



# Lower Merion School District

301 East Montgomery Ave. Ardmore, PA 19003-3399  
Phone: 610-645-1930 ♦ Fax: 610-645-0703 ♦ [www.lmsd.org](http://www.lmsd.org)

## UNDERSTANDING SCHOOL DISTRICT BUDGETS AND “FUND BALANCE”

### *The Foundation of a Fiscally-Sound School District*

*“In the case of a school district, a decreasing fund balance reduces the district’s ability to generate investment income, pay for costs such as emergency building repairs, or cover unexpected interruptions in revenue such as last year’s nine-month state budget impasse. In addition, the district’s credit rating could be adversely affected by an inadequate fund balance, which could then increase the cost of borrowing.”*

*--- Statement from the Pennsylvania Department of The Auditor General following an audit of Eastern York School District that found a steep drop in the District’s fund balance (July 21, 2016)*

**Dear LMSD Community,**

We hope the school year is off to a smooth and enjoyable start for your family. It has been an exciting first full week in the District, with regular reminders of what matters most – our amazing students. The hallways and classrooms are buzzing with enthusiasm, anticipation and lots of learning.

As you may be aware, the District last week filed its appeal of a recent trial court order that overrules the decision-making authority of our elected school board in enacting a budget that supports LMSD’s high-quality educational programs. We respectfully believe the order is legally incorrect and remain hopeful that the District will prevail upon appeal. While we are hesitant to inundate your inbox at such a busy time of year, we believe this is a matter that requires timely, factual, and comprehensive communications. It is important that you are well-informed as the ultimate outcome will have an enormous impact on our children and the future of public education in Lower Merion and across the Commonwealth.

#### **The District has been compliant and transparent.**

This is a civil case that started in and is ongoing in the Montgomery County Court of Common Pleas (though part of it is now before the state Commonwealth Court on appeal) that centers on legal interpretations of Pennsylvania’s school budgeting statutes, procedures and state oversight. There are no other related pending legal matters: no investigations at any level into conduct by anyone associated with the District. It is important to know that the District follows strict, state-mandated procedures every year in developing its budgets and conducts an extensive public budget process that includes numerous community meetings and presentations. Every meeting is advertised and budget information is posted directly to the District website and made accessible to all. Every state and independent audit of the District has affirmed the District’s full compliance with budgeting and accounting standards and the District has consistently been lauded for strong fiscal management by credit ratings agencies. **In short, the District has acted lawfully and appropriately.**

Much of the discussion in this case (*Arthur Alan Wolk vs. LMSD*) is focused on the District’s “fund balance.” To better understand what a fund balance is and how and why it is vital to the fiscal health of a school system, it is important to know the context of the school budgeting process.

Each year school districts prepare budgets that are an estimation of expenses for the following school year. In Pennsylvania, budgets are prepared almost a year in advance of implementation and must take into account numerous variables, including but not limited to:

- Enrollment changes
- Staffing needs
- State budgets (which often aren't determined until late in the budget cycle)
- Fluctuations in the local real estate market and transfer tax revenues
- Special education costs
- Facilities planning and emergency needs (winter weather, repairs, etc.)

This timetable can be particularly challenging to rapidly-growing districts like Lower Merion. The District makes a best estimate as to its projected costs using historical data and guidance obtained from multiple sources, including its financial advisor, insurance broker, energy consultant, county and local planners, various local and state purchasing consortiums and internal staff.

**The District does not view its budget as a “blank check” to be spent carelessly.**

Throughout the year, the District makes every effort to reduce expenditures and realize cost savings. Funds are not spent simply because they have been budgeted – they are spent because they are necessary. The Court’s interpretation that the District’s unspent funds are the result of intentional overestimation is flawed; these funds – which contribute to a “fund balance” – instead reflect efforts (shared at every step with the public) taken by the District to manage its finances in a responsible manner, with an eye on present and future needs. They also reflect the well-documented uncertainties of the budgeting process.

By way of example, in its last audited fiscal year (2014-15), the District realized a surplus of approximately \$4M. This surplus was not and could not be forecast when the budget was developed. The two main factors were a one-time bond refunding (similar to mortgage refinancing) and fewer employee healthcare claims (District is self-insured) that reduced expenses and together accounted for the surplus.

Without these non-recurring savings, the District would not have experienced a surplus for the year. Following an accepted practice, these funds were transferred to LMSD’s capital reserve account upon a public Board vote; they will be used as part of the District’s 5-year capital improvement plan, 5-year technology/infrastructure plan and for the replacement of aging buses. Without those surplus funds, it is likely these projects would have been deferred, eventually resulting in increased maintenance costs and the degradation of District facilities and operations. This is a snapshot of just one fiscal year, but it is telling in the context of the fund balance discussion.

A common misconception is that the fund balance is a cash account, and, therefore, corresponds to the district's bank balance. In fact, a fund balance represents the fund's total assets minus its liabilities (what a fund after what it owes is deducted). Districts with adequate and healthy fund balances can address short-term and long-term needs, demonstrate financial stability and preserve or enhance bond ratings, thereby lowering debt issuance costs. As mentioned in previous communications, the ratings agency Moody's affirmed LMSD's Aaa credit rating last year, enabling the refinancing of general obligation bonds that will save taxpayers \$9.8M. **Among Pennsylvania’s 500 school districts, LMSD is one of only five that carries the Moody’s Aaa credit rating.** Moody’s specifically cited the district's "strong and stable reserve levels" in its most recent report. In the best and worst of times, a strong credit profile serves a district well.

**The LMSD Fund Balance is at a reasonable level.**

When it comes to fund balance, one size doesn’t fit all. The Government Finance Officers Association (GFOA) recommends "at a minimum, that general-purpose governments, regardless of size, maintain unreserved

budgetary fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures." We have budgeted expenditures of approximately \$21.5M per month for 2016-17 (based on a total budget of \$259M). Per the GFOA recommendation, LMSD should seek to maintain an unreserved fund balance of a minimum \$42M (two months' expenses). In fact, our most recent audited financial statements indicate an unreserved (unassigned) fund balance of \$20M. We would like to have more funds in reserve, but due to mandates and future obligations like retirement costs, special education, capital projects, etc. it is nearly impossible for any school district to maintain what GFOA recommends.

Additionally, Pennsylvania law sets the "estimated ending unreserved, undesignated fund balance limit" for most districts (including LMSD) at 8% annually. LMSD's estimated ending unreserved, undesignated fund balance for the current year represents around 4% of the overall budget - **well below the allowable limit**.

Most of LMSD's \$55.9M total fund balance for 2016-17 represents a "committed" fund balance, which means it serves a financially-prudent purpose as permitted by law. This includes \$15.3M for PSERS (state pension system). While the District's PSERS obligation for this year is estimated at \$18M dollars, the state projects that within five years this amount could increase to over \$20M, necessitating planning for the future. An additional \$15M is committed for capital projects and will be used for ongoing facilities needs, decreasing the District's reliance on borrowing. A total of \$5M is committed for post-employment benefits as determined by actuaries and an additional \$0.5M is committed for rate stabilization on variable interest rate bonds (so that in the event interest rates rise, the District will be covered). Of the remaining \$20.1M in "unassigned" fund balance, the District will utilize approximately \$9M to close its budget deficit and maintain the remaining balance in reserve.

LMSD's total fund balance accounts for 21.6% of the total District budget for 2016-17 and was 24.56% in the last audited (2014-15) budget. It should be noted that while the court order in the *Wolk* case singles out LMSD:

- One-third of all districts in PA (167 districts total) have a higher percentage of total fund balance than Lower Merion.
- More than 50 districts are operating with a total fund balance of less than 6%, including 17 districts completely in the red and operating in deficit.

This statewide snapshot underscores our district's fiscal vitality and illustrates that there is great variance in total fund balance percentages across the state and no guidelines, mandates or even general consensus as to what an appropriate percentage should be.

Once again, putting the District's budget into perspective requires additional context. More than 90% of the school districts in Pennsylvania levy an earned income or wage tax in addition to real estate taxes to generate revenue. Unlike these districts, Lower Merion does not have an earned income tax, so its reliance on real estate taxes is particularly pronounced. Also notable is that state and Federal subsidies account for just 14% of LMSD's total revenue – well below the state average. The result is that communities with different taxing authorities must take significantly different approaches to budgeting. In Lower Merion, the heavy reliance on property taxes as a primary source of revenue forces more conservative budgeting.

It should also be noted that school districts are required to live by a different set of rules than other governmental entities (municipalities, for example) when it comes to generating revenue. These entities can establish budgets and cover projected expenses (and shortfalls) through other means like municipal service fees and have **no fund balance limit**. School districts do not have this opportunity, nor the same degree of flexibility.

**The District is committed to preserving high-quality programs at a time of uncertainty and growth.**

**LMSD is the fastest-growing district in the region and one of the fastest-growing districts in the state.**

Enrollment has grown more than 20% in less than ten years and has consistently exceeded projections due to factors beyond the District's control, including but not solely:

- The growth in number of families choosing public school vs. private school
- More public school students originating out of multifamily developments/apartments
- Turnover in the real estate market
- The decline of services in some surrounding districts.

This issue has had a significant impact on staffing and facilities planning. Five years ago, there was no projected need for additional elementary classroom space. Now, we have a need to expand classroom capacity across the District and have already expanded at several schools in the past two years. Our budgets reflect the need for additional flexibility during a time of uncertainty and growth, while maintaining the Board's priority of preserving the high-quality programs and services that define the LMSD experience.

Bottom line: this is a complex issue that warrants deliberative dialogue. Throughout its history, the administration and the volunteers elected to serve on the Board have taken great pains to present and inquire into budget information in a transparent, open and responsible manner. While at times there may be disagreements on educational priorities, the budget process – and the process by which the District develops its fund balance – has been a bipartisan effort, characterized by careful management and respectful public discussion and debate. **This is what our students, schools and broader community deserve and have come to expect.**

We hope this information is helpful. For additional details on the District's budgeting process and fund balance, please refer to the [extensive budget section on our website](#), which includes budget data and presentations for the past nine years as well as a set of FAQs on the 2016-17 budget. Additionally, we have a dedicated section on our website for information related to this case, available by [clicking here](#). If you have any questions, please direct them to [communitycomments@lmsd.org](mailto:communitycomments@lmsd.org). We will continue to update you on this important and evolving matter.

Thank you for your consideration and best wishes for a successful start to the school year.

Sincerely,

Robert Copeland  
Superintendent

Dr. Robin Vann Lynch  
President, Board of School Directors