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How Do We Locally Determine an Adequate Reserve Level? [Part 1 of 2]

[Editor's Note: As we emerge from the Great Recession, one of the lessons we learned was that strong leadership, teamwork, planning ahead for contingencies, taking early actions to avoid a fiscal calamity, and having an adequate reserve got everyone through. Given Governor Jerry Brown's concerns about a coming recession and the potential cap on local school district reserves, we continue to receive a lot of questions about what constitutes an adequate reserve level. This series is divided into two parts: (1) a primer on what reserves are and how they are defined, and (2) what constitutes an adequate reserve level. The following is Part 1 of the series.]

What Is a Reserve?

The term "reserve" can be a verb, a noun, or an adjective. As a noun it is defined as "cash, or assets readily convertible into cash, held aside, as by a corporation, bank, state or national government, etc., to meet expected or unexpected demands."

In California school finance we use a certain set of official terms for our reserves. To start with, the term "fund balance" means the total amount of funds available at either the beginning or end of an accounting period. The fund balance can be made up of the following:

- **Nonspendable Amounts:** These are amounts that are, as the label indicates, not in spendable form. For example, the value of the inventory in the central warehouse or food services storage area is an asset that is part of the fund balance, but it is not cash so it is not spendable.
- **Restricted Amounts:** These amounts are the carryover balances from restricted or categorical programs. These amounts cannot be used for any purpose other than those purposes allowed by the grantor agency, regulations, and/or statutes governing the programs.
- **Committed Amounts:** The highest level of decision making authority, which in the case of local school agencies is the governing board, can take formal action to set aside a portion of the fund balance for a specific purpose. An example of this would be to commit funds for a future textbook adoption or a future technology initiative.
- **Assigned Amounts:** Generally these amounts are designated administratively for specific purposes, which are usually routine in nature. For example, most local agencies have a policy of allocating a certain amount of discretionary funds to school sites and then allowing unspent funds to be carried over and available for expenditure the next year, in which case the funds would be assigned amounts in the ending fund balance.
- **Unassigned Amount:** In the General Fund only this amount is the residual balance that was not allocated to any of the above categories of fund balance (the unassigned amount also includes the Reserve for Economic Uncertainties (REU), which is discussed further below). In funds other than the General Fund all amounts should be allocated to the above categories (with rare exceptions).

Reserve for Economic Uncertainties

The state has established a set of formal “Criteria and Standards” to guide the development and review of local school agency budget reports and for monitoring their fiscal stability. These Criteria and Standards include the following criteria for reserves:

Available reserves for any of the budget year or two subsequent fiscal years are not fewer than the following percentages or amounts as applied to total expenditures and other financing uses:

- The greater of 5% or \$65,000 for districts with 0 to 300 average daily attendance (ADA)
- The greater of 4% or \$65,000 for districts with 301 to 1,000 ADA
- 3% for districts with 1,001 to 30,000 ADA
- 2% for districts with 30,001 to 400,000 ADA
- 1% for districts with more than 400,001 ADA

Available reserves are the unrestricted amounts in the REU and the Unassigned/Unappropriated accounts in the General Fund and Special Reserve Fund for Other Than Capital Outlay Projects. Available reserves will be reduced by any negative ending balances in restricted resources in the General Fund.

The REU is the amount within the unassigned fund balance that is set aside to meet the minimum fund balance as designated in the state’s Criteria and Standards above. In addition, the REU is to reflect any amounts established as a reserve by a local agency’s fund balance policy that extends beyond the amount in the Criteria and Standards.

In order to clarify that the REU, even though it is part of the unassigned fund balance, is important to local agency financial stability and is not available for spending, a unique code within the state’s accounting structure has been created to separately identify the REU within the unassigned fund balance of local school agencies.

Stay tuned for Part 2 of this series on how to determine an adequate reserve level . . .

—*Sheila G. Vickers*

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