

Date of Hearing: May 13, 2015

**ASSEMBLY COMMITTEE ON EDUCATION**

Patrick O'Donnell, Chair

AB 1318 (Gray) – As Amended May 6, 2015

**SUBJECT:** School finance: school districts: annual budgets: reserve balance.

**SUMMARY:** Makes various changes to existing law regarding school district assigned and unassigned ending fund balances. Specifically, **this bill:**

- 1) Specifies that the requirement to disclose, at a public hearing, the assigned and unassigned fund balance and the reasons for exceeding the minimum recommended balance takes effect when the assigned and unassigned ending fund balance in the General fund and Special Reserve Fund for Other than Capital Outlay Projects exceed the recommended minimum.
- 2) Requires the public disclosures to include a description of the purposes of the amounts in the assigned and unassigned ending fund balances in each fund.
- 3) Requires each school district governing board to adopt a policy setting the amounts of assigned and unassigned balances the governing board expects to be necessary to address economic uncertainties, funding volatility, cash flow, and savings for expenditures.
- 4) Deletes the requirement to make these disclosures when a budget is revised.
- 5) Specifies that each county superintendent of schools, when conducting his or her review of school district budgets, to determine whether the adopted budget includes a combined assigned and unassigned ending fund balance in the district's general fund and special reserve fund or other than capital outlay projects.
- 6) Changes the cap on assigned and unassigned reserves that takes effect in specified years from two times the minimum reserve for districts with fewer than 400,000 average daily attendance (ADA) and three times the minimum for districts with more than 400,000 ADA to unspecified amounts.
- 7) Makes other nonsubstantive changes.

**EXISTING LAW:**

- 1) Requires, beginning in 2015-16, the governing board of a school district that proposes to adopt a budget that includes a combined assigned and unassigned ending fund balance in excess of the minimum recommended reserve for economic uncertainties adopted by the State Board of Education (SBE) to provide the following for review and discussion at a public hearing:
  - a) The minimum recommended reserve for economic uncertainties for each fiscal year identified in the budget;
  - b) The combined assigned and unassigned ending fund balances that are in excess of the minimum recommended reserve for economic uncertainties for each fiscal year identified in the budget; and

- c) A statement of the reasons that substantiates the need for an assigned and unassigned ending fund balance that is in excess of the minimum recommended reserve.
- 2) Establishes the Public School System Stabilization Account (PSSSA) at the state level to be funded by a transfer of capital gains-related tax revenues in excess of 8 percent of general fund revenues.
- 3) Specifies that funds will be appropriated from the PSSSA to schools and community colleges when state support for K-14 education exceeds the allocation of general fund revenues, allocated property taxes and other available resources.
- 4) Requires school districts to maintain the following minimum reserves for economic uncertainties, as a percentage of total expenditures:
  - a) The greater of 5% or \$64,000 for districts with 0 to 300 average daily attendance (ADA);
  - b) The greater of 4% or \$64,000 for districts with 301 to 1,000 ADA;
  - c) 3% for districts with 1,001 to 30,000 ADA;
  - d) 2% for districts with 30,001 to 400,000 ADA; and
  - e) 1% for districts with 400,001 and over ADA.
- 5) Limits the amount that districts may set aside in an assigned or unassigned reserve in the fiscal year following the fiscal year in which a transfer is made to the PSSA as follows:
  - a) For school districts with 400,000 or fewer ADA, the minimum reserve multiplied by 2; and
  - b) For school districts with more than 400,000 ADA, the minimum reserve multiplied by 3.
- 6) Authorizes a county superintendent of schools to grant a school district under its jurisdiction an exemption from the reserve cap for up to two consecutive fiscal years within a three-year period if the school district provides documentation indicating that extraordinary fiscal circumstances, including, but not limited to, multiyear infrastructure or technology projects, substantiate the need for a combined assigned or unassigned ending fund balance that is in excess of the minimum reserve.
- 7) Requires a school district, as a condition of receiving an exemption to do all of the following:
  - a) Provide a statement that substantiates the need for an assigned and unassigned ending fund balance that is in excess of the minimum;
  - b) Identify the funding amounts in its budget that are associated with the extraordinary fiscal circumstances; and
  - c) Provide documentation that no other fiscal resources are available to fund the extraordinary fiscal circumstances.

**FISCAL EFFECT:** Unknown

**COMMENTS:** School districts use assigned and unassigned reserves to set funds aside for potential future use. An unassigned reserve is typically the reserve for economic uncertainty, and its purpose is to provide a cushion against unforeseen shortfalls in revenue or increases in expenditures. An assigned reserve contains funds that may be set aside by the district superintendent and designated for a specific future use, such as a large, one-time instructional materials acquisition.

Existing law requires districts to maintain a minimum reserve, specified as a percentage of total expenditures, but does not impose a cap on reserves except in the year following a transfer to the PSSSA, also referred to as the Proposition 98 reserve account. As a consequence of no cap, some districts have accumulated very large reserves, mounting to 50% or more of total expenditures. Some have noted that this violates a basic tenet of public finance, which is that today's tax revenues should be used to support programs and services for today's taxpayers. The cap on reserves in specified years was enacted in part to prevent the accumulation of unreasonably large reserves and in part to recognize that the transfer of funds into the state-level Proposition 98 reserve reduces the need for large local reserves. This is because the state-level reserve will be used to help maintain K-14 funding during economic downturns, a purpose previously served by the local reserves for economic uncertainty.

*Concerns have been raised about the cap on reserves.* Many in the education community have raised concerns about the cap on school district budget reserves. The concerns focus on two primary issues. First, opponents of the cap argue that it prevents districts from setting aside prudent reserves to guard against an economic downturn and a reduction in state funding for schools. The minimum requirement to guard against such an event is 3% of total expenditures for most districts. The cap is twice that amount, or 6% of total expenditures for most districts. Supporters of the cap argue that 6% is sufficient protection, because (1) it is applied only in a year following a year in which funds are deposited in the state Proposition 98 reserve, and (2) the state reserve serves the same purpose as the local reserve—to provide a cushion against a reduction of revenue to schools. Hence, the state reserve reduces the burden placed on local reserves for this purpose.

Opponents of the reserve cap also argue that it prevents districts from setting aside monies for a specific purpose in future years. For example, districts may need to accumulate monies over two or more years to purchase technology, instructional materials, or deferred maintenance. Districts may use an assigned reserve for this purpose, however assigned reserves are also subject to the cap.

*Unintended consequence?* Existing law requires districts to disclose, at a public hearing, the amount of their reserves and the reasons for them when the adopted and revised budget contains reserves in excess of the recommended minimum. In the absence of specification, existing law has been interpreted to refer to General fund balances. **This bill** specifies the General fund and the Special Reserve Fund for Other than Capital Outlay Projects. Adding an additional fund subjects more dollars to the reserves and increases the likelihood that districts will exceed the minimum, thus triggering the disclosure requirements. This may also increase the likelihood of districts exceeding the reserve cap in years when the cap is in effect. Put another way, it could be more difficult for districts to stay within the cap. The author's office has not provided the committee with any information regarding the purpose of this change.

*Unspecified changes.* This bill changes the cap on budget reserves to unspecified amounts. The author's office has not indicated what the new cap might be.

*Related legislation.* AB 1048 (Baker), which is pending in the Assembly Education Committee, repeals the cap on budget reserves. AB 531 (O'Donnell), which is pending in the Assembly Appropriations Committee, specifies that that committed reserves are not subject to the cap and defines committed reserves as monies set aside for a future purpose by a majority vote of the district governing board. A committed reserve serves the same purpose as an assigned reserve, but, unlike an assigned reserve, requires a vote of the governing board.

**REGISTERED SUPPORT / OPPOSITION:**

**Support**

Ceres Unified School District  
Yosemite Community College District

**Opposition**

None received

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