ATRA SPECIAL REPORT

April 2009

*Action without information is dangerous. Information without action is futile.*

# K-12 Cash Balances Could Help Close FY 2010 Deficit

As the Legislature continues its efforts to develop and pass a balanced FY 2010 budget, some have recently noted that school district fund balances could potentially provide much needed funds to help close the gap between planned expenditures and anticipated revenues.

ATRA has long pointed out that using one-time revenues, such as cash balances, to fund ongoing expenditures provides only a temporarily balanced budget that masks an ongoing structural deficit. Budgets that use one-time revenue sources to increase the gap between ongoing expenditures and ongoing revenues imprudently set the stage for a budget crisis as soon as the one-time revenue sources wear thin. For that reason, ATRA has consistently voiced opposition to such budgeting maneuvers. While ATRA opposes using one-time revenues to increase a structural deficit, using cash balances in conjunction with reductions in the existing structural deficit can put the state on a path toward a structurally balanced budget while avoiding a tax increase that could devastate a faltering economy.

Fund sweeps accounted for $583.7 million of the revenue used in the FY 2009 budget fix that passed earlier this year, and most expect several hundred million dollars in additional balance transfers to be part of the FY 2010 budget. Notwithstanding the several rounds of fund sweeps, school district cash balances have remained untouched. The Annual Report of the Superintendent of Public Instruction indicates that school districts began the current fiscal year with more than $2.3 billion in the bank (see table below). So the question naturally arises whether some of these funds might be used to lessen the spending cuts or the tax increases necessary to balance the FY 2010 budget.

Much of the $2.3 billion cash balance could not be used to close the state's budget deficit. For example, this total balance includes $539.9 million in school districts' debt service accounts. This revenue was raised by secondary property taxes that were authorized by voters specifically for the debt service requirements of

| Fund | FY 2008 Ending Cash Balance | 1-year Change | % Change |
|---|---|---|---|
| Maintenance & Operations (M&O) | $442,720,510 | $32,934,688 | 8.0% |
| Classroom Site Fund and Instructional Improvement Fund | $178,538,096 | $35,350,552 | 24.7% |
| Unrestricted Capital Outlay | $272,979,868 | $23,155,262 | 9.3% |
| Soft Capital Allocation | $145,558,916 | $14,686,585 | 11.2% |
| Deficiencies Correction | $566,922 | -$725,891 | -56.1% |
| Building Renewal | $76,043,624 | -$25,656,080 | -25.2% |
| New School Facilities | $2,821,374 | -$4,092,321 | -59.2% |
| Adjacent Ways | $70,778,233 | $23,435,223 | 49.5% |
| Debt Service | $539,894,149 | $77,181,552 | 16.7% |
| School Plant | $42,977,604 | -$2,158,899 | -4.8% |
| Federal Projects | $47,797,370 | -$10,274,758 | -17.7% |
| State Projects | $17,592,515 | -$3,028,827 | -14.7% |
| Food Services | $58,339,105 | $9,518,470 | 19.5% |
| Other | $434,566,352 | $70,685,668 | 19.4% |
| **Total** | **$2,331,174,638** | **$241,011,224** | **11.5%** |
| Bond Building | $732,122,450 | -$10,248,168 | -1.4% |
| Intergovernmental Agreements | $6,160,840 | -$22,379,826 | -78.4% |
| Indirect Costs | $34,938,879 | $4,128,055 | 13.4% |

Source: Arizona Department of Education, Annual Report of the Superintendent of Public Instruction voter-approved bonds. School districts, therefore, have an obligation to the voters as well as the bond holders to spend this revenue on nothing other than the debt service payments of the voter-approved bonds. Similarly, $47.8 million of the balance is found in funds for federal projects such as Title I grants. The federal requirements associated with these funds limit the state's ability to require districts to use this cash balance to offset a reduction in state aid.

But a substantial portion of the total cash balance could be used to help balance the FY 2010 budget by transferring the cash into the county aid for equalization assistance fund or by using some other similar method. This money would then reduce the amount of state revenues needed to fund the equalization formula. Of the cash balances that are available for such a sweep, transferring the balances of some of the funds would have an impact on school districts while other revenues could be transferred with virtually no affect to the schools. This difference stems from the districts' authority, or lack of authority, to spend the cash balances.

Cash balances result from one of two reasons: 1) because a district did not spend all of the funds they were authorized to spend in a given fiscal year or 2) because the district overestimated the property tax levy it would need to fund its authorized expenditure limit. In either case, A.R.S. § 15-991 (A)(3) requires school districts to use the cash balances remaining at the end of a fiscal year to decrease the next year's property tax levy. And A.R.S. § 15-992 (A) prohibits districts from including a delinquency factor for estimated uncollected taxes in the computation of the district's primary tax rate. Regrettably, in recent years these statutes have been largely ignored, and many school districts have amassed larger and larger cash balances. In many cases, the higher tax rates necessary to build up these cash balances have offset the property tax relief that otherwise would have resulted from the state's continued compliance with truth-in-taxation laws. In meetings with school district representatives, the justification for ignoring this law was that the cash balances were a request of the investment banking industry conducting bond ratings.

In situations where a cash balance resulted from a district not spending every authorized dollar, the district, in most cases, is allowed to increase the next year's budget. This budget increase results in a higher property tax levy which offsets the levy decrease that would otherwise result from the portion of the cash balance pertaining to the unspent budget capacity. Cash balances that correspond to a budget balance carryforward, therefore, cannot be swept without cutting school district budgets.

If, however, a cash balance exceeds a district's unexpended budget capacity then a cash balance will remain even if the district spends every authorized dollar. The cash balance that remains after subtracting a district's carryforward results because the district levied more property taxes in the previous levy than the district was authorized to spend.

Property taxes are levied in August based on estimates of both revenues and expenditures for a fiscal year that is only 30 days old. As the fiscal year develops, the actual revenues and the finalized expenditure limit may divert significantly from the estimates used to determine the authorized levy in August. If a district overestimates its authorized expenditures or underestimates its revenues then the district will have levied too much in its property tax. The district, therefore, is required to refund the excess levy to the property taxpayers by using the cash balance to offset the next year's levy as mentioned above. Conversely, if the district underestimates the authorized amount of property taxes, the district will end the year with a negative cash balance. The negative balance will increase the next year's levy, thereby, charging the taxpayers for the amount that should have been levied in the previous year.

Over the last five years the ending cash balances in school districts' maintenance and operations (M&O) funds have increased an average of 16.1% each year. The fact that school districts have consistently ended



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| Ending Cash Balances in Districts' M&O Funds | |
|---|---|
| **FY 2003** | $218,653,828 |
| **FY 2004** | $299,660,656 |
| **FY 2005** | $381,687,642 |
| **FY 2006** | $427,890,899 |
| **FY 2007** | $409,785,822 |
| **FY 2008** | $442,720,510 |

Source: Arizona Department of Education, Annual Report of the Superintendent of Public Instruction

each fiscal year with cash balances substantially greater than the budget balance carryforward indicates that districts regularly overestimate the authorized property tax levy in order to maintain a larger cash balance. On paper the districts technically refund the balance back to the property taxpayers each year; but, as the next year's levy is also overestimated, the balance remains with the schools. As school districts are not permitted to spend these cash balances, the state could transfer these balances into the county equalization fund to decrease the state aid required to fund the FY 2010 equalization formula. Alternatively, the state could transfer these funds directly into the state's general fund. Such a transfer will have virtually no effect on school districts because the districts are not permitted to spend these balances.

The amount of the unspendable cash balances that school districts held in their M&O funds at the end of FY 2008 is easily calculated by subtracting the total budget balance carryforward of all districts from the total of the ending cash balances. At the end of FY 2008 school districts' M&O funds held $442.7 million. The adopted FY 2009 school district budgets, as of February 9, 2009, included a total of $112.9 million in the general budget balance carryforward as well as the carryforward of budget balances for special programs such as career ladder and performance pay programs. This means schools held $329.8 million in their M&O funds which they were not authorized to spend. Since history has demonstrated that districts have consistently overestimated their property tax levies, the districts likely overestimated their 2008 property tax bills by a similar amount as they did the previous year. This means the districts will likely end the current fiscal year with at least the same $329.8 million of unspendable revenue in their M&O funds.

Unspendable cash balances will also exist in the districts' unrestricted capital outlay funds and their soft capital allocation funds. The Department of Education estimates that school districts ended FY 2008 with $388 million more in cash than they had in unexpended budget capacity.

***Justin Olson***