K-12 Public School Funding Study
Structure of School Funds Working Group Report - 11/1/2001

Background:
HB 625 (L.2001) created a K-12 Public School Funding Study to be conducted during the interim between the 2001 legislative session and the 2003 session. One of the topics for study is to "determine if the existence of 25 budgeted and nonbudgeted funds unreasonably restricts local decision makers."

To address this topic the Governor's Advisory Council on School Funding has convened a working group to review and suggest improvements in the current structure of school funds. The working group includes district clerks from large and small districts, a county superintendent, an auditor, and representatives from the Office of Public Instruction, the Governor's Office, and the Montana School Boards Association.

Charge to the Fund Structure working group:

- To review the current structure of school funds;
- To outline the positive and negative impacts of the existing fund structure;
- To propose modifications to the existing school fund structure that will simplify fund accounting and provide more flexibility to school districts while maintaining the standards of Generally Accepted Accounting Principles;
- To propose changes to the fund structure that will allow more dollars to flow toward educational services to students;
- To ensure that the proposed fund structure is responsible and accountable to school trustees, the legislature, the taxpayers of Montana, and federal program reporting requirements;
- To identify adjustments to the general fund budget caps that are associated with proposed changes to the fund structure;
- To propose any modifications to timelines for budget adoption, elections, and financial reporting that fit with the changes proposed in the fund structure; and
- To report its findings to the Governor's Advisory Council on School Funding by December 1, 2001.

Members of the Fund Structure working group:

Steve Johnson, CPA (Chair)	Clerk/Business Manager, Bozeman Schools
Joan Anderson, CPA	Administrator, OPI School Budgets & Accounting
Shirley Barrick	Fergus Co. Supt.
Sue Becker	Clerk/Business Manager, LaMotte School
Mark Bruno	Governor's Office
Amy Carlson	Analyst, Governor's Office
Karla Christenen	Garfield Co. Supt.
Don Davies, CPA	Auditor, Ronald Paul Foltz, PC
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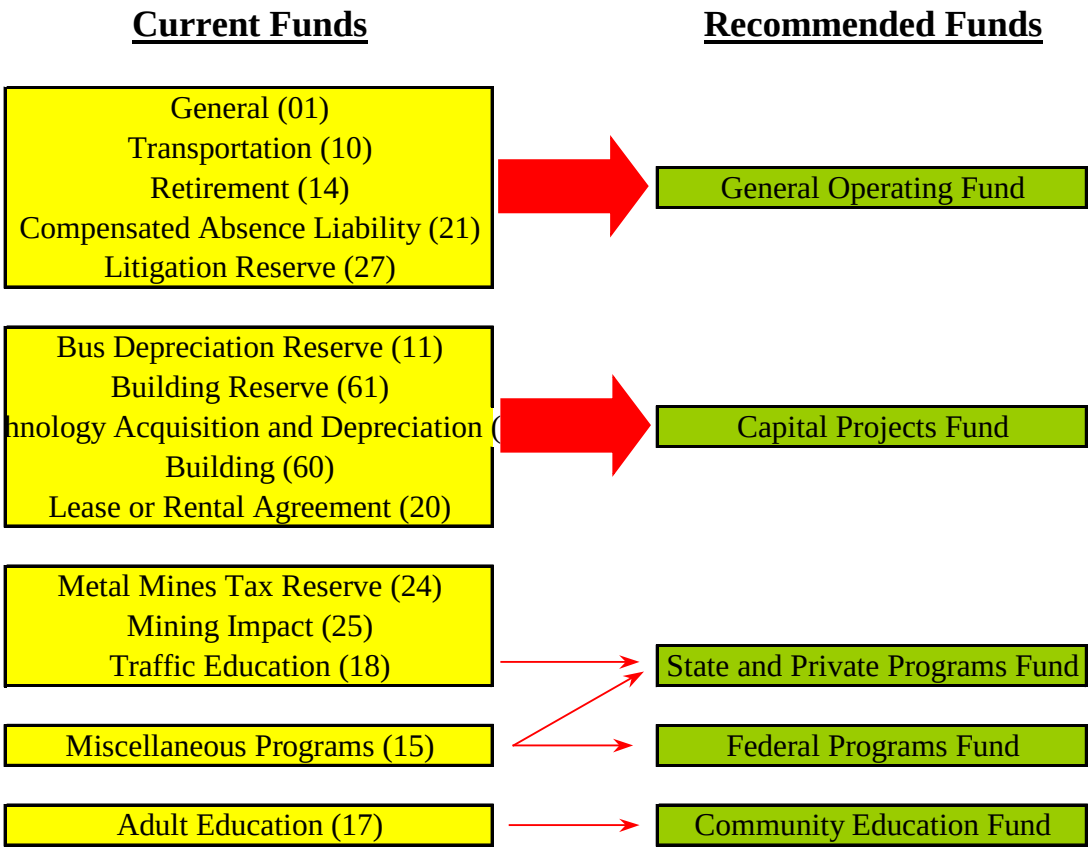
Summary of Working Group Recommendation



No change Recommended

Tuition (14)
Nonoperating (19)
Debt Service (50)
Flexibility
School Food Service (12)
Interlocal Cooperative (82)
Internal Service (77-79)
Impact Aid (26)
Enterprise (70-74)
Agency (86-95)
Trust (83-85)
Endowment (81)

A. Streamlining Funds Used for Operations

We recommend consolidating the Litigation Fund, Compensated Absences Fund, Retirement Fund, and Transportation Fund into the general fund and rename it the "General Operating Fund."

1. Litigation Reserve Fund (Fund 27) (MCA 20-9-515)

Close this fund and in its place allow a designation of fund balance in the general fund. Approximately 1-3 districts use the Litigation Reserve fund each year. The fund is used to accumulate and set aside funding outside the general fund for potential payments required by specific legal judgements pending against the district. Currently, cash is moved from the general fund using budgeted general fund transfers. Instead, the money should remain in the general fund and be identified as a Litigation Reserve (excess reserve).

To establish the reserve, a district must: 1) Establish the reserve within the general fund, as is currently the case, establish the reserve with unanticipated revenues, or under-spend the general fund budget in order to have money left at year-end to designate as Litigation Reserve; 2) Have a specific potential judgement pending; and 3) First, hold a "full" (10%) general fund reserve.

To spend the reserve, a district must: 1) Use it only to pay legal judgements, not attorney fees and costs of litigation (i.e., current rules for use of the Litigation Fund money would still apply); and 2) Use accounting codes that identify the payment of judgements. Expenditures of the Litigation Reserve, having already been "charged" to the general fund budget in the year the reserve was established, would not be charged to the budget again when the judgement is paid. Any money remaining in the reserve after the specific litigation is settled must be returned to the unreserved fund balance to be reappropriated.

2. Compensated Absences Fund (Fund 21) (MCA_20-9-512)

Close the Compensated Absences Fund and in its place establish a designated fund balance for termination payouts within the general fund. The fund is used by approximately 268 (60%) districts each year. The fund is currently used to accumulate and set aside funding outside the general fund for up to 30% of the liability for sick leave and vacation leave payouts for classified and administrative staff (not teachers) who leave the district. Currently, funding is moved from the general fund using budgeted general fund transfers. Instead, the money should remain in the general fund and be identified as a Termination Payout Reserve (excess reserve).

To establish the reserve, a district must: 1) Establish the reserve within the general fund, as is currently the case, establish the reserve with unanticipated revenues, or under-spend the general fund budget in order to have money left at year-end to designate as the Termination Payout Reserve; 2) Have specific future liabilities for sick leave and vacation payouts; and 3) First, hold a "full" (10%) general fund reserve.

To spend the reserve, a district must: 1) Use it only to pay sick leave and vacation payouts, including employer contributions payments to TRS, PERS, FICA and unemployment to cover payouts; and 2) Use accounting codes that identify the payment of termination leave. Expenditures of the Termination Payout Reserve, having already been "charged" to the general fund budget through under-spending the budget in the year the reserve was established in most cases, would not be charged to the budget again when the termination payouts are made.

> Additional comments/concerns: The problem of high cost TRS "Option 1" payouts could possibly be resolved using the Termination Payout Reserve, although currently the Compensated Absences Fund cannot be used for liabilities associated with teachers (certified staff). This working group does not offer a recommendation to expand the use of the reserve, but does suggest further consideration as a possible solution to the retirement issue.

3. Retirement Fund (Fund 14) (MCA 20-9-501)

Close the fund and pay retirement costs using the general fund. Currently, the district adopts a retirement fund budget and the county and state guaranteed tax base subsidies (GTB) fund the costs of the employer's contribution to the teachers' retirement and public employees' retirement systems (TRS and PERS), social security (FICA) and unemployment insurance. Instead, the employer costs should be added to the entitlements in the BASE. The funding should be provided by the state through Direct State Aid (DSA) or continue to be provided by the county through an equalized countywide levy.

> Additional comments/concerns: 1) Routine retirement fund payments are based on percentages of salaries, so the amount needed to pay retirement obligations can be estimated for purposes of determining the increase in the entitlements. 2) The following issue must be resolved before the recommendation is feasible: Employer contributions under TRS retirement "Option 1" can result in substantial district obligations. These obligations are practically impossible to absorb in a district's capped general fund budget. The retirement fund budget can currently be adopted at the level needed to fund those obligations, and the county can permissively fund the obligations and make up in the following year for shortages caused by unexpected retirements. This working group has not yet resolved this issue and our recommendation is made contingent on its resolution.

4. Transportation Fund (Fund 10) (MCA 20-10-143)

A thorough study of transportation regulations and funding would be necessary to address these complex issues as a package, since the transportation laws are antiquated.

Currently, the district adopts a transportation fund budget that is funded by a state/county mileage reimbursement, non-levy revenues, and a non-subsidized permissive local mill levy.

This working group recognizes that simplification, improved flexibility of spending, and equalization are necessary. The needs that must be met include:

1) The system must fairly fund districts for transportation. With wide variations in transportation needs and costs among districts, that challenge is not easily met. It is not likely the funding could be included in the current entitlement system due to the variation of costs and needs. Transportation aid should only be available to districts that have a transportation program
2) More local control should be allowed by eliminating the eligible ridership criteria. Districts should be able to transport students on the basis of safety and efficiency rather than base their decisions on whether students live outside a 3-mile radius;
3) Simplification is sorely needed. Adoption of HB 163 funding concepts would greatly simplify transportation budgeting and funding; and
4) The permissive local levy must be maintained to accommodate changing transportation needs. The transportation fund is not currently capped and the local levy is permissive, allowing necessary flexibility (e.g. if you need to add a bus route, you can build the necessary budget authority).

If several issues could be resolved, the following recommendation appears to address those needs:
Close the transportation fund and use the general fund to pay costs of transportation. Transportation aid should be based on a flat rate per mile depending on the size of the bus (HB163). The transportation aid should be budgeted in the BASE. Also in the BASE, the district should be allowed to budget an additional percentage of their budgeted transportation aid, which would be determined based on factors of density (such as road miles, square miles, and ANB) that would be reevaluated periodically to determine the ongoing validity of the factors. The percentage built into the BASE would be funded locally with state subsidies, as part of the "GTB area." Assuming the BASE transportation aid and additional percentage are 80% of the total transportation budget, the maximum budget would include another 20%, which would be funded using non-subsidized local mills, as part of the "Over-BASE budget." Increases in taxes to support the OverBASE would be voted. [NOTE: Large costs for bus barn construction, bus purchases, etc., would be paid using the "Capital Projects Fund."]

Additional comments/concerns: 1) The density factor that would show a correlation between transportation costs and district geographic and population conditions has not yet been determined and would require further study; 2) The provision of transportation based on safety and efficiency factors rather than on the 3 mile limit may result in increased state costs, which would be offset by a reduction in the state's potential liability for the safety issues.

B. Create a Single "Capital Projects Fund"

Close the Lease Rental Fund (Fund 20, MCA 20-9-509), Bus Depreciation Fund (Fund 11, MCA 20-10-147), Building Reserve Fund (Fund 61, MCA 20-9-502), Building Fund (Fund 60, MCA 20-9-508), and Technology Fund (Fund 28, MCA 20-9-533) and create a single Capital Projects Fund. The new Capital Projects Fund would be used for a variety of capital expenditures, including:

- Building projects funded using bond proceeds

- Building projects and purchase of assets, funded through a voter-approved mill levy up to 20 years
- Purchase and replacement of assets, funded through a permissive levy of up to20% of the original cost of the assets, up to 150% to be accumulated over time;
- Use of disaster restoration/recovery funded though insurance proceeds;
- Federal or state grant projects, including State Technology Aid, received specifically for building or purchase of assets, or technology costs (Miscellaneous Programs Fund is alternative).

Separate accounting for various projects would be accomplished using project reporter codes to identify the related revenues and expenditures for each project in the fund. Most districts would have fewer than five projects at any time.

We recommend the Capital Projects Fund be a nonbudgeted fund, however mills are limited based on voter approval and percentages of asset costs. The trustees must therefore adopt the levy amount, not an expenditure budget, for this fund. This should be done as part of the formal budget hearing process. Expenditures are automatically limited to amounts made available through the approved levies and receipt of grants, so it is not necessary to adopt an expenditure budget.

The state should subsidize this fund, not based on a per-mill subsidy, but with entitlements based on relative tax wealth. A single subsidy in the capital projects fund would apply to debt service and to other capital project expenditures. The subsidy should be used first to subsidize any debt service tax levies, and second to subsidize the capital expenditures of this fund at the trustees' discretion.

> Additional Comments/concerns: 1) The details of the capital projects subsidy mechanism require more study; 2) Currently, buses and technology costs can be "depreciated" for purposes of replacement and additional purchases. This proposal would allow assets other than buildings to be depreciated. Alternatively, the law could set a minimum dollar value of assets to be "depreciated", or set the limit equal to the district's capitalization policy, which is usually $300 to $5000 dollars; 3) The capital projects fund would be used only for capital costs, so the other costs of technology that are currently allowable in the Technology Fund would have to be funded using general fund; 4) Subfund accounting (i.e., identifying separate projects with a fund) is accommodated better by some computerized accounting programs than others.

C. Changes in Minor Funds

1. Miscellaneous Programs Fund (Fund 15, MCA 20-9-507)

Split the current Miscellaneous Programs Fund into a “State and Private Programs Fund” and a “Federal Programs Fund”. This would better facilitate the investment of State and Private program money. Federal law discourages the investment of federal funds, therefore the current Miscellaneous Programs Fund is cumbersome for investment

purposes. Individual projects would continue to be tracked using project reporter account codes within the funds.

2. Metal Mines Fund (Fund 24, MCA 20-9-231) and Mining Impact Fund (Fund 25, MCA 90-6-307)

Close these funds and use separate accounts ("project reporters") in the district's State and Private Programs Fund to account for these moneys. Approximately 40 (9%) districts hold money in these funds. Law allows use of the moneys, which come from mining impact fees and royalties, for any district purpose.

3. Adult Ed Fund (Fund 17, MCA 20-7-705)

Rename the Adult Education Fund the "Community Education Fund."

4. Traffic Ed Fund (Fund 18, MCA 20-7-507 and 20-9-510)

Close the Traffic Ed fund and account for the program in the district's State and Private Programs Fund.

D. Other Issues/Suggested Improvements

1. Cash Shortages in the Transportation Fund

Districts suffer from cash shortages in the district transportation fund by October. The shortage occurs because by law, districts receive taxes in November and May (month 5 and 11 of the fiscal year) and the state and counties make transportation aid payments in March and June (month 9 and 12 of the fiscal year). Cash reserves (20%) held on July 1 are depleted before November tax collections.

Recommendation:
Assuming the district transportation fund remains as a separate fund, alleviate the cash flow problem by:

- Allowing the state to advance a portion of the districts' transportation aid early in the year. An advance based on 25% of the previous year's state transportation aid by October 1 seems adequate, but further study would be needed to verify that assumption.
- Passing HB163 (proposed in the 2001 Legislative Session) to pay state/county transportation aid based on bus size and days transported, instead of the current combination of ridership, bus size, and days transported. Districts could submit bus route information to the state in October (instead of December), allowing the state to accurately estimate and pay the first semester reimbursement in December instead of March (3 months earlier). The estimate could be adjusted, as necessary, with the second semester payment in June.

  Additional comments/concerns: Although the funding mechanism for transportation aid is not specifically within the scope of this working group's charge, we urge the committee's support for the concepts of HB163, which would greatly simplify transportation budgeting and accounting.

- Raising the transportation fund reserve from 20%, if it is not possible to provide state/county transportation aid payments earlier in the year. A larger cash reserve would last until the district received taxes in November. Further study would be needed to determine the level of adequate reserves.

  Additional comments/concerns: The one-time increase in reserve would be funded by a local levy. A phase-in period may be needed to gradually build reserves, spreading the mill levies over more than one year.

2. Deadline for Submitting Budgets to the County

Law should be amended to require the trustees to submit the budget to the county superintendent "by August 20" instead of "within 5 days" of adoption (MCA 20-9-131). The budget must be adopted and the Trustees Annual Financial Report must be submitted to the county superintendent by August 15. Although trustees may adopt the budget in July or early August, it is rarely possible to complete all calculations and accompanying reports for submission to the county before August 20. Additionally, the deadlines for budget should be moved from MCA 20-9-131 to 20-9-213, Duties of the Trustees for clarity.