



Pennsylvania Association of School Business Officials

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PASBO Response to the Lower Merion School District Decision

The decision against Lower Merion School District calling into question their budgeting practices is erroneous and creates potentially negative implications not only for Lower Merion School District but for all school districts across the commonwealth that follow the rules, budget conservatively, and engage in long-term financial planning.

Budget Challenges

In recent years, school districts have faced ever-increasing budgeting challenges, as operating costs outpaced revenues. Increasing mandated costs such as pension costs, healthcare costs, charter school costs and special education costs, just to name a few, make it difficult for districts to maintain the status quo in their educational operations. For 2016-17, adding up all of these mandated costs, school districts would have needed an additional \$600 million just to maintain operations at the prior year's level.

In an Act 1 environment in which school districts are limited in their ability to raise property taxes, even if all school districts raised taxes to their adjusted index, school districts would still be nearly \$300 million short in covering only the mandatory increases in operating costs. That does not include costs due to increasing enrollment, additional state or federal mandates or anything beyond simply maintaining the status quo.

Financial Planning

To ensure that districts have the resources necessary to plan for the future and to fund needed programs and projects, school districts have no choice but to use Act 1 exceptions where applicable, use fund balance and budget conservatively in an attempt to end the year without a deficit. When a district realizes a surplus in operating expenses at the end of the year, it is something to be celebrated, as the district saved necessary funds without placing additional burdens on taxpayers or borrowing money.

To deal with the challenge of budgeting in this precarious environment, the business office, in conjunction with the superintendent and school board in every district, scrutinizes all expenditures, tracks potential changes in revenues and plans for all possible contingencies as they prepare their budgets. While absolute precision is the target, the uncertainty in the system makes that virtually impossible to achieve.

Funding Uncertainty

School districts have faced absolute uncertainty regarding the funding coming from Harrisburg and the policy changes that will require the implementation of new programs. At the local level, in addition to the mandated increases in the costs described above, there are many other issues outside a district's control that have the potential to significantly impact the budget.

Enrollment Growth

School districts experiencing growing enrollment, such as Lower Merion School District, which has seen its enrollment increase by 20% over the last decade, with similar increases projected into the future, are at a severe disadvantage. Their rising mandated costs and Act 1 limitations ignore their increasing costs due to their growth in students, heightening the need for these districts to use increase taxes, use fund balance, budget conservatively, and engage in long-term financial planning.

Health Care Budgeting

Health care is a major expense for school districts. While healthcare costs generally rise from year to year, a particularly difficult year health-wise could mean that a district's costs are much greater than budgeted. However, the opposite is also true and a healthy year among employees can mean that a district's healthcare costs are over budgeted.

Unpredictable Expenses

In addition, predicting charter school enrollment from year to year, budgeting savings from refinancing of existing bonds due to the timing and estimating legal costs, which may vary extensively from year to year, are just some of the items that provide real uncertainty in school district expenditures. It is important to note that in none of these examples can the prior year be predictive of costs going forward.

Uncertain Revenues

While there is tremendous difficulty in estimating annual expenditures, that is only half of the challenge. In addition to property tax revenues, earned income tax revenue, realty transfer tax revenue and interest earnings can fluctuate—sometimes significantly—from year to year. Couple all of this with the uncertainty regarding annual state revenue mentioned above, and school district budgeting becomes a complex process of prognostication and educated guesswork, all of which must be completed and finalized before there is any indication of which contingencies will actually occur on both the expenditure and revenue side.

As a result of this uncertainty in the budgeting process, school districts often start on day one of a new fiscal year looking for opportunities to reduce expenditures to ensure that they do not overspend their budget should their estimates not come to fruition. School districts, like Lower Merion School District, that have reached the end of a fiscal year with a surplus, have not gamed the system as is insinuated in the decision. These districts have budgeted conservatively, adhered to the rules, planned ahead, potentially experienced a bit of luck and are exhibiting best practices in school financial operations.

Purposeful Transfer of Funds

In Lower Merion School District, for example, the surplus funds achieved through conservative budgeting, effective management of resources and positive experiences with healthcare and employee costs, were transferred to the district's capital reserve fund. This is a common practice for school districts, and these transfers are accompanied by specific board authorizations to ensure that there is no question about the intent of the transfer or the purpose of the funds.

A capital reserve fund is not a hiding place for operating surpluses. Due to Act 1 limitations and the lack of a consistent state program to fund ongoing and needed capital repairs and replacement equipment, a capital reserve fund creates the opportunity for a school district to set aside, in advance, funds necessary for appropriate projects. Such a fund allows a district to avoid excessive short-term borrowing, eliminating associated interest costs and reducing the impact of such projects on students and taxpayers.

In the case of Lower Merion School District, operating surplus transfers were made to their capital reserve fund in accordance with their 5 year plan for capital projects, technology refreshment and replacement buses. Lower Merion School District should be applauded for their long-term planning through their capital reserve fund.

Fund Balances

The decision also focuses on fund balances, and the importance of having fund balance cannot be overstated. The nine month budget impasse that accompanied the 2015-16 state budget perfectly illustrates the necessity of such funds. Furthermore, a school district's fund balance is a demonstration of its financial stability, which in turn, will preserve or enhance the district's bond rating and lower debt issuance costs.

While most would agree that long-term use of fund balance to fill budget gaps is not ideal, a large number of school districts have been required to do so during recent years due to unpredictable revenue and rising mandated costs that outpace the Act 1 index. Until Pennsylvania establishes a track record of consistent and adequate funding, local revenue sources such as interest earnings and real estate transfer stabilize, the state adequately funds capital projects, pension obligations reach the summit, and healthcare costs become more predictable, use of fund balance will continue to be a prudent technique for school districts to fill annual budget gaps and fund capital projects.

Conclusion

Overall, Lower Merion School District did nothing wrong or misleading. The district adhered to all applicable laws, provided appropriate transparency regarding financial decisions, engaged in careful, long-term financial planning and budgeted conservatively in light of the myriad of fluctuating issues that are beyond their control. In the face of rising mandated costs and uncertainty, they did everything they could to balance the needs of their students with the

needs of their taxpayers, and yet, they are being criticized and penalized for coming in under budget and planning for future taxpayer savings.

This decision, if upheld, will upend all current policies and best practices for school district budgeting. It will also negate a school district's ability to plan for future educational and capital needs in a thoughtful and effective manner. We believe that Lower Merion School District was prudent in its budgeting decisions, and we are confident this decision will be overturned on appeal.