
SENATE COMMITTEE ON EDUCATION

Senator Carol Liu, Chair
2015 - 2016 Regular

Bill No: AB 531
Author: O'Donnell
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Urgency: No
Consultant: Lenin Del Castillo
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Fiscal: Yes

Subject: School finance: budget calculations

SUMMARY

This bill provides that the limitation on the amount that school districts may set aside in an assigned or unassigned ending fund balance in the fiscal year immediately after a fiscal year in which a transfer is made into the Public Stabilization Account does not apply to monies in a committed fund balance.

BACKGROUND

As part of the 2014-15 Budget Act, the state enacted a new requirement to cap school district reserves in years following a deposit in the state school reserve established by Proposition 2. The legislation also created a separate requirement for districts to disclose certain information about their reserves each year. Specifically, existing law requires that in a fiscal year immediately after a fiscal year in which a transfer is made into the Public School System Stabilization Account, a school district budget that is adopted or revised shall not contain 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, 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 State Board of Education, 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 are associated with the extraordinary fiscal circumstances.
- 3) Provide documentation that no other fiscal resources are available to fund the extraordinary fiscal circumstances. (Education Code § 42127.01)

ANALYSIS

This bill:

- 1) Provides that the limitation on the amount that school districts may set aside in an assigned or unassigned ending fund balance in the fiscal year immediately after a fiscal year in which a transfer is made into the Public School system Stabilization Account does not apply to monies in a committed fund balance, as defined in the California School Accounting Manual.
- 2) Provides that school district governing boards retain the ability to redirect monies in a committed fund balance to an alternative purpose in any subsequent year.

STAFF COMMENTS

- 1) ***Need for the bill.*** According to the author's office, some in the education community have argued that the reserve cap imposes a burden on school districts, in large part because it prevents them from setting aside monies in a reserve for a future specified purpose. The author's office indicates that the bill is intended to address this issue by specifying that monies in a committed fund balance are exempt from the cap. Further, using committed fund balances instead of assigned reserves for this purpose has several advantages, including an increase in transparency because a board's action to put funds into a committed fund balance occurs during a public meeting of the board.
- 2) ***Concerns on the reserve cap.*** Opponents of the cap have argued 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.

However, it does not appear that the bill is intended to address any of these issues. Rather, it proposes clarifying language that could be helpful for school districts to the extent there is confusion or misunderstanding regarding which fund balances are subject to or exempt from the cap. This could help them to plan accordingly.

- 3) ***When will the reserve cap be triggered?*** The state must make deposits into the Rainy Day Fund when certain conditions are met to trigger the reserve cap for

districts. 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. The Legislative Analyst Office (LAO) indicated in its 2015-16 Proposition 98 Education Analysis in February 2015 that the interaction between these two requirements makes deposits unlikely in the near term.

Additionally, the 2015-16 Governor's Budget Summary indicated that "the Administration does not anticipate fiscal conditions requiring a Proposition 98 Rainy Day Fund deposit and the related potential for caps on local reserves at any point in the budget forecast period (through 2018-19). Nonetheless, the Administration appreciates the concerns expressed by stakeholders regarding potential caps on school district reserves and will engage in a dialogue with these groups in the coming months to protect the financial security and health of local school districts." While there have been several meetings with stakeholders, the Administration has yet to issue any related proposal.

- 4) ***LAO's assessment and recommendations on the cap.*** The LAO released a report, "Analysis of School District Reserves" in January 2015. In the report, the Legislative Analyst's Office (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) ***Related legislation.***

SB 774 (Fuller) repeals the existing statutory cap on the amount of fiscal reserves that a school district is allowed to maintain. This bill is pending before the Senate Education Committee.

AB 1048 (Baker), similar to SB 774, proposes to repeal the statutory cap on the amount of fiscal reserves that a school district would be allowed to maintain under specified conditions. This bill failed passage in the Assembly Education Committee on May 13, 2015.

AB 1318 (Gray) proposes to modify the calculation of the statutory cap on fiscal reserves. This bill is pending before the Assembly Education Committee.

SUPPORT

Association of California School Administrators

OPPOSITION

None received.

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