there are two payments out of the eleven state aid payments that are actually received after the district’s fiscal year has ended. Using accrual accounting the payments are “booked” at the end of the school district’s fiscal year and included in calculating fund balance. These funds are not available to the school district until they are actually received in July and August.

3) Inventory and pre-paid assets – includes teaching, custodial and office supplies and fuel in storage tanks. These are typically modest amounts and are obviously not available to expend.

Other considerations in discussing fund balance include:

A. The level of non-homestead tax base in the district. The 18 mill levy is only on non-homestead property. Since the main sources of funding for a district come from local property taxes and state aid the level of non-homestead property in the district determines the amount retrieved locally. If the district has a low non-homestead tax base it will result in greater funds received from the state which means the district will probably have to borrow funds to operate if their fund balance isn’t sufficient.

B. The tax collection practice of the school district. A 100% summer collection allows a district to receive the local share of its funding up front with the July tax levy. If a 50/50 collection exists they will receive half in the summer and half in the winter collection. A 100% winter collection means the local taxes are collected during the winter only.

C. The trend of the fund balance level. Districts spending more than they receive can create a structural deficit, which eventually has to be addressed. The reason for the deficit will determine the level of concern necessary. For example if fund balance is used to purchase a capital asset (buses, technology) that is preferable to spending the fund balance on recurring costs (employee costs).

D. Future obligations that will require a greater level of spending such as opening a new building, districts can build up fund balance in order to meet the increase obligations of a larger operation.

E. Declining enrollment presents a myriad of problems for a school district. The presence of a fund balance allows the district to better manage the decline.

F. The absence of sufficient fund balance will likely result in borrowing to meet cash flow needs. If a district borrows money it will pay a related interest cost, which is charged to the general operating budget.

G. The presence of a reasonable fund balance along with a stable trend in the level of fund balance is viewed favorably by the bond rating agencies. This benefits local taxpayers with lower interest costs on bonds that are issued.

H. Fund balance provides flexibility in dealing with unanticipated emergencies such as mid-year reductions in state funding.

As a general rule, MSBO recommends that districts have a fund balance of 15 to 20 percent of their budget. We selected that amount based on the above listed considerations. In simple terms this level of fund balance is necessary to avoid borrowing during the two month period between the August and October State Aid payments. Additionally it is important to have a sufficient fund balance to allow a school district to absorb cuts in sate funding such as those that have occurred in the past two years, and may occur again in the next year. Having a financial cushion allows a district to avoid drastic changes in educational programs and/or employee layoffs during the school year.