

**Manual of Accounting and Financial Reporting for
Pennsylvania Public Schools**

CHAPTER 19
TABLE OF CONTENTS

Chapter 19	19.1
Advanced Accounting Issues And Board Policies	19.1
Requirements For Accounting Changes	19.2
❖ Change In Accounting Principle	19.2
❖ Change In Accounting Estimate	19.3
❖ Reporting A Correction Of An Error	19.3
❖ Subsequent Events	19.4
Cash And Investments	19.4
❖ Definitions Of Cash And Investments	19.5
❖ Local Investment Policies	19.5
❖ Authorized Types Of Investments For School Districts	19.6
❖ Financial Statement Presentation And Disclosures	19.7
Extraordinary And Special Items	19.10
LEA Capitalization Policy	19.10
Accounting For Fund Balances	19.11
❖ What Is A Fund Balance?	19.11
Reserved Fund Balances	19.11
Unreserved Fund Balances	19.12
❖ Why A Fund Balance Should Be Maintained	19.13
❖ Determining The Size Of The Fund Balance	19.14
❖ Changes In Fund Equity	19.15
❖ Fund Balance Account Codes	19.15
❖ Fund Balance Summary	19.15

Chapter 19

Advanced Accounting Issues And Board Policies

**** Updated 5/1/05 ****

This Chapter addresses advanced accounting issues and recommendations for board policies. The following items are discussed in this Chapter:

- ❖ Reporting Accounting Changes
- ❖ Reporting Corrections
- ❖ Subsequent Events
- ❖ Cash and Investments
- ❖ Reporting and Disclosure Requirements for Investments
- ❖ Accounting for Fund Balances

Requirements For Accounting Changes

The following information, which is based on the guidance included in Accounting Principles Bulletin (APB) Opinion No. 20, summarizes accounting requirements relating to *accounting changes*. School business officials should also consult other relevant authoritative literature when consideration is given to making accounting changes.

APB Opinion No. 20 defines accounting changes as a change in the following:

- ◆ *An accounting principle* – e.g., adoption of a generally accepted accounting principle that is different from the one previously used in reporting financial information.
- ◆ *An accounting estimate* – e.g., change in useful lives of assets, the uncollectibility of receivables, estimation of the amount of inventory considered to be obsolete, and the number of future periods to be benefited by deferred costs.

The term accounting principle includes not only the accounting principles and practices used, but also the methods used to apply them.

GAAP assumes that an accounting principle will not change once it has been adopted. Frequent changes in accounting principles used or the methods of applying them reduce comparability of financial data from one period to the next. In order for an LEA to change accounting principles, it must demonstrate that the new principle is preferable. Also, the issuance of new accounting principles by standard setting bodies (i.e., a new GASB standard) may require an LEA to make a change in accounting principle.

❖ **Change In Accounting Principle**

APB Opinion No. 20 requires that the following disclosures be made in reporting a change in accounting principle:

- ◆ Financial statements for prior periods included for comparative purposes should be presented as previously reported.
- ◆ The effect on beginning fund balance / retained earnings of changing to a new accounting principle should be included in net income of the period of the change.
- ◆ The effect of adopting the new accounting principle on fund balance / income before extraordinary items and on ending fund balance / net income of the period of the change should be disclosed.
- ◆ Fund balance / Income before extraordinary items should be shown on the face of the operating statements for all periods presented as if the newly adopted accounting principle had been applied during all periods affected.

Chapter 19

Advanced Accounting Issues and Board Policies

19.2

Annual Financial Report (AFR) Requirements: Do not revise prior years' AFRs. Report the effect of the new accounting principle on beginning fund balance / retained earnings on the operating statement. Disclose the effect of adopting the new accounting principle on fund balance / income for the period of change in the note disclosures to the financial statements.

❖ Change In Accounting Estimate

APB Opinion No. 20 paragraph 31 describes requirements for changes in accounting estimates:

... the effect of a change in accounting estimate shall be accounted for in (a) the period of change if the change affects that period only or (b) the period of change and future periods if the change affects both. A change in an estimate shall not be accounted for by restating amounts reported in financial statements of prior periods or by reporting pro forma amounts for prior periods.

Annual Financial Report (AFR) Requirements: Do not revise prior years' AFRs. Report the effect of the change in estimate in the period of change and in future periods, if necessary. Do not restate beginning fund balances / retained earnings.

❖ Reporting A Correction Of An Error

The correction of an error is not an accounting change. Accounting changes occur due to a change in an accounting principle or a change in accounting estimate, as discussed above. Errors in financial statements result from mathematical mistakes, incorrect application of an accounting principle or inattention to the facts at the time of preparation of the financial statements.

Reporting the correction of an error requires the following financial statement disclosures in the period that the correction is reported.

- ◆ Retroactive restatement of prior period financial statements.
- ◆ Disclosure of the nature of the error and the effect of the correction on income before extraordinary items and fund balance / net income.

Annual Financial Report (AFR) Requirements: Restate and revise prior years' AFRs. Disclose the nature of the error and the effect of the correction on fund balance / income in the note disclosures to the financial statements. The revised AFR must be accompanied by a written letter signed by your school's chief administrative officer discussing the nature of the change. Adjust beginning fund balance of current year AFR to reflect the amount it would have been if the error had not occurred. Adjust beginning fund balance of current year AFR to reflect the amount it would have been if the error had not occurred.

❖ Subsequent Events

To ensure that the financial statements are not misleading, an LEA should consider the need to disclose subsequent events, which are events or transactions related to risk management that occur after the date of the balance sheet. Disclosure should be made for material items that have one of the following characteristics:

- ◆ The subsequent event resulted in the impairment of an asset or the occurrence of a liability (actual loss, such as damage from a tornado).
- ◆ There is a reasonable possibility that a subsequent event will result in the impairment of an asset or the incidence of a liability (contingent loss, such as the personal injuries to parties in which it has been alleged that the LEA's negligence contributed to the injuries).

If an LEA concludes that a subsequent event should be disclosed, the following information should be presented in the disclosure:

- ◆ The nature of the actual loss or loss contingency.
- ◆ An estimate (or range of estimates) of the actual loss or contingent loss (if no estimate can be made, disclose appropriately).

Cash And Investments

Cash and investments represent some of the largest assets on an LEA's balance sheet. The investment of excess LEA funds should be made with judgment, care, prudence, discretion and with diligent management. The investment of public funds should never be made for speculative purposes, but rather with consideration for the probable safety of principal and probable return on such investments.

This cash and investment section will not contemplate all of the possible investment scenarios that can be utilized by an LEA. However, following three general rules may protect an LEA from problems related to investment decisions.

- ◆ The purchase of investments should be made with the intent and ability to hold the investment to maturity if necessary.
- ◆ All investments should be made with the LEA's cash needs and cash flow forecast in mind.
- ◆ The LEA must understand the investment instrument, the investment mechanics and the associated risk of the investment. Knowledge of these factors and the variables that affect the market value of each investment will assist the LEA in determining its investment policies and strategies.

Chapter 19

Advanced Accounting Issues and Board Policies

19.4

❖ Definitions Of Cash And Investments

- ◆ *Cash* is the most liquid (readily available) asset on the financial statement. Cash includes readily available cash held by the LEA, current bank accounts and certificates of deposits.
- ◆ *Cash equivalents* are short-term highly liquid (readily convertible to known amounts of cash) investments that are so near to their maturity that they present an insignificant risk of change in value resulting from changes in interest rates. Generally, only investments with original maturities of three months and less qualify under this definition. Items commonly considered as cash equivalents are Treasury bills, commercial paper and money market funds. Investments that qualify as cash equivalents are not all required to be treated as cash equivalents. An LEA should establish a policy concerning short-term highly liquid investments (that satisfy the definition), which are to be treated as a cash equivalent. An LEA must disclose its policy for cash equivalents in notes to the financial statements. Any change in that policy represents a change in accounting principle that shall be effected by restating financial statements for earlier years presented for comparative purposes.
- ◆ *Investments* are defined as securities and other assets acquired primarily for the purpose of obtaining income or profit. Interest-bearing deposits (including certificates of deposits) with financial institutions should be treated as deposits, not as investments.
- ◆ A *security* is a transferable financial instrument that evidences ownership or creditor status. Securities that are often held by or pledged to LEAs generally include U.S. Treasury bills, notes and bonds, federal agency and instrumentality obligations, direct obligations of the State of Pennsylvania or its agencies, commercial paper, negotiable certificates of deposit, fully collateralized repurchase agreements and prime domestic bankers' acceptances.
- ◆ *Pooling of cash and investments* allows LEAs to pool their cash and investments of all funds with other entity's cash and investments. The advantages of pooling can include better physical custody and control, enhanced investment opportunities and ease of operations. Pooling cash may simplify custody, collection and disbursements. In some situations, pooling cash and investments may be prohibited in contractual clauses or through legal restrictions.

❖ Local Investment Policies

LEAs are to adopt local investment policies. The local investment policy must be written, primarily emphasize the safety of principal and liquidity, and address investment diversification, yield, maturity and the quality and capability of investment management. Each LEA should customize its policies to meet board and administrative objectives as defined. LEAs should review their investment policies and investment strategies annually.

❖ Authorized Types Of Investments For School Districts

Section 440.1(c) of the Pennsylvania School Code authorizes the types of investments school districts may have:

- ◆ United States Treasury bills;
- ◆ Short-term obligations of the United States Government or its agencies or instrumentalities. *Short-term obligations* usually refer to investments of less than 13 months.
- ◆ Deposits in savings accounts or time deposits or share accounts of institutions insured by:
 1. The Federal Deposit Insurance Corporation (FDIC), or
 2. The Federal Savings and Loan Insurance Corporation, or
 3. The National Credit Union Share Insurance Fund.

to the extent that such accounts are so insured, and for any amounts above maximum, provided that approved collateral as provided by law therefore shall be pledged by the depository.

- ◆ Obligations of the United States of America or any of its agencies or instrumentalities backed by the full faith and credit of the United States of America, the Commonwealth of Pennsylvania or any of its agencies or instrumentalities. *Full faith and credit* means the obligation is backed by the government's ability to levy taxes to repay debt. These investments include any bonds issued by the Commonwealth of Pennsylvania or any municipality or school district carrying the backing of the taxation powers of the governmental unit issuing the debt. Some investments of the Federal government do not have full faith and credit backing. Fannie-Mae (FNMA) and Freddy-Mach (FNMC) bonds do not. Ginnie-Mae (GNMA) bonds do have full faith and credit backing.
- ◆ Shares of an investment company registered under the Investment Company Act of 1940 whose shares are registered under the Securities Act of 1933 provided that the following are met:
 1. Only investments of that company are in the authorized investments for school district funds listed in the categories above, and repurchase agreements fully collateralized by such investments.
 2. The investment company is managed so as to maintain its shares as a constant net asset value in accordance with 17 CFR 270 2a-7 (relating to money market funds).
 3. The investment company is rated in the highest category by a nationally recognized rating agency.

This classification includes pooled investments such as the Pennsylvania School District Liquid Asset Fund, Pennsylvania Local Government Investment Trust and the Pennsylvania State Treasurer's Invest Program.

Chapter 19

Advanced Accounting Issues and Board Policies

19.6

In the past, some schools fell victim to investment scams, which resulted in huge financial losses. There are several things you can do to avoid a similar situation. Just a few are listed below for your consideration:

- Develop a sound board-approved investment policy. Consider the level of risk you are willing to take with taxpayers' dollars.
- Diversify investments. Think carefully before investing all of your funds with a single institution.
- Be cautious of promises of high rates of return that are above the market. Remember that the higher the rate of return, the greater the risk associated with the investment.
- Use your independent auditors to verify pool values.
- Review investment firm audits before committing funds. Although the audit report is not a form of complete protection, it should provide a level of comfort for investors.
- Ask questions before you invest to make sure you understand the terms being used.
- Minimize risk to the principal.
- Confirm that all investments are permitted by Section 440.1 of the School Code.
- Verify how the investments are being valued. Depending on the maturity date of the investment, market values and maturity values could be very different!
- Ensure your money is available to pay obligations.

❖ *Financial Statement Presentation And Disclosures*

GASB Statement #31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, was issued March 1997 and is effective beginning with the 1997-1998 Fiscal Year. GASB Statement #31 provides guidance for applying fair value to certain investment transactions.

- ◆ LEAs should report investments at fair value in the balance sheet (or other statement of financial position). Fair value is defined as the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. However, governmental entities other than external investment pools are permitted to report certain money market investments at amortized cost, provided that the fair value of those investments is not significantly affected by the impairment of the credit standing of the issuer or other factors, such as:
 1. Interest earning investment contracts maturity within one year of their acquisition by LEA,
 2. Money market investments maturing within one year of their acquisition by LEA, and

3. Interest bearing investment contracts that are unaffected by market changes.
- ◆ The Statement requires all investment income, including changes in the fair value of investments, to be recognized as revenue in the Statement of Revenues, Expenditures and Changes in Fund Balances (or other statement of activities) at the end of the fiscal year. When identified separately as an element of investment income, the change in the fair value of investments should be captioned *net increase (decrease) in the fair value of investments*. Realized gains and losses should not be displayed separately from the net increase (decrease) in the fair value of investments in the financial statements.
 - ◆ The Statement requires that you make the following *disclosures* in the notes to the financial statements:
 - The methods and significant assumptions used to estimate the fair value of investments, if that fair value is based on other than quoted market prices.
 - The policy for determining which investments, if any, are reported at amortized cost.
 - For any investments in external investment pools that are not SEC-registered, a brief description of any regulatory oversight for the pool and whether the fair value of the position in the pool is the same as the value of the pool shares.
 - Any involuntary participation in an external investment pool.
 - If an entity cannot obtain information from a pool sponsor to allow it to determine the fair value of its investment in the pool, the methods used and significant assumptions made in determining that fair value and the reasons for having had to make such an estimate.
 - Any income from investments associated with one fund that is assigned to another fund.

LEAs may also disclose realized gains and losses in the notes to the financial statements computed as the difference between the proceeds of the sale and the original cost of the investments sold.

See GASB Statement #31 for detailed information, including examples concerning reporting investments. You may request a copy of the Statement from the GASB.

GASB Statement #3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements* was issued in April 1986, and was effective for periods ending after December 15, 1986. The following are summaries of required disclosures in accordance with GASB Statement #3:

- ◆ Disclose legal or contractual provisions, including significant violations during the period.

Chapter 19

Advanced Accounting Issues and Board Policies

19.8

- ◆ Disclose insured bank balances and deposits (including certificates of deposit) as of balance sheet date by the following categories of credit risk, unless bank balances are entirely insured or collateralized with securities held by the LEA.
 - Category 1 are insured or collateralized with securities held by the entity or its agency in the LEA's name. If deposits with financial institutions are insured by the FDIC or other insurance carriers, such as deposits are classified in this category.
 - Category 2 are collateralized with securities held by the pledging financial institution's trust department or agency in the LEA's name.
 - Category 3 are uncollateralized (this includes any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the LEA's name).
- ◆ Disclose carrying amounts and market values of investments (including repurchase agreements) by category.
 - Category 1 are insured or registered securities held by the LEA or its agent in the district's name. Registered securities are those registered in the LEA's name.
 - Category 2 are uninsured and unregistered, with securities held by the counterparty's trust department or its agent in the LEA's name.
 - Category 3 are uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the LEA's name.

A counterparty is the party that pledges collateral or repurchase agreement securities to the LEA, or that sells investments to or buys them for the LEA. For collateral on deposits on financial institutions, the pledging financial institution is a counterparty. The counterparties in a repurchase agreement can include both the seller-borrower and the broker-dealer or financial institution that acquires the repurchase agreement for the LEA.

- ◆ Disclose the basis of allocation of investment and interest income to various funds.

The following important issues for GASB Statement #3 disclosures should be noted.

- ◆ Investments that are not securities are not classified in categories of credit risk. However, such investments are subject to other GASB Statement #3 disclosures such as market value (examples of this type of investments are real estate investments).
- ◆ Although three-month commercial paper and three-month U.S. Treasury Bills are both cash equivalents, they are not considered an "investment type" for GASB Statement #3 purposes. Significant differences in the forms of these investments make it necessary to present them as separate investment types in GASB Statement No. 3 disclosure.

- ◆ GASB Statement #3 does not require the classification of investments in pools managed by other governments in categories of risk, and it does not prohibit it. If the LEA possesses the necessary information in order to be able to classify investments in pools by credit risk, it can choose to do the classification in the footnote disclosure. However, if the LEA does not have such information, the amount invested in an investment pool needs to be disclosed as a separate investment type, but need not be classified under the categories of credit risk.
- ◆ Disclosure in the notes to the financial statements related to cash and investment balances required by GASB Statement #3 should be reconciled to the cash and investment balances on the face of the financial statements.

See GASB Statement #3 and the Implementation Guide for GASB Statement #3 for more guidance on Deposits with Financial Institutions, Investments (including Repurchase Agreements) and Reverse Repurchase Agreements.

Extraordinary And Special Items

Extraordinary items are transactions or other events that are *both* unusual in nature *and* infrequent in occurrence. Accounting Principles Board (APB) Opinion NO. 30 defines the terms *unusual in nature* and *infrequency of occurrence*. Extraordinary items should be reported separately at the bottom of the Statement of Activities after “general revenues.” Debt refundings of governmental funds are not extraordinary items.

Special items are significant transactions or other events *within the control of management* that are *either* unusual in nature *or* infrequent in occurrence. Special items should also be reported separately in the Statement of Activities after general revenues and before extraordinary items.

Special and extraordinary items in the Government Fund Statement Of Revenues, Expenditures, And Changes In Fund Balances should be reported separately after “other financing sources and uses.” Special and extraordinary items should be reported after nonoperating revenues and expenses in the proprietary fund Statement of Revenues, Expenditures, And Changes In Fund Net Assets.

In addition, significant transactions or other events that are either unusual or infrequent but not within the control of management should be separately identified within the appropriate revenue or expenditure category in the statement of revenues, expenditures, and changes in fund balances or disclosed in the notes to the financial statements.

LEA Capitalization Policy

Each LEA should establish a board policy for the capitalization of all capital assets and infrastructure. The board policy should list a monetary threshold and a useful life threshold. The original policy and any changes in policy must be disclosed in the notes to the Basic Financial Statements. An asset should be capitalized if it (1) has a greater useful life than a single reporting period and (2) meets your LEA capitalization policy.

Chapter 19

Advanced Accounting Issues and Board Policies

19.10

Accounting For Fund Balances

❖ What Is A Fund Balance?

The equity for Governmental and Fiduciary Funds is known as a “fund balance.” The calculation for fund equity may be reduced to a mathematical equation written as:

$$\text{Assets} - \text{Liabilities} = \text{Fund Balance}$$

The fund balance of the General Fund is of primary significance because the General Fund is the primary fund through which most functions are financed and which includes state aid and local taxes. One primary criterion of rating agencies for school bonds is the relative amount of undesignated, unreserved fund balance. Bond rating agencies view undesignated, unreserved fund balances as a reflection of the financial strength of school districts and show concern when fund balances decrease.

Governmental fund balances do not always represent cash in the bank or funds available for expenditures. Accordingly, it is necessary to determine what portions of the gross fund balance pertain to:

- ◆ Reserved fund balances;
- ◆ Designated, unreserved fund balances; and
- ◆ Undesignated, unreserved fund balances.

Fund balances are divided into two (2) parts: “reserved” and “unreserved.” A Reserved Fund Balance identifies the part of the fund balance not available for appropriation. Unreserved Fund Balance identifies the part that is available for appropriation.

The difference between assets and liabilities for Proprietary Funds is classified as either equity or net assets.

RESERVED FUND BALANCES

The term “reserve” should be used in governmental fund financial reporting only to identify the portion of the fund balance that is:

- ◆ Not available for appropriation or expenditure (for example, reserve for inventories) and / or
- ◆ Legally earmarked for a specific future use, i.e., legal restriction on the use of assets (for example, reserve for encumbrances).

For Proprietary Funds, reserves relate only to the latter item above. Generally, reserves should represent restrictions imposed by external parties of the school district. The amount and nature of the reservation of fund balance should be

disclosed on the face of the financial statements. The description may need to be supplemented by disclosure in the notes to the financial statements.

Examples of reservations of fund balance are as follows:

- ◆ Inventories
- ◆ Retirement of Bonded Indebtedness
- ◆ Endowments
- ◆ Prepaid Items
- ◆ Outstanding Encumbrances
- ◆ Construction
- ◆ Federal and State Programs

The aggregate fund balance in the debt service fund is legally reserved for payment of bonded indebtedness and is not available for other purposes until all bonded indebtedness is liquidated. The fund balance of the capital projects fund reflects an amount designated for construction and major renovation projects, and it usually represents unexpended proceeds from the sale of school building and revenue bonds, which primarily have restricted uses.

Valuation accounts, such as the allowance for uncollectible property taxes, should not be referred to in the financial statements as a reserve. Likewise, estimated liabilities or deferred revenues should **not** be classified as reserves. Amounts that are properly classified as fund balance reserves should be reported as part of the fund balance section of the balance sheet and not placed somewhere between the liability section and the fund balance section.

UNRESERVED FUND BALANCES

The Unreserved Fund Balance is the difference between the total fund balance and the reserved fund balance. The Unreserved Fund Balance is not legally restricted and has two (2) components, **designated and undesignated**. Generally, the fund balance that has the flexibility for legal appropriation and expenditure for general operating expenditures is found in the General Fund.

1. Designated Unreserved Fund Balances

Portions of the fund balance may be identified, i.e., designated, by management to reflect **tentative** plans or commitments of governmental resources. Designations require board action to earmark fund balance for bona fide purposes that will be fulfilled within a reasonable period of time. These tentative amounts are not the same as fund balance reserves since they represent planned actions, not actual commitments. Such plans may change and never be budgeted or result in expenditures in future periods of time. A fund balance reserve arises from statutory requirements or actions already taken by the LEA. For this reason, designated amounts should not be classified with fund balance reserves but rather should be reported as part of the unreserved fund balance.

Chapter 19

Advanced Accounting Issues and Board Policies

19.12

The amount and nature of the designated fund balance should be explained in:

- ◆ A separate line in the balance sheet;
- ◆ A parenthetical comment; or
- ◆ A note to the financial statements.

NOTE: Designations should be reported on the face of the balance sheet only in connection with governmental funds. The term designation is used in risk-financing internal service funds when premiums are collected which include estimates of anticipated future catastrophic losses. However, this designation is included in the notes to the financial statements rather than on the face of the balance sheet.

Designations may be related to items such as:

- ◆ Construction
- ◆ Claims and Judgments
- ◆ Capital Expenditures
- ◆ Self-insurance Contingencies

2. Undesignated Unreserved Fund Balances

Undesignated unreserved fund balances are the difference between the unreserved fund balance and the designated unreserved fund balance. This portion of the fund balance is usually available to finance monthly operating expenditures. The fund balance having the flexibility for legal appropriation and expenditure for general operating expenditures is found in the General Fund.

Prudent financial management requires accumulating an undesignated unreserved fund balance in the General Fund in an amount that is adequate to cover net cash outflows that occur in virtually all schools during most of the fiscal year. Additionally, users of the financial statements should be careful to distinguish between cash, cash flows, and fund equity. Cash is only one (1) of the asset accounts that affect the amount of undesignated unreserved fund balances.

❖ **Why A Fund Balance Should Be Maintained**

An unreserved fund balance should be maintained to accommodate unforeseen expenses that may occur for any reason throughout the fiscal year. These expenses could occur for a number of reasons. Some examples of unforeseen expenses are:

- **Uncertainty in state funding.** State funds may be delayed for a period of time, leaving districts to finance costs in the meantime with their own funds.
- **Lack of state funding.** There may be a lack of appropriation on the state's behalf. In this case, districts would not be able to rely on state funds.

- **Self-insurance.** School districts may carry large insurance deductibles in order to lower premiums. Other school districts may assume added risk when self-insuring health, dental or other types of required insurance.
- **Contingencies.** Unanticipated emergencies such as epidemics, floods, fires or other catastrophes.
- **Periodic large expenditures.** Large anticipated plant expenditures, such as a boiler replacement, can be financed through a fund balance that has been built up over several years for this purpose.

A further use of an unreserved fund balance is as a source of revenue to replace local taxes in a district's budget. By maintaining a fund balance, the district would be able to finance projects using their own funds rather than increasing taxes. This also is a good short-term approach to abate the size of an overly large fund balance.

However, the misuse of fund balances could result in financial disaster. Unreserved fund balances should never be used as a source to finance ongoing expenses. They are to be used for one-time unforeseen expenditures that were not accommodated in the budget. Many school districts have experienced financial trouble by misappropriating fund balances. "For the equivalent of each mill of tax taken from the fund balance to be used to balance the local budget, at least two (2) mills of tax increase will be required in the subsequent years to maintain a balanced budget: One (1) mill to offset the fund balance used and no longer available and one (1) mill to pay for the ongoing expenses included in the budget."¹

❖ Determining The Size Of The Fund Balance

Pennsylvania has no specific set of rules mandating the size of an LEA's unreserved fund balances. Since the Commonwealth does not have a legal requirement governing the size of fund balances, individual LEA governing boards should establish their own policies and requirements governing fund balance levels. The goals, objectives and strategic plan of the district should be considered when establishing a fund balance level policy. LEAs are required by law to present a balanced budget. Section 687 of the Pennsylvania School Code of 1949 prohibits deficit financing; the total amount of such budget shall not exceed the amount of funds, including the proposed annual tax levy and state appropriation, available to the district. Throughout the year, when projected revenues exceed projected expenditures, an increase in fund balance will be generated.

Section 688 of the PA Public School code states that: For the 2005-06 school year and beyond, no school district shall approve an increase in real property taxes unless it has adopted a budget that includes an estimated ending unreserved undesignated fund balance as a percentage of total budgeted expenditures that is less than the amounts listed in the law. Refer to this section of the school code for the percentages and other pertinent information regarding this issue.

¹ Principles of Sound Fund Balance Management. Sandra M. Vidlicka, D.Ed., Pennsylvania Association of School Business Officials, Harrisburg, Pennsylvania 1994. Page 8

Chapter 19

Advanced Accounting Issues and Board Policies

19.14

❖ Changes In Fund Equity

Changes in fund balances should be presented on the Statement of Revenues, Expenditures and Changes in Fund Balances (or net assets for proprietary funds). The school district can show the change in the total fund balance or the unreserved undesignated fund balance. If changes in total fund balance are presented, material changes in reserved or designated fund balances should be disclosed in the notes to the financial statements.

❖ Fund Balance Account Codes

The balance sheet account codes listed below are described in detail within the Balance Sheet section of the Chart of Accounts.

<u>CODE</u>	<u>DESCRIPTION</u>
0750	Fund Balance Reserves
0751	Reserve for Inventories
0752	Reserve for Prepaid Expenses
0753	Reserve for Encumbrances Control Account
0754	Reserve for Retirement of Long Term Debt
0755	Reserve for Capital Projects
0759	Reserve for Other
0770	Unreserved Fund Balance
0771	Unreserved – Designated
0772	Unreserved – Undesignated

❖ Fund Balance Summary

The fund balance is a tool that can provide flexibility and control for expected and unexpected events. It can also reduce or eliminate the need for short-term borrowing. A healthy fund balance can also lead to a better credit rating for your school.

Each LEA should establish a written board policy concerning the level of fund balance to be maintained. The policy should be consistently applied, understandable, and relevant. When setting a policy, it is important for the district to examine its fund balance in relation to sound budgetary practices. Some schools use a 5 percent of total revenue figure, while other schools base their fund balances on a measure of expenditures estimated over a certain time frame, such as 60 days.

Levels of fund balance do not necessarily determine how well or how poorly your school manages funds. However, the amount may say something about how your school budgets revenues and expenditures.

A fund balance provides flexibility and control, can affect your school's credit rating, and can be invaluable when unexpected situations occur.