Budget Contingencies and Fund Balances:
A White Paper

Over the years, K-12 education has experienced many funding cuts or shortfalls in areas such as Flexible Focus funds, transportation, and flat SEEK base per pupil allocations. Although there has been a recent increase in federal education funding through the Title I and IDEA stimulus programs, these funds have generally been used to maintain existing programs and not for new or innovative programs. Also, these programs have created a potential funding cliff to overcome once these programs are completed. There has been discussion of the possible use of contingency funds and fund balances to reduce future K-12 education funding or to balance the budget. This paper will explain that budget contingencies and fund balances are not synonymous with each other and should not be used to balance the state budget.

Contingency funds –
School districts are required by law to have a certain amount of money set aside. The minimum amount is 2% of the district's entire budget. However, it is suggested that at least 5% be set aside, for reasons which are explained below.

The minimum amount of 2% is actually not an adequate reserve; this amount would not cover even one payroll period of wages. The required minimum should be raised to 5%.

If a district is reserving an amount greater than 5% of its overall budget, the district should be able to explain the purpose for that reserve. Appropriate designations may include school "start up" costs (costs associated with opening a new school, including staffing, utilities, etc.), purchase of land, construction projects, SBDM allocations / carryovers, or purchase commitments.

Fund balance –
A public school district's fund balance is actually a "snapshot" of the net amount that remains between assets and liabilities at any given point in time. Although this amount fluctuates daily, school districts report "official" fund balances at the end of the fiscal year, which for Kentucky schools is June 30.

As mentioned, this amount is always in flux and is affected by many factors. Cash flow is generally at its lowest level in the autumn of each year; in fact, it is not uncommon to show a negative balance at this time, which drains the fund balance until tax receipts begin in the winter.

The relationship between contingency and fund balances –
Differences between fund balance and contingency can usually be explained by cash flow issues as described above. However, if there are other issues affecting these balances, those should also be explained.

It is important to realize that neither fund balance nor contingency funds can be considered "surplus funds" in the state budget. There are many differences in the requirements that regulate school district budgets. School districts must budget a contingency fund, as explained above, so this is really a budget expense item. The only real "surplus" is the excess of the fund balance above the contingency fund. Some of this is generated from local taxes and some comes from state funding and it would be impossible to determine the source.

School districts operate on a perpetual, rolling basis for budgets and reporting. State government operates on a two-year biennium, which does not necessarily have to balance. School districts have to balance their budgets each year and also provide a fund balance to use at the beginning of the next year's budget.

One way to think about "fund balance" is to compare school district finances to that of an ongoing business, such as Wal-mart or Toyota. These companies produce either an income (surplus) or a loss (deficit) each year; but in order to avoid bankruptcy, they always have to maintain an equity balance (excess assets over liability). This amount is what school district's call "fund balance."