

UNDERSTANDING SCHOOL



FINANCE

Presented by: John O'Keefe, Deputy Superintendent

What is a school district budget?

State law requires the Board of Education to budget its income and expenses each year and to make the budget available for public inspection before final adoption. The annual budget serves **three major purposes**:

1. The budget represents a plan for receiving and expending money. It tells the school Board, its employees, and the public how much the school district can spend during the year and for what purposes.
2. The budget provides information necessary to determine the amount of school taxes that must be levied on real property, and how much the district expects to receive from state and federal governments.
3. The budget also satisfies a minimum level of financial and program information for local, state, and federal governments, meets requirements imposed by State law, and provides both expending and taxing authority.

A school district budget is actually **many budgets rolled into one**, i.e., the budget consists of a number of major funds or accounts specifically defined by how the money is collected, held, and spent. Among them are:

- **Instruction**
- **Operations and Maintenance**
- **Debt Service**
- **Transportation**
- **Capital Projects**
- **Special Education**
- **Extra-Curricular Activities**
- **BOCES Services**
- **Employee Benefits**

The single largest component is the Education expenses. In addition to all of the direct costs of instruction (teachers' salaries, etc.), this fund includes any expenditure not specifically covered in another fund. While the Board of Education may, from time to time, make transfers between various items in any one fund, there are limitations to these transactions. Changes may also be made, again with Board approval, to transfer money between certain operating funds. Neither of these actions will necessarily improve the financial health of the district. However, they can be used to maintain cash flow, to meet timely payments, and to avert or defer costlier options.

Who decides what goes into the budget?

- Some of what goes into the school district budget is determined by the Board of Education, based on the advice of its Administration, Professional Staff, advisory committees, and local citizens.
- More and more budget decisions, however, are forced on the Board by factors beyond its control, including literally hundreds of State and Federal mandates; the majority of which are unfunded.
- Each year the District Administrators gather information from a variety of sources to present the school Board with a proposed budget.
- After carefully reviewing the budget, the Board gives tentative approval and puts it on file for public inspection. The Board gives final approval of the budget only after a public hearing.
- The timeline for developing a tentative budget to its adoption varies from district to district. Numerous factors are at work throughout this seemingly simple process. Some of these factors affect school income, some affect expenses. Taken together, these factors represent the financial cards dealt to each school Board.

How is school income determined?

Three major factors determine the amount of money available for the school budget. They are as follows:

Property values — The total property value in a school district determines how much revenue the district is capable of raising from property taxes. Some school districts have very high property values, sometimes including utilities or industries. Others have low property values.

Tax rates — Like property values, tax rates play a key role in determining the amount of a school Board's local revenue. Additionally, tax rates are also beyond the school Board's control. Property values are set by the marketplace and the assessor.

State appropriations and federal aid — Each year the State appropriates a fixed amount of dollars for the schools. The majority of the revenue is received from the State through a mechanism known as Foundation Aid. There are additional categorical aid funds to support such things as transportation, special education, school nutrition programs, and building renovation or construction projects.

Where does school income go?

A school district consists of people, buildings, equipment, and supplies. Thus, a typical school district in a typical year will spend about two-thirds of its income to compensate employees and about one-fourth to heat, light and maintain its buildings. The money that remains — usually less than 10 percent — goes mostly for equipment and supplies.

Another way to look at the school district budget is by type of program or activity. A typical school district spends 50 percent of its funds on student instruction, plus another 15 percent on other student and community services.

Insurance, utilities, maintenance, supplies, and other fixed charges usually amount to more than 20 percent. Capital outlay, retirement, interest, administration, and other costs consume the remaining five to fifteen percent. Numerous factors affect where a school district's income goes. For example:

- Instructional costs vary with the number of teachers in relation to the number of students (class size) and the amount of compensation (salaries and benefits) paid to the average teacher;
- Operating costs vary with the number, size, age, and relative energy-efficiency of school buildings;
- Bond and interest costs, i.e., borrowing and the cost of borrowing, vary with the amount of long-term and short-term debt;
- Other costs vary with the variety and number of programs and services offered to students and the community.

How can schools reduce costs?

But what happens when local taxes, and state and federal aid don't cover the cost of essential school services?

What choices does the school Board have if state or federal funding is reduced, local property wealth declines, or voters won't raise taxes?

- Schools can realize small savings by cutting back on supplies, postponing improvements or maintenance, lowering utility expenses, cutting staff by attrition, combining duties, eliminating extra-curricular activities, or by reducing other services available to students or the community.
- However, to make significant or broad cost reductions, a school Board must look to its major expenses – people and buildings. Only by eliminating jobs or closing buildings can a school Board make significant budget cuts.

If the Board opts to eliminate teaching jobs or close buildings, curriculum and class sizes may be severely impacted. Unless enrollment is declining, these cuts will severely strain the system. Class sizes will grow; facilities will have to be shared; equipment will wear out faster; and maintenance needs/costs will increase. More importantly, individual and overall student performance could be compromised if curriculum cuts are deep or long lasting.

That's why many school administrators keep updated reports and long-term data on population projections, community development, the job market and labor costs, utility capacity and delivery, land values, and housing markets. This data can be highly useful in the district's strategic planning.

Neither may reduce the frequency or timing of economic downturns, but they can reduce the severity or duration. In the short term, the school Board can control costs only by limiting the amount spent for each teacher, each program, each building, its equipment, and supplies, and ultimately the amount spent on each student. While it may find some success in limiting expenses or negotiating wage and benefit concessions, the Board is still required to meet state and federal education standards.

In addition to the needs of the regular student population, schools have to provide services or facilities for the handicapped, those who speak little or no English, special education students, truants, and children with other needs.

State and federal law also require food service, driver's education, pupil transportation, and other services whose costs are not entirely subsidized with outside funds. Before making any decisions to reduce or cut any service, program, teacher or building, school Boards first listen to parents, taxpayers, teachers, and administrators. The Board may have a clear vision for the community wants and needs, but it is the Board's responsibility to find the support for this vision and to deliver it.

What is a Reserve Fund?

The simplest way to describe reserve funds is that they are a kind of savings account for school districts. They are often informally referred to as "rainy day" funds.

At the end of the school year, if a school district has excess funds (as a result of not spending its entire budget or receiving more revenue than anticipated) its options for using those funds are prescribed by the laws and regulations of New York State.

The amount of money the district may keep in the bank without designating it for a specific purpose — consequently called an "unreserved" or "undesigned" fund balance — is capped at four percent of the regular school budget.

All other funds must either be returned to the taxpayers by reducing the following year's tax levy, or appropriated into a reserve fund.

When money is put into a reserve fund, it can only be expended for the specific purpose of the fund. For example, money in a Worker's Compensation Reserve Fund can only be used to pay for claims and expenses related to workers' compensation.

The reason why districts have reserve funds is very much the same as the reason why individuals put some of their discretionary income into savings - to set money aside for a later time when it may not be available, or to avoid using regular income for special, non-recurring expenses.

The difference is that school districts are required to specify which expenses are anticipated and to dedicate the funds for that purpose. A reserve fund earns interest, much like a savings account.

Types of Reserve Funds

State law authorizes schools to establish and maintain a limited variety of reserve funds, such as:

- ✓ **Workers' Compensation Reserve**
- ✓ **Unemployment Insurance Reserve**
- ✓ **Repair Reserve**
- ✓ **Capital Reserve**
- ✓ **Employee Benefit Accrued Liability Reserve (EBALR)**
- ✓ **Employees Retirement System (ERS) Reserve**

The "Controversy" about Reserve Funds

Reserve funds have been in the news in the last few years. New York State Comptroller Thomas DiNapoli first reported in 2009 that, in his view, excessive amounts of money were being held in school district reserve funds across the state. The implication was that property taxes could be lower if school districts held less money in reserve. In 2011, Gov. Cuomo has revived this debate by stating that school districts with reserve funds should use them to mitigate the effects of reductions in state education aid.

School districts have generally objected to this view of reserve funds for several reasons:

- strong reserve funds are generally acknowledged as a sign of fiscal health;
- reserve funds may be beneficial in navigating through a severe economic downturn, like the one we are experiencing now, but expending them all at once could severely damage a school district's long-term fiscal health;
- the state has changed its own long-held policy of encouraging school districts to build up their reserve funds. Because each school district has different needs and different ways of addressing them, how much is "too much" is clearly a variable and subjective judgment which, under state law, is left to the discretion of local school Boards.

Summary

Reserve funds enable school districts to appropriate money for long-term needs. Used judiciously, they help maintain a district's fiscal integrity. They can also contribute to keeping budget increases moderate and steady by using savings instead of operating funds for unusual and/or large expenses.

What is Fund Balance?

School officials are often asked about fund balances, an aspect of fiscal management which is unique to public entities like school districts. Because a fund balance is often mistaken for a "surplus", it may seem unnecessary to have it in the budget. The concept is fairly complicated, so we offer the following (relatively) simple explanation of how fund balances, when properly managed, can be an effective budgeting tool and beneficial to taxpayers.

SCENARIO:

A school district has an annual budget of \$40 million. It levies \$40 million in property taxes. At the end of the school year, it finds that it has only spent \$39 million. The \$1 million that was not spent is called a "fund balance" because it's the balance that's left in the general fund at the end of the fiscal year.

What can the district do with the \$1 million that's left over? Its options under the law are these:

1) Put the money in a "reserve account", which is like a savings account except that it has a specified purpose (e.g., capital improvements, workers' compensation, employee retirement obligations). A district may not put this money in a regular bank account and just leave it there.

ADVANTAGE: A lump sum like this may not come again.

DISADVANTAGE: Once reserved, the money cannot be used for any other purpose.

2) Apply the money to the following year's budget. In other words, use the leftover \$1 million as a revenue source that reduces the amount of money the district has to raise in taxes in the following year.

ADVANTAGE: Lowers the tax liability for one year.

DISADVANTAGE: After the first year, the tax benefit will turn into a liability unless it is repeated annually.

HOW COULD NOT HAVING A FUND BALANCE BE A LIABILITY?

Let us follow the scenario:

The school Board does not like the idea of having any money left over at the end of the year. So, in year two, with a \$1 million increase in costs, the budget is kept to \$40 million (remember, only \$39 million was spent in year one). The "leftover" money from year one is used to reduce the tax levy from \$40 million to \$39 million — in other words, even though spending goes up, taxes decrease by 2.5 percent. Everybody is happy.

But keep this in mind: The district projects \$40 million in expenditures; levies only \$39 million in taxes; uses the \$1 million "leftover" from the previous year; and plans to have no fund balance at the end of year two.

At the end of year two, the district finds that it has spent precisely \$40 million, with nothing left over. Exactly as planned.

In year three, rising costs push the budget up another million to \$41 million. Without a fund balance to apply as revenue, the tax levy jumps from \$39 million to \$41 million: an increase of more than 5 percent. The Board has a difficult time explaining why there is a greater than 5 percent increase in taxes when spending only increased by 2.5 percent. The budget is defeated.

HOW COULD THIS HAVE BEEN AVOIDED?

If the district had planned for a \$1 million fund balance at the end of year two, the budget would have been \$41 million and the tax levy would have been \$40 million (instead of \$39 million), about a 2.5 percent increase. In year three, with another increase of \$1 million, again about 2.5 percent, the tax levy would have kept rising at a steady rate, in parallel with spending increases, instead of jumping 5 percent in one year.

BUT ONCE THE FUND BALANCE IS ELIMINATED, AREN'T WE BETTER OFF?

Eliminating the fund balance is a good thing only if the district spends exactly the amount that is in the budget every year. However, in the real world, this does not happen; good budget management will always leave at least a small amount left over. In addition, by cutting it too close, there is always a risk of going over budget.

By law, districts cannot borrow money to cover a budget deficit. In an emergency, unless the district had set aside money in a reserve fund that could be used for that particular kind of emergency the district would have to make immediate cuts to personnel, programs, or transportation in order to meet its obligations and balance the budget.

CONCLUSION:

Fund balances help school districts to keep their finances steady from year to year without running the risk that unforeseen events will disrupt the delivery of educational services to children.

How Are Property Taxes Calculated?

It ought to be simple ... if the school budget increases by a certain amount, school taxes should go up by that same amount. However, school spending is just one of a number of factors that influence the actual school taxes that property owners pay. In fact, school spending is the only part of the property tax scenario over which the school district has direct control.

Individual property taxes are determined by this equation:

$$\text{Assessed value} \times \text{tax rate} / 1000 = \text{property tax}$$

Tax Levy - The total amount of property taxes a school district must collect to balance its budget, after accounting for all other revenue sources including state aid. The tax levy is the basis for determining the tax rate for each of the cities, towns, or villages that make up a school district.

Tax Levy Limit – A calculated tax levy amount (based on a state provided formula) that sets the threshold by which a district is able to raise taxes for the upcoming school year with a simple majority vote. Despite its name ("**2% Tax Cap**"), there is **NO** fixed number that is the limit, but rather it will vary from district-to-district from year-to-year based upon the state formula.

Maximum Allowable Tax Levy – The tax levy limit plus certain allowable exclusions. Exclusions include items such as: voter approved capital expenditures and increases in state-mandated school district contribution rates for teacher and employee pension systems that exceed two percentage points.

Assessed Value - This is the dollar value placed on a parcel of property by the Assessor's Office. It is computed by analyzing thousands of individual sale transactions, thousands of inspections and a thorough study of all the neighborhoods in a given community. It is the Assessor's estimate of market value. It is important for maintaining equity between and among all taxpayers.

Tax Rate – The tax bill continues to be calculated by using a property's assessed value (as determined by the local town assessor) and the tax rate, or the amount paid in taxes per \$1,000 of assessed value. The tax rate is the total school tax levy divided by the total assessed value of property in the school district as determined by the local taxing authority (i.e. municipality, County, etc.). The Tax Rate is the proportionate amount that the home owners pay of the total Tax Levy.

There are many variables that influence tax bills that are beyond the control of the school district, which has authority over **only one factor** concerning property taxes, which is the **tax levy**. Only if an individual home's assessed value increases or decreases at exactly the same rate as the community overall does the homeowner's tax bill change at the same rate as the tax levy.

Changes in assessed valuation do not change how much tax revenue the school district receives. Whatever amount the tax levy is, that is precisely the amount that will be collected from taxpayers. If there are changes in the community's overall assessed value — whether from changes in market conditions, new properties being developed, or individuals filing tax grievances — tax rates will be adjusted to ensure that the district receives no more and no less than the amount that was levied.

For example, if the total assessed value of all homes in the school district decreased by 12 percent in a particular fiscal year, and an additional 4.3 percent in the following fiscal year, there would need to be a corresponding increase in the tax rate to ensure that tax revenues for the school district were not affected.

Why Is My Tax Increase Usually Different from the Budget Increase?

At the time of the annual budget vote in May, the school district provides to voters an estimate of the tax levy and tax rate based on the best information available prior to that date. By the time the Board of Education sets the tax levy in August, however, the estimated amounts may be different for a variety of reasons that are mostly beyond the district's control.

In the first place, the change in the tax levy is often different from the change in the budget because revenues do not rise and fall in direct proportion to changes in spending. It is possible for the tax levy to increase even if there is no increase in the school budget; for example, if state aid revenues decline from the previous year, the tax levy would rise by the same amount, unless the district is able to make up the shortfall through other sources of revenue.

School spending is the only part of the property tax equation that is directly controlled by the school district. There are a number of other reasons why the change in your tax bill may not be the same as changes in the budget or the tax levy:

- Total assessed valuation for the community can change because of new properties entering the county tax rolls, or because of homeowners' assessment challenges. Remember the equation: a higher total assessed

value in the overall community means a lower tax rate for the community as a whole, while a lower total assessed value means a higher community-wide tax rate.

- If a homeowner makes improvements to his or her home, the increased assessed value of that home will result in a larger tax bill for that particular homeowner. Conversely, if a homeowner successfully challenges his or her assessment, the reduced assessed value may result in a lower tax bill.
- The school district may receive more or less in state aid than was originally projected before the budget vote. If the state budget is late, school districts don't always have an accurate projection of state aid by the time of the budget vote. If the district is notified in June or July that it will receive more aid than anticipated, for example, the school Board may lower the tax levy accordingly, and vice versa.

How Are Property Taxes Collected?

Property taxes are collected by the Receiver of Taxes, and are distributed to the school district in periodic payments during the school year.

Conclusion

No guide can be expected to be fully inclusive of all the details and nuances of law that control the operations of a school district. We hope that this overview has been helpful in explaining some of the arcane aspects of public school finance. The Sachem CSD Administration and Board of Education welcome your questions and commentary, as this open dialog is key to developing an understanding of the entire process so that we continue to deliver the best possible programs to the children we have the privilege to serve.