Why State Statute 14.17.505 Fund Balance in School Operating Fund should not be overridden by local municipalities.

Many of the points contained in this letter are obtained from *What Everyone Needs to Know About THE NEW FUND BALANCE,* Stephen J. Gauthier, Copyright 2009, Government Finance Officers Association of the United States and Canada.

Fund Balance, in spite of all of the attention it receives by elected officials and members of the public, remains a mysterious concept for many. Determining what is an appropriate level of "unreserved" fund balance has been a contentious discussion item for decades. Recent pronouncements and requirements imposed by the accounting establishment now require that the fund balance be more closely defined into categories that define the constraints on the specific purposes for which amounts in the fund balance can be spent. While intended to make it easier for all concerned to understand the components of the fund balance, these definitions do not alter the total amount reported as fund balance. It is our interpretation that AS 14.17.505 pertains to the entire fund balance.

Accountants use the term "fund balance" to describe the difference between the assets and liabilities report in a governmental fund. To put it in simpler terms fund balance is similar to the working capital of a private-sector business.

I will use this definition to illustrate why it is essential in times of uncertain revenues and unpredictable expenses to have the ability to utilize a fund balance to stabilize general operating fund operations.

The Government Finance Officers Association (GFOA) for years prescribed the recommended minimum fund balance to be 5% of operating expenditures; with the recent troubles within the economy the recommendation has been raised to no less than two months of operating revenues or expenditures, or 16.67%. Of course the size of the government and the volatility of the revenue and expenditures must be taken into account when a government defines the appropriate level of fund balance.

A ten year review of Alaska's funding for education reveals anything but stable funding. Over the last ten years increases in educational funding at the State level range from 0% to a high of +9.97%. This speaks to the volatile nature of the majority of funding for school districts within the State. A review of our local funding support for education, Mat-Su Borough, shows a similar level of volatility with the range from local support for educational of -2.73% to +8.01%.

While expenditures for K-12 school districts are fairly stable, there are still significant unpredictable events that can have a dramatic impact on a district's budget. For example large mid-year increases in high needs students, heavy snows, other weather related damage to buildings, large increases in the number of students, catastrophic events such as a fire at a school, large increase in the cost of employee benefits, and increases in the cost of utilities.

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How does a government build fund balance? This should occur through a directed fund balance policy that specifically directs what level of fund balance is appropriate, specifically designated by AS 14.17.505 as to not exceed 10% of operating expenditures, and directs how in any given budget year when revenues exceed expenditures the funds should be allocated. Once this policy has been established the use of any fund balance must be made in accordance with this established policy.

Fund balance funds are by definition “one-time” funds and should never be used or allocated for ongoing expenditures. For example, to grant an increase in a salary schedule using any portion of the fund balance is folly; to do so invites subsequent year operating deficits as the one-time funds are exhausted with no identified revenue source to fund the ongoing expenses. The proper use of a fund balance allows a government to build the fund balance over time and to use the funds to lessen the impact of higher than anticipated expenditures or reduced revenues.

Specifically, had our District had even a 5% fund balance we would have been able to reduce the impact of our class size increases and staff reductions that occurred last fiscal year. In our case we could have smoothed the transition to less than expected revenue over three years. We could have slowed the increase in class size by ½ student per class while at the same time saving 16 full time positions. During the transition period expenditures could have been adjusted to more closely match anticipated revenue. If it was felt that expenditures could have been reduced more quickly, then the District could have perhaps prevented the increase in class size more dramatically.

With no fund balance, all changes in revenue or expenditures occur immediately; therefore no opportunity exists for any transition. Without the ability to build a fund balance, Districts cannot plan for unforeseen events. Couple this with restrictions that force no year-end encumbrances and you force Districts to attempt to manage large complex operations with no margin for error since they are not allowed to maintain any operating capital. A 10% fund balance represents only one month of operating expenditures for most districts, 5% is only two weeks of operating expenditures. When you consider that in our District we are responsible for in excess of 17,000 students, 44 school sites, and over 2,500 employees, operating with only 1 ½ days of operating surplus, our current level of fund balance, represents an extremely high level of risk.

The maintenance of a fund balance as prescribed by AS 14.17.505 is not only reasonable but a best business practice well within the recommendations of all experts in the field of governmental finance.

In addition to the fund balance provision the fact that student count information used for funding would be known is a significant benefit for all school districts within the State.

Sincerely,

Ken A. Forrest

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