
SENATE COMMITTEE ON EDUCATION

Senator Benjamin Allen, Chair

2017 - 2018 Regular

Bill No: AB 235 **Hearing Date:** July 12, 2017
Author: O'Donnell
Version: March 27, 2017
Urgency: No **Fiscal:** Yes
Consultant: Ian Johnson

Subject: School finance: school district annual budgets: reserve balances

SUMMARY

This bill adds a minimum fund balance in the Public School System Stabilization Account (PSSSA) to the conditions that must be met for the cap on school district reserves to be triggered and exempts small and basic aid school districts from the reserve cap requirement.

BACKGROUND

Existing law places a cap on school district reserves in years following a deposit in the PSSSA, established by Proposition 2 (2014). Additionally, districts are required to disclose certain information about their reserves each year. Specifically, in a fiscal year immediately after a fiscal year in which a transfer is made to the PSSSA, a school district budget that is adopted or revised may not have a combined assigned or unassigned ending fund balance that is in excess of the following:

- 1) For school districts with fewer than 400,000 units of average daily attendance (ADA), the sum of the school district's applicable minimum recommended reserve for economic uncertainties adopted by the State Board of Education (SBE), as specified, multiplied by two.
- 2) For school districts with more than 400,000 units of ADA, the sum of the school district's applicable minimum recommended reserve for economic uncertainties adopted by the SBE, as specified, multiplied by three.

Existing law authorizes a county superintendent of schools to grant a school district under its jurisdiction an exemption from the 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, multi-year infrastructure or technology projects, substantiate the need for a combined assigned or unassigned ending fund balance that is in excess of the minimum recommended reserve for economic uncertainties. As a condition of receiving an exemption, a school district shall do all of the following:

- 1) Provide a statement that substantiates the need for an assigned and unassigned ending fund balance that is in excess of the minimum recommended reserve for economic uncertainties.

- 2) Identify the funding amounts in the budget adopted by the school district that is associated with the extraordinary fiscal circumstances.
- 3) Provide documentation that no other fiscal resources are available to fund the extraordinary fiscal circumstances.

ANALYSIS

This bill:

- 1) Provides that the cap on local school district reserves will be imposed whenever the level of funding in the Public School System Stabilization Account (PSSSA) is equal to or exceeds 3 percent of the combined total General Fund revenues and local proceed of taxes for school districts for that fiscal year.
- 2) Clarifies that the cap applies to the total of assigned and unassigned ending balances in the general fund accounts of school districts, including in the Special Fund for Other Than Capital Outlay.
- 3) Exempts basic aid districts and small school districts from the cap.
- 4) Requires the Superintendent of Public Instruction to notify school districts and county superintendents of schools when the conditions for imposing the reserve cap have been met and when they are no longer in effect.

STAFF COMMENTS

- 1) ***Need for the bill.*** According to the author, “Neither the Department of Finance nor the Legislative Analyst forecast that the reserve cap will be in effect in the foreseeable future. However, if imposed, a cap could impose a hardship on small districts, which have small budgets. A 6 percent cap on such districts would result in a small dollar reserve that may not provide adequate protection against economic uncertainty.

The cap could also pose a unique hardship for basic aid districts, which do not receive Local Control Funding Formula allocations from the state. This means there is no statutory mechanism to transfer funds from the PSSSA to basic aid districts should the need arise, so the PSSSA does not necessarily provide them with the same level of protection against funding shortfalls.

Finally, under existing law, the cap takes effect whenever a transfer is made into the PSSSA, regardless of the amount. This may not provide a sufficient reserve to protect districts from low revenue years.”

- 2) ***Existing conditions for reserve cap requirement unlikely to be met in the near term.*** The reserve cap requirement is triggered once the state makes a deposit into the PSSSA, which only occurs when certain conditions are met. Among these conditions, Test 1 must be the applicable Proposition 98 test level and the state must have paid off all maintenance factor created before 2014-15. According to multi-year forecasts published as part of the 2017-18 Governor’s

Budget, no Test 1 operative years are projected through 2020-21, making a state deposit very unlikely in the near term.

- 3) ***Exemptions for school districts already in law?*** To the extent that school districts are concerned about the potential impact the cap would have on their ability to maintain adequate reserve levels and save for future and unanticipated expenditures, existing law provides two types of exemptions for school districts. First, school districts can change the way in which they treat their reserves, increasing the amount of their committed reserves and decreasing the amount of assigned and/or unassigned reserves. Reserves become committed for a specific purpose upon a vote of the district governing board. Second, a county superintendent of schools is authorized to grant a school district under its jurisdiction an exemption if a school district is able to provide documentation that demonstrates extraordinary fiscal circumstances.
- 4) ***LAO's assessment and recommendations.*** The Legislative Analyst Office (LAO) released a report, "Analysis of School District Reserves" in January 2015. In the report, the LAO provided its assessment and recommendations on the reserve caps. Specifically, the LAO indicated, "to the extent districts begin shifting monies to avoid the caps, we are concerned that local budgeting practices could become more confusing. To the extent districts begin spending down their reserves, we are concerned that they would incur a number of risks." The risks include difficulty for school districts to maintain programs in tight fiscal times, difficulty addressing unexpected costs, greater fiscal distress, and higher borrowing costs. The LAO also indicated concern that the caps become operative following any deposit into the state school reserve, even if the size of that deposit is smaller than the triggered reduction in local reserves. To avoid all of these risks, the LAO has recommended the Legislature repeal the reserve caps.
- 5) ***Which small school districts would be exempt from the reserve caps?*** This bill includes an exemption for "small school districts", defined as either: (1) a unified school district with average daily attendance (ADA) of less than 1,501, (2) a high school district with ADA of less than 301, or (3) an elementary school district with ADA of less than 901. This is an unusual definition of small school districts, established in 1976 and related to the authorization of certain school districts to contract out for social workers as counselors in schools and homes of pupils. A more common definition of small school districts—used for calculating funding for Necessary Small Schools under the Local Control Funding Formula and for certain exemptions related to School Safety Plans—is those districts with fewer than 2,501 units of ADA.
- 6) ***Related Legislation.***

SB 590 (Moorlach) repeals the current maximum reserve level school districts are allowed to maintain in any year following a deposit being made into the Public School System Stabilization Account. The measure was held by this Committee.

SB 751 (Hill and Glazer) increases the cap on school district reserves, exempts small and basic aid school districts from the reserve cap requirement, and specifies that only unassigned general fund and a portion of special reserve fund ending balances are counted for purposes of the reserve cap requirement. The measure is currently pending before the Assembly Education Committee.

AB 1164 (Thurmond) extends the probationary period up to three years for certificated employees in school districts and teachers in county offices of education with an average daily attendance greater than 250 pupils, and increases the cap on school district reserves, changes the conditions that must be met for the cap to be triggered, and exempts small and basic aid school districts from the cap.

SUPPORT

Beverly Hills Unified School District
Bret Harte Union High School District
College School District
Encinitas Union School District
Forestville Union School District
Fremont Union High School District
Goleta Union School District
Horicon Elementary School District
Kenwood School District
Laguna Beach Unified School District
Las Lomas Elementary District
Los Altos School District
McKittrick School District
Montecito Union School District
Mountain View Los Altos High School District
Nevada City School District
Newport-Mesa Unified School District
Rancho Santa Fe School District
San Luis Coastal Unified School District
San Rafael City Schools
Santa Clara Unified School District
Schools for Sound Finance
Shoreline Unified School District
Solano Beach School District
St. Helena Unified School District
Sunnyvale School District
Tamalpais Union High School District
Tahoe Truckee Unified School District

OPPOSITION

None received