The Basics of Understanding School District Financial Statements

What you will learn:

- The importance of the four major financial statements
- Key Indicators of district financial position
- The definition of a fund balance and its optimal level
- How fund balances that may be available for the budget accrue or diminish
- The Texas Education Agency (TEA) indicators used to assess district solvency

Key points:

- Monitor your district's fund balance—it is the primary indicator of financial health.
- A district's adopted budget, particularly the relationship between revenues and expenditures, can strongly impact a district's financial position.
- Measure your district against TEA's solvency indicators to avoid insolvency.

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Dominic began his career in state government as an analyst for the Legislative Budget Board from 1997 to 2002. He then moved to Massachusetts where he worked for a state representative on the Ways & Means committee. During that time Dominic also pursued further education at Boston College. Soon after his return to Texas, Dominic worked for the House Appropriations Committee under Chairmen Jim Pitts and Warren Chisum. In 2009, Dominic came on board TASB to lobby on issues related to appropriations, finance, personnel, and tax policy on behalf of Texas school districts.

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Introduction

School boards, as the governing bodies of school districts, are responsible for overseeing, among other things, district financial management. As school board trustees come to the table from various walks of life and diverse backgrounds, understanding and assessing the district's financial condition will be more challenging for some than others. The goal of this section of the Guide is to provide a basic understanding of the type of financial statements you will have access to as a trustee, as well as the key information within these statements that are indicators of a district's financial position.

Major Financial Statements

Every school district, by law, is required to have district accounts audited annually at the close of the fiscal year. The audit is performed on the record of the accounts as maintained by the school district's treasurer. In some instances, the results of this audit, including numerous district financial statements, will be reported in a district's "Comprehensive Annual Financial Report," commonly known as the "CAFR." While all of the information is informative, there are four statements that are particularly important in assessing the district's financial position.

Depending on the size and capability of your district's finance department, you may have access to unaudited statements over the course of your fiscal year. These statements are:

- Statement of Net Assets;
- Statement of Activities;
- Balance Sheet; and
- Statement of Revenues, Expenditures, and Changes in Fund Balance.

The Statement of Net Assets and the Statement of Activities are government-wide financial statements that provide both long-term and short-term information about the district's overall financial status. While these statements contain summary data for the district itself, they also include data for any legally separate entities for which the district is accountable. In contrast to the government-wide financial statements, the Balance Sheet and the Statement of Revenues, Expenditures, and Changes in Fund Balance, are fund financial statements that focus on discrete parts of a district's activities as segregated through the use of a fund account ("fund").[1] The purpose of fund financial statements is to describe how the services provided through each fund were financed in the short-term, and what remains available for future spending. Thus, these statements exclude some financial data that will be found in government-wide statements, as discussed below.

The Statement of Net Assets and the Balance Sheet

The statement of net assets and the balance sheet provide financial information on the district as a whole, and on a particular fund respectively. They are similar in that both statements detail this information in terms of assets, liabilities, and an ending balance. Assets are economic resources, tangible or intangible, that are owned or controlled by the district and that can be converted into cash. District assets include cash and investments, but also include things such as land, buildings, and vehicles. Liabilities are obligations of the district, arising from past transactions or events, the settlement of which may result in the transfer or use of assets. Some of the more common liabilities include interest payable on bonds, accrued salaries, and accounts payable.

Net assets are the district's liabilities subtracted from its assets; it represents what the district would retain if all of its financial obligations were satisfied. Or, to put it another way, if a district were developing a plan to cease operations, the net assets are what the district would expect to return to the taxpayers or transfer to a successor entity. The fund balance is what remains in a particular fund at the end of the fiscal year that a school board may use in subsequent fiscal years to pay for activities for which the fund was created.

In addition to describing a fund's financial position, rather than the financial position of the district as a whole, balance sheets differ from a statement of net assets in one crucial respect—a focus on the short-term. This means that the balance sheet contains information only on *current* assets and liabilities.[2] Finally, a balance sheet will provide detail on restrictions or commitments related to the fund balance.

> ***Financial Indicator # 1:*** Over time, increases or decreases in net assets may serve as a useful indicator of whether the district's financial position is improving or deteriorating.
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> ***Financial Indicator #2:*** Accumulated depreciation is a contra-asset found on the statement of net assets that is used to write down the value of an asset as it is consumed due to usage or age. The higher the amount of accumulated depreciation compared to the value of a district's capital assets (buildings and improvements, vehicles, etc.), the more likely the district will need to make significant purchases in that area.
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> ***Financial Indicator #3*:** Beginning with the fiscal year ending in 2011, fund balances must be characterized as nonspendable, restricted, committed, assigned, and unassigned. Prior to the fiscal year ending in 2011, unassigned fund balances were referred to as unreserved, undesignated fund balances. These fund balances are available for future use at the discretion of the school board. TEA has published a rule of thumb for the General Fund's optimum unreserved, undesignated fund balance as "equal to the estimated amount needed to cover cash flow deficits in the fall period in the following fiscal year plus estimated average monthly cash disbursements of the General Fund for the following fiscal year."[3] The district's administration should be able to report if this standard is being met.

The Statement of Activities and the Statement of Revenues, Expenditures, and Changes in Fund Balance

The Statement of Activities and the Statement of Revenues, Expenditures, and Changes in Fund Balance provide financial information on the district as a whole, and on particular funds respectively. They are similar in that both statements detail this information in terms of revenues, expenditures, and net assets or fund balance.

Revenues represent a school district's gross receipts. These receipts include local property taxes, state aid, federal funds, donations, and investment earnings. In short, revenues are all income received by the school district in the form of cash or its equivalent. Expenditures are financial outlays allocated to a specific function or program which is charged against revenue. School districts have expenditures related to providing an educational program such as instruction, school leadership, and transportation. Additionally, many districts have expenditures related to servicing debt and acquiring capital items.

As with the Balance Sheet, the Statement of Revenues, Expenditures and Changes in Fund Balance focuses on revenues and expenditures made in the short-term. It will not contain information on revenue or expenditures that are expected to be realized outside of one year, such as uncollected taxes or earned, but unused vacation leave.

> ***Financial Indicator #4*****:** The statement of revenues, expenditures, and changes in fund balance will have a subtotal line titled "Excess (deficiency) of revenues over (under) expenditures." When revenues exceed expenditures, a surplus is created which adds to net assets/fund balances, and may be used by trustees in subsequent fiscal years. When expenditures exceed revenues the result is a deficit. Deficits may be met by using fund balances, borrowing, or transfers from other funds. Over time, if deficits persist, the district may need to enhance revenues through tax increases or other means, or reduce expenditures through program or service cuts, debt refinancing, or other means.

The District's Budget

As a school board trustee, you are tasked with managing the school district's finances through the adoption of a budget. The financial statements that have been discussed present a picture of actual financial data at the end of a fiscal year. In fact, you may already be aware of the similarities between the statement of revenues, expenditures, and changes in fund balance, and your district's budget summary. The former document details how the budget impacted the district's financial condition during the last fiscal year, while the latter document captures the financial impact of district operations over the next fiscal year. For this reason, the financial indicators, such as revenues compared to expenditures, remain applicable when analyzing the district's proposed budget.

Of course, the most important part of adopting a budget is allocating the district's resources in a manner that reflects the board's stated vision and priorities. However, from a financial stewardship perspective, the most important part of budget adoption process is whether the budget positions the district to continue as an ongoing entity well into the future. There are numerous financial indicators that can be gleaned from budget documents about a district's financial viability, but the following three should assist a trustee in beginning to make this determination.

> ***Financial Indicator #5*****:** If the proposed budget uses fund balances, how many years can the district continue operating at the same program levels while using the same amount of fund balances before fund balances have been exhausted. If the answer is less than three years, the district may not have the opportunity to seek additional state aid and may be forced into severe program cuts or tax increases.

> ***Financial Indicator #6:*** Are property values rising or falling in your district and in the Austin Independent School District (AISD)? Districts are exempt from recapture on the first six pennies ("golden pennies") levied above the compressed tax rate. If property values fall, the district will receive less revenue. AISD has estimated that its taxable value will decline by 5.7% for fiscal year 2011, even as district enrollment is increasing. Property-poor districts are guaranteed a yield at AISD's level, which will result in a reduced golden penny yield for these districts if Austin property values do not increase.

> ***Financial Indicator #7:*** Are items and programs funded with American Recovery and Reinvestment Act funds (i.e., stimulus funds) things the district can forgo? Stimulus funds were sent to the states and school districts as an extraordinary federal expenditure that would not be continued into the future. If stimulus funds were used for one-time investments, like to fund capital purchases or provide special programming, the district is better positioned when stimulus funds end. If, however, stimulus funds paid for salaries or programs which local citizens expect to continue, the board may find its hands tied when trying to make prudent financial decisions on behalf of the district.

Texas Education Agency's Financial Solvency Review

In 2009, the Texas Legislature passed House Bill 3 which directed the Texas Education Agency (TEA) to develop a review process to anticipate the future financial solvency of each school district. TEA has developed a methodology to determine financial solvency, and identified school districts at risk of financial insolvency for the first time in 2010. The indicators in the attached table have been identified by the TEA as critical indicators in evaluating school district solvency. The data needed to test these indicators can be found in a district's financial statements or budget documents or may be provided by district administration. If TEA determines that a district is at risk of financial insolvency, it may require the district to submit a financial plan for approval. Failure to resolve the situation can earn a district an "Accredited-Warned" status. Consequently, trustees should keep these indicators in mind when analyzing district financial statements.

Conclusion

It can be a daunting task for an individual without an accounting or finance background to look through financial statements and understand the district's financial condition. However, it is a necessary step in becoming informed about the resources the district has at its disposal and the obligations the district needs to fulfill. With this knowledge, board members will be prepared to ask the right questions during board meetings and to make informed decisions, particularly during budget adoption. Understanding the information contained within financial statements is a key step toward ensuring that your district can continue to provide a quality academic program for years to come.

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Critical Indicators For School Districts	Where to Find Relevant Data	Determination of Category Flags	Final Determination
Student to Staff Ratio Outside the Norm or Declining			Any district with 3 or more flags Any district with 2 or more flags and a fund balance less than 2 months general fund expenditures Any district with the fund balance flag and one other flag Any district with a fund balance less than 1% of general fund expenditures
WADA-to-all-staff ratio is less than 85% of mean ratio for group	Group mean Ratio provided by TEA. WADA, Staff, and Enrollment Data usually found as part of budget packet.	Any Yes causes a "Yes" flag for this category	
WADA-to-all-staff ratio declined by more than 7% from prior year			
Enrollment-to-teacher ratio less than 85% of mean ratio for group			
Enrollment-to-teacher ratio less than 85% of mean ratio for group			
General Fund Expenditures Exceeding Revenues			
Expenditures exceed revenues by more than 6%	For current year data, review budget documents. For the prior year look at the statement of revenues, expenditures, and changes in fund balances.	Any Yes causes a "Yes" flag for this category	
If expenditures exceed revenues by more than 4% and exceeded revenues by more than 3% in the prior year			
If expenditures exceed revenues by any amount and the district has a prior year end-of-year fund balance that has declined from the year before and that is less than 4% of the general fund expenditures			
Actual Expenditures Consistently Exceeding Budgeted Expenditures (Inability to Stay Within Budget)			
Actual expenditures exceeded budgeted expenditures by more than 10% in the prior year	Compare expenditures in the prior year or two using the applicable year's statement of revenues, expenditures and applicable year's adopted budget.	Any Yes causes a "Yes" flag for this category	
Actual expenditures exceeded budgeted expenditures by more than 6% in the prior year and actual expenditures exceeded budgeted expenditures by more than 4% two years prior			
Declining or Low General Fund Unreserved Fund Balance			
The prior year end-of-year fund balance has declined from the year before and the fund balance is less than 6.25% of the district's General fund expenditures	Compare fund beginning and ending fund balances from the Statement of Revenues, Expenditures and Changes in Fund Balance and budget documents. Compare ending fund balances to current year adopted budget expenditures.	Any Yes causes a "Yes" flag for this category	
The prior year end-of-year fund balance has declined from the year before by more than 25% and the fund balance is less than 12.5% (1 and a half months) of the district's general fund expenditures			
The prior year end-of-year fund balance is less than 1% of the district's general fund expenditures			

[1] Texas school districts typically have up to four types of governmental fund accounts. These accounts, called Major Accounts, are the General Fund (to account for the daily operation of school districts), Special Revenue Funds (to account for revenue sources with legal restrictions on expenditures), Debt Service Fund (to account for principal and interest accounting on debt paid with a dedicated tax), and Capital Project Fund (to account for projects finance with bond proceeds). In addition to the aforementioned "governmental funds", districts may also have proprietary funds, including internal service and enterprise funds, to account for operations related to food service, Medicaid or other programs, and fiduciary funds, which account for assets held by the district as trustee or as an agent of another organization.

[2] Current assets are cash or assets that can be converted into cash within one year. In contrast noncurrent assets are assets that generally take longer than one year to convert to cash. Examples of noncurrent assets include vehicles, buildings, or a two-year certificate of deposit. Similarly, current liabilities are obligations that the district is required to or expects to pay off within one year. An example of a current liability is interest payments owed on a bond over a one year payment. A noncurrent or long term liability would be the interest payments owed over the life-time of a bond outside of the one-year period.

[3] Financial Accountability System Resource Guide, Module 1. Financial Accounting and Reporting, Update 14, January 2010, available at www.tea.state.tx.us/index4.aspx?id=1222, pp. 143-144.