

School Finance 101

Introduction to Public School Finances

Who determines how the public education system in Pennsylvania works? Who decides how much a school district spends and on what? Where do school districts get the money they spend? What do they spend this money for? How do they keep track of what they receive and spend? Who holds the district accountable? How do parents, taxpayers, and others learn about and participate in the overall process?

School Finance 101 offers answers to these and other questions to help citizens understand the how, what, and where of school finances in the Commonwealth. It can help citizens understand how issues and factors vary from district to district and enable them to ask better questions about their local school district's finances. Many complex issues have been summarized here in order to provide greater insight into how tax dollars fund public education. This document includes an overview of school finance, followed by a more in-depth discussion that expands on each topic. In addition to this document, other information on schools is available at *Your Schools, Your Money*¹ and the Pennsylvania portion of *Standard and Poor's School Evaluation Services* website².



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¹ <http://www.pde.state.pa.us/>

² <http://www.ses.standardandpoors.com/>

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Overview

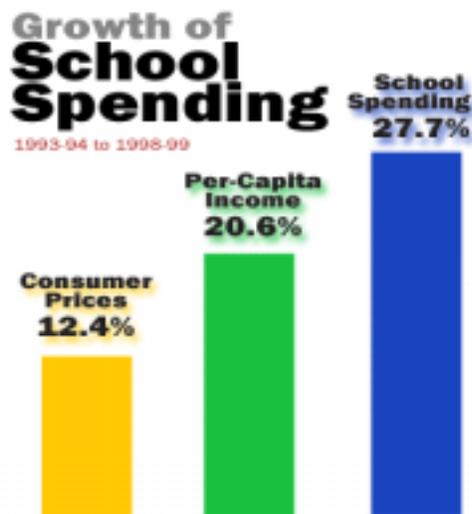
Governance

Pennsylvania’s Constitution requires the State Legislature (the state Legislature) to “provide for the maintenance and support of a thorough and efficient system of public education to serve the needs of the Commonwealth.” In order to fulfill this responsibility, the state has established a system of local public school districts. The state also created the Pennsylvania Department of Education (PDE)³ to administer school laws and help school districts carry out their educational programs.

The public school system, including career and technical schools (formerly known as vocational-technical schools), charter schools⁴, special schools, and intermediate units⁵, provides elementary and secondary education services to about 85 percent of the state’s 2.1 million school-age children. The other 15 percent receive their K-12 education in private schools and home schools.

Finances

Figure 1 Growth of school spending



Public education in Pennsylvania requires significant financial resources. Local school districts spend about \$15 billion each year to educate the Commonwealth’s 1.8 million public school pupils. These funds are used to pay teachers and other employees, buy books, heat school buildings, transport children, and carry out various other responsibilities. And costs are rising, going up by \$3.2 billion or 27.7 percent between the 1993-94 and 1998-99 school years.⁶ During the same period the rate of inflation as measured by the

Consumer Price Index (CPI) rose 12.4 percent and per capita personal income in Pennsylvania rose by 20.6 percent. The accompanying chart contrasts the percentage increases of these three measures of spending.



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³ http://www.pdeinfo.state.pa.us/depart_edu/site/default.asp

⁴ <http://www.pde.state.pa.us/charter.html>

⁵ <http://www.pde.psu.edu/>

⁶ All figures are provided by PDE for fiscal year 1998-1999 unless otherwise noted.

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The financing and operation of Pennsylvania’s public school districts is a process that involves multiple parties, including local business owners, retirees, parents, residents, taxpayers, school administrators, teachers, staff, and the students themselves.

The primary responsibility for the activities of a school district lies with the locally elected school board.⁷ While local control has a strong tradition in Pennsylvania, the board must direct the affairs of the school district within the framework of the Pennsylvania School Code, other state laws, and various regulations and standards. These regulations and standards are established primarily by the PDE, the State Board of Education⁸, the Pennsylvania State Legislature, other state agencies, and independent groups that help set accounting and financial standards.

As part of its responsibilities, the local school board adopts a budget, collects revenues, makes expenditures, executes related responsibilities, and makes numerous other decisions in the interest of providing a sound program of education for the district’s children. All school district finances start with a budget. In making budgetary decisions, the board must balance a variety of competing interests and chose between what it finds necessary for a good educational program and what it and its taxpayers can afford. The board is accountable to its citizenry for all its activities through a system of financial reports and audits, public and state oversight, and, of course, the election process.

Public Participation

In order to help ensure accountability, state law establishes various requirements relating to public participation in the decision-making process of each local school district. The two major laws that set the general rules for public involvement in all Pennsylvania local governments are the:

- Sunshine Act
- Right to Know Law

With some exceptions, the Sunshine Act requires public agencies to take official actions and conduct deliberations leading to official action at public meetings. These meetings must be advertised in a newspaper (except for emergency meetings), and the public must be given a reasonable opportunity to comment at these meetings. A court can set aside any actions taken in violation of the act.

The Right to Know Law requires school districts to make certain types of records available for inspection by citizens at reasonable times and gives citizens



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⁷ <http://www.pde.psu.edu/k-12>

⁸ <http://www.pde.psu.edu/regs/regulations>

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the right to make copies of these records. If a citizen is denied access to this information, he or she can appeal to the court, which can order compliance.

Other state laws go further and specifically require, for example, that school districts adopt their budgets at a public meeting, and that public hearings be held on certain proposed school construction projects.

Budgeting

State law requires that each Pennsylvania school district prepare an annual budget. The budget has two equally important parts. One is a spending plan for the programs and services designed to achieve the district's educational goals and objectives. The other is the financing plan to meet the district's expected costs for these programs and services. The financing plan outlines the financial resources needed by the district, including the taxes that must be levied.

Many households and businesses also develop budgets. However, a school budget differs in that it is a legal document which sets limits on how much a district can spend for various purposes throughout the year and which provides for other financial controls and accountability. Those controls and accountability are fundamentally important because school districts use public funds. Action taken in obtaining and spending these funds are part of the public trust given by citizens to their elected officials.

The Pennsylvania State Legislature has therefore required specific actions for school districts to carry out as part of their budgetary process. These include providing public notice and making the budget document available for public inspection prior to adoption. The Legislature has also established certain restrictions. For example, school districts cannot approve deficit budgets (that is, if planned spending will exceed the expected amount of funds available), and districts cannot spend any funds without an approved budget.

Numerous people affect the budget process. These include state and federal elected officials and agencies, local school boards and administrators, the citizenry, and the immediate stakeholders: the teachers and students.

Because every district is different, various factors affect budgetary decisions. On the expenditure side, these may include:

- Geographic location in the state and its geographic size
- Enrollment and enrollment trends (whether it is growing or declining)
- Staffing, including size, length of service, and educational level
- Policies on class size
- Collective bargaining agreements
- Building age, energy efficiency, and space capacity requirements



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- Special educational programs
- Busing requirements for both public and non-public pupils
- Technology programs and infrastructure
- Extracurricular activities
- Other required programs

On the revenue side, influencing factors may include:

- Zoning within the district — the mix of industrial, commercial, residential and agricultural/open space property
- Trends in the assessed value of real estate
- Other tax-generating capacity
- Practical and legal limits on the rates of local taxation
- State subsidies and other funding (including building construction reimbursements)
- Federal and state grants
- Current and future debt
- Funds available from prior years

Several other factors have a major bearing, particularly on real-estate tax revenue. These include property assessments (including appeals) and state legislation such as Act 50, the Clean and Green program, the Keystone Opportunity Zone (KOZ) program, and the Local Economic Revitalization Tax Assistance Act (LERTA).

The budget must strike a balance among the three principal forces in the budgeting process:

- Educational Programs
- Overall Spending
- Financial Resources



Figure 2 Three forces in the budgeting process⁹

Which one of these factors is the controlling force? In the view of some of the participants, educational programs may be the most important consideration; to others it might be overall spending, or the realities of limited financial resources. But no single factor consistently and uniformly drives the budget

⁹ Source: Walter G. Hack, I. Candoli, and John R. Ray, *School Business Administration: A Planning Approach*, 6th ed. (Boston, MA; Allyn and Bacon, 1998), P. 147



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process in all districts. Nonetheless, the budget must bring these primary factors together and balance them in a coherent plan.

Finances

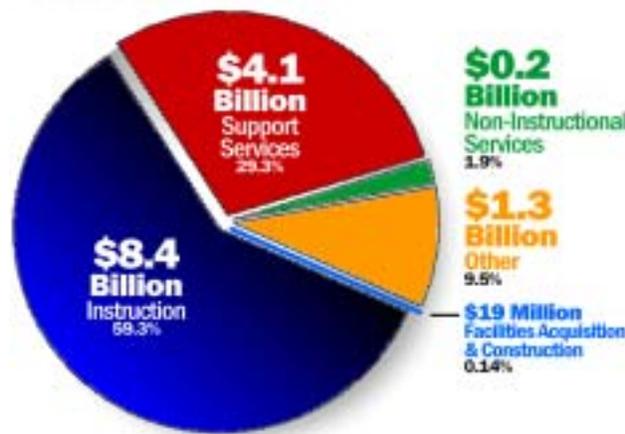
General Fund Expenditures

School districts spend money for their day-to-day needs (such as salaries, books, and heat and light for buildings) as well as longer-term needs (such as new buildings and the repair or expansion of older buildings, including the repayment of borrowed funds for these and other purposes).

Total spending translates to about \$7,500 per pupil (1998-99). This figure represents the statewide median or midpoint of annual spending on a per pupil basis by Pennsylvania's 501 school districts: half the districts spend more (some as much as \$15,800 per pupil) and half spend less (some as little as \$4,650 per pupil).

Figure 3 Total expenditures by function

Expenditures by Function



The state requires school districts to account for their spending in two main ways. First, they must identify spending based on why the expenditures are made. There are five educational cost categories (known as functions): instruction; support services; non-instructional services; facilities acquisition, construction, and improvement; and other financing uses. Instruction costs represent the largest portion of this type of spending.



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Spending by Object

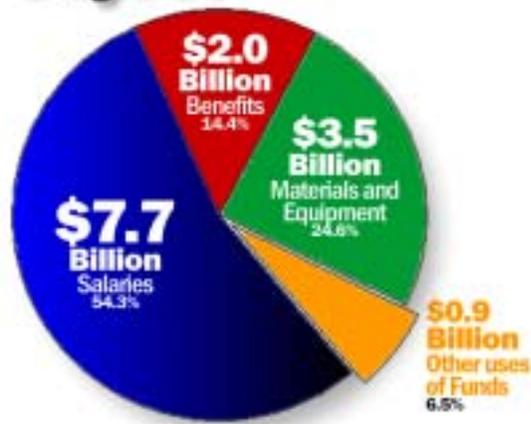


Figure 4 Total spending by object

Secondly, school districts record spending according to what they buy. These costs provide a different perspective on spending. The various things school districts may buy include salaries, benefits, various types of services, supplies, and expenditures for facilities. These are known as objects of expenditure. Salaries and benefits represent the largest portion of this type of spending.

General Fund Revenues

Pennsylvania’s public school districts receive their funds from two primary sources: local sources — mainly local taxes — and the state government. Relatively small amounts come from the federal government and miscellaneous sources. School districts may also use money left over from prior years. As shown by the accompanying chart, Pennsylvania’s school districts receive 57 percent of their revenues from local sources and 38 percent from the state.

Sources of School Funding

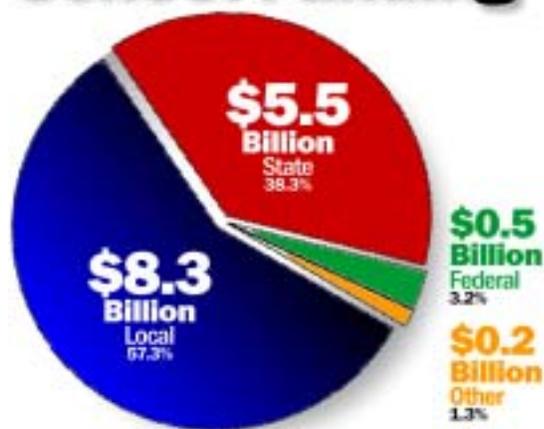


Figure 5 Sources of school funding

One of the Commonwealth’s objectives in funding local education has been to provide state support where the need is greatest by allocating more state aid on a per-pupil basis to poor school districts and less to wealthy districts. This, in turn, is designed to reduce the differences in spending for public school pupils among the 501 school districts. As a result, there can be a large variation in the levels of state and local funding among districts.



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Local Revenues

Local taxes are the primary source of local revenues for school districts and generally produce more than half of total district revenues. A relatively small portion of local revenues comes from sources other than taxes.

Local Taxes

Most people pay some form of local taxes to their school district. These include the real estate tax, the earned income/net profits tax, and a mixture of other non-property taxes. While there may be a wide variety of taxes, they have three things in common: a base, a rate, and a yield. Each involves the taxation of an object, a person, an action, or a transaction, which is considered the “base” for the tax. Each tax also involves a “rate” of taxation, which is determined by each local school board within the limitations established in state law. The rate can be in the form of a millage, a percent, or a flat dollar amount. Ultimately, each tax has a potential yield, or the amount a district expects to receive from the tax. The yield is equivalent to the base multiplied by the rate. For the individual taxpayer, his or her tax bill is calculated in the same fashion.

Local Taxes are the Majority of Local School Funding

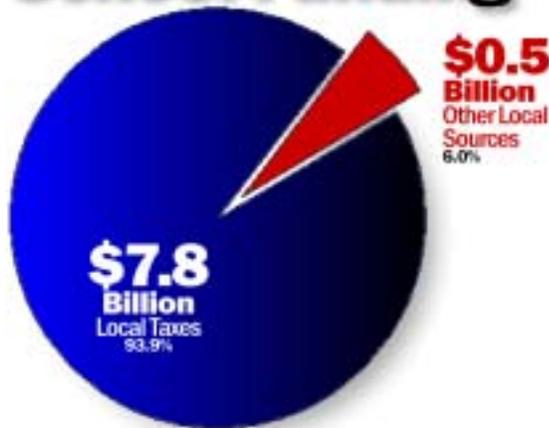


Figure 6 Local taxes are the majority of local school funding

For example, the real estate tax (the major source of tax revenue for most school districts and used by all Pennsylvania districts) is levied on the land and buildings owned by individuals and businesses. The county assessment office sets the base by placing an assessed value for taxation purposes on each property in the district. A uniform tax millage rate is then levied by the school district against the value of each property. One mill is equivalent to \$1 of tax for each \$1,000 of value. The millage

rate multiplied by the sum of the values of all properties (known as the district’s assessed valuation) produces the potential tax revenue of the district. The actual revenue varies due to multiple factors, including discounts and uncollected taxes. For individual taxpayers the millage multiplied by the assessed value of their property produces the owner’s tax bill.



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Similarly, the earned income tax (the largest of the non-property taxes) is levied on the wages, salaries, commissions, net profits, and other compensation of those who reside in the district. (Income from interest and dividends is not included.) This tax applies to employed individuals, unincorporated business owners, partnerships, etc., and is normally withheld from workers' paychecks. Most Pennsylvania residents pay 0.5 percent to their school district and 0.5 percent to the municipality in which they reside.

The real estate transfer tax (the second largest source of non-property taxes) is imposed when someone sells an item of real estate. The tax is based on the selling price of the property and is paid by the purchaser at the time of transfer. A total of 486 of 501 districts levy this tax. The maximum real estate transfer tax for school districts is 1.0 percent. (The state also levies another 1.0 percent transfer tax.)



The occupation tax is levied on the assessed value of a worker's occupation. Although fewer than one-quarter of Pennsylvania's districts levy this tax, it is a significant revenue producer for these districts and is the third largest generator of non-property taxes statewide. The county assessment office assigns a value to the occupation of each adult in the district — including those not employed. As with the real estate tax, the district levies a tax rate in the form of a millage against these valuations, and the district sends each taxpayer a bill. This tax is not subject to sharing with the district's municipal governments, and there is no specific rate limit on the occupation tax.

Other non-property taxes include occupational privilege, amusement, per capita, mercantile, business privilege, mechanical devices, and several others.

The remaining sources of tax revenue include delinquent taxes and special taxes for the Philadelphia and Pittsburgh school districts.

Most school districts also receive revenues from the statewide tax on utility property, which is exempt from local taxation. Some districts receive voluntary contributions from governmental entities and/or organizations exempt from real estate taxation; these contributions are known as payments in lieu of taxes.

Other Local Sources

Revenues at the local level also include investment income. Because school districts often receive large amounts of dollars, especially from the real estate tax, within the early months of the budget year and most costs tend to be spread evenly over the entire year, a temporary cash surplus may result. Simi-



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larly, if the district has borrowed for a construction project or other major capital spending, it may not need the proceeds from the bond issue to pay the project’s cost right away. In both cases the district can invest this money to generate additional income.

Interest earnings and other revenue generated from investments can be quite significant. Some districts use this money to meet current expenditures, thereby enabling them to levy less in taxes. Because school districts use public money, their investment goals are normally very conservative: to minimize risk and protect principal. In keeping with this philosophy, the Pennsylvania School Code limits school districts in their investment options.

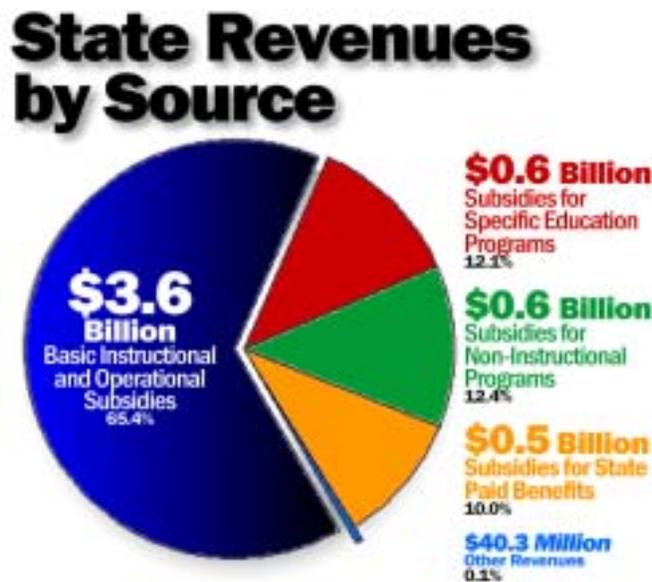
Other sources of local income can include rents, tuition payments, receipts from the sale of materials and supplies, and other miscellaneous sources.

Borrowing

A district may also borrow money in order to complete a large-scale project or when it has special needs as defined by state law. A district generally borrows money from a bank or other lending institution. But if the project is particularly large and complex, a school district may borrow from individual and institutional investors by issuing bonds. How the money will be used and how much will be needed determines whether a school district borrows from a bank, issues bonds, or uses some other type of financing.

State Sources

Figure 7 State revenues by source



State funding for public schools in the Commonwealth takes a variety of forms and is designed in part to balance differences between the ability of a school district to raise its own funds and its spending needs.

Funds flow from a number of appropriations enacted annually by the Pennsylvania Legislature and signed into law by the

Governor. These include both subsidies and grants. Subsidies are payments to all schools based on formulas determined by the Legislature. Grants normally have



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specific award criteria, and school districts must compete with other districts by submitting applications and demonstrating a need for the funds.

The state's appropriation for Basic Education Funding (BEF) is the largest subsidy provided by the Commonwealth to its 501 public school districts to help meet instruction costs. In 1998-99, it totaled more than \$3.5 billion or more than half of all state funds available to districts, making up about 25 percent of all General Fund revenues for Pennsylvania school districts. It has been the largest single appropriation in the Commonwealth's Budget each year.

This subsidy used to utilize a formula that took into account several factors in determining the amount distributed to each school district. Since the early 1990s, the amount determined by that formula has been supplemented by annual percentage increases established by the Legislature. In addition to the BEF subsidy, the Commonwealth provides funding to school districts to help meet the variety of costs including improving libraries, providing technology, educating exceptional children, transporting children between home and school (including eligible non-public pupils), and half of the employer share of retirement and Social Security payments for public school personnel. The Commonwealth also provides funds for a number of other programs and services using a variety of reimbursement mechanisms. These programs include career and technical education; certain medical, dental, nurse, and related health services; driver education; homebound instruction; adult literacy; school food services; education of educationally deprived children; and dropout prevention.

The state may also provide funding to cover a portion of the costs incurred by local school districts in constructing, acquiring, or renovating a building; acquiring a site; or leasing facilities. The amount of state reimbursement for construction depends in general upon the number of students, the type of facility (elementary, secondary, etc.), the construction costs, and the relative wealth of the district. If the district wishes to secure state funding for building construction, it must follow guidelines established by the state. However, the decision about the merits of a school building project rests with the local school board.

Because of growing interest in school construction issues, the Pennsylvania State Legislature passed Act 34 in 1973. This law generally requires that school districts hold public hearings and solicit public comment on new construction projects or substantial additions to existing structures. Act 34, also called the Taj Mahal Act, does not apply to alterations of existing structures.

Various state grant programs exist to promote certain goals and to reward school district performance. In order to receive most grants a school district must compete with other districts by submitting applications and demonstrating a need for the funds. Two such grants programs are "Read to Succeed" and Performance Incentive Awards, which recognize districts that demonstrate significant im-



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provements in students' academic achievement and school attendance. Districts may also qualify for the high standards component, which rewards those that maintain a high level of achievement.

Federal Sources

Revenues from federal sources represent a relatively small portion of a district's income. Title I is a key element of federal funding. It provides funds to districts to help educationally deprived children gain basic and advanced skills and to provide guidance, health, and nutrition services. The federal government also provides funding for special education programs; local school to work partnerships; technology literacy; libraries; safe and drug-free schools; bilingual education; immigrant education; and community learning centers. In addition, the federal food and nutrition program provides reimbursement for various meals or foods to students.

Federal funding is generally program-specific and can come from a number of sources including the U.S. Department of Education, the U.S. Department of Health and Human Services, and the U.S. Department of Agriculture. Federal funds can be in the form of grants or subsidies provided directly by the federal government or through the Commonwealth.

Other Sources of Revenues

Other sources of revenues include the sale of fixed assets and refunds of prior years' expenditures. These normally produce a very small portion of total district revenues.

Accounting, Reporting, and Auditing

In order to evaluate their financial status, all school districts need to track and analyze their revenues, expenditures, assets, liabilities, fund balances, and related financial activities. The state established a standard accounting system for these purposes.¹⁰

School districts, like businesses, use their accounting system to keep track of financial activities. In addition, they must assure the public that public moneys are received and spent in keeping with legal requirements and the adopted budget. The accounting system provides the framework to achieve this goal.

In order to measure and control the legal and budgeted activities properly, separate accounting funds are set up. An accounting fund is a set of self-balancing accounts or a "separate set of books" used for a legally defined or prescribed purpose. Each fund is accounted for as if it were a separate business, with

¹⁰ <http://www.pde.state.pa.us/forms/pdeformpg.html>



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most activities accounted for in the General Fund. Districts might have additional funds for capital projects, debt service, food service, athletics, and others. At the end of the fiscal year the district prepares an Annual Financial Report (AFR). This is a public document that the school district must submit to the state. A number of financial statements and supporting documents make up the AFR. The most important ones include the balance sheet; statement of revenues, expenditures, and changes in fund balance; statement of net assets; and statement of activities.



Fund Balance

An important concept used in government accounting and reflected on the district's AFR is "fund balance." Fund balance is a measure of net financial assets, which is similar but not identical with equity or accumulated savings. The fund balance is equal to financial assets less financial

liabilities. In other words, it is like the balance in your checking account. Deposits are like assets and the bills you need to pay are like your liabilities. What is left over is generally considered your available balance, or what is left for discretionary household spending. But it is important to recognize that there is often a portion of the fund balance for a school district that is reserved and can only be used for specific purposes because of legal or accounting commitments. The unreserved portion of the fund balance can be used for any future district spending. Good financial practices suggest that districts maintain an adequate unreserved fund balance to cover district emergencies or other contingencies.

Financial statements and the fund balance provide valuable information on the financial activities and position of a school district. In general, a negative unreserved fund balance means the district's financial obligations are greater than its resources, and additional resources will be required to meet this gap. Similarly, a positive but decreasing unreserved fund balance needs to be reviewed by district officials in order to make sure there will be sufficient funds to meet future needs.

The school district's financial transactions are audited, or examined by an independent auditor, to determine their accuracy. There are three main audits.

- A financial audit (required by the Pennsylvania School Code), is used to determine whether the financial statements produced by the school district fairly represent the district's financial position and operations. A Certified Public Account (CPA) performs this audit in all Pennsylvania districts except Philadelphia, where the City Controller assumes this responsibility.



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- The Pennsylvania Auditor General performs another key audit to verify that school districts received the proper allocation of state funds and followed state rules and regulations.
- Federal grant programs require a separate audit to verify that the federal funds were received and spent according to established rules and regulations.



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Your Schools, Your Money

Purpose

Within the past few years there has been a major movement at the national, state, and local levels to provide more information to citizens about the finances and operations of their schools. In Pennsylvania, this movement is reflected in the passage of Act 16 of 2000 by the Pennsylvania State Legislature. This act sets the legal framework for the PDE initiative, *Your Schools, Your Money*.

Your Schools, Your Money will provide easily understandable and meaningful financial data about each school district in the Commonwealth. In order to achieve this goal, PDE has developed a subsystem of common components, definitions, and methods to present financial information extracted from each district's accounting records along with the relevant non-financial information. With certain modifications, these data are intended to help citizens better understand how their resources are being utilized by their school district.

Types of Data

Using the internet, *Your Schools, Your Money*¹¹ will make information available on a district level for such items as revenues by source, administrative support costs, special education, instruction costs, transportation costs, and other uses. Starting in February 2002 spending for instruction costs will be presented at the school building level; beginning in February 2003, this type of information will be available by elementary grade and at the secondary subject levels. In most cases three principal categories of spending will be shown: salaries and benefits; materials and equipment; and other expenses. In addition, other pertinent information such as the cost per pupil and relevant enrollment figures will be provided for each component.



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System Development

The accounting system for this program builds upon what districts currently use. Modifications involve the expansion of expenditure codes designed to capture a larger portion of direct costs linked to each school building and ultimately each elementary grade and secondary subject level. Districts will need to show instruction costs, which traditionally have been reported in a single account, at the school building level. They will also show instruction costs by grade level

¹¹ <http://www.pde.state.pa.us/>

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and subject matter. As a cooperative effort PDE has been developing and testing the underlying data approach with over 50 volunteer local education agencies including school districts, intermediate units, and career and technical schools for the past four years.

The data presented, along with the method of presentation, is designed to help all citizens make rational choices in educational development and encourage active participation in discussing education policy and funding.

Meetings, Information, and the Public

Pennsylvania's School Code requires that school districts adopt their budgets at a public meeting, while other provisions of state law require public hearings on proposed school construction activities. These legal provisions are focused on providing the public with the opportunity to participate in the decision-making process and to make these views known to their elected representatives on the school board.

There are two major laws which set the general rules for all Pennsylvania local governments with respect to ensuring that citizens can learn about and take part in the democratic process. They are the Sunshine Act, as amended, enacted 1987, and the Right to Know Law, enacted 1957.

The Sunshine Act



With some exceptions, the Sunshine Act requires public agencies to take official actions and conduct deliberations leading to those actions at public meetings. Like any law, the terms and applications of the Sunshine Act are subject to judicial or court interpretation. The general principles are:

- School boards are agencies covered by the law
- School board meetings must have a quorum (at least five members) in order to conduct official business. Therefore, a meeting with fewer than five members cannot result in any official action.
- Meetings where there is a discussion of district business, even if no vote takes place, must be open to the public



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- The law does not cover administrative actions. For example, if the superintendent meets with staff to review budget items, it is administrative in nature and not a policy action. It is not subject to the Act.
- Certain issues may be discussed in executive session (closed to the public), but the vote on these issues must be done in public. Issues eligible for executive session are:
 - Personnel matters
 - Collective bargaining strategy
 - Purchase or lease of real estate
 - Legal matters (such as lawsuits)

In addition to the central theme that policy decisions and debate must be done at public meetings, other provisions of the law state that:

- All meetings must be publicly advertised except for emergency meetings
- There must be written minutes of all meetings
- The public has the right to bring and use recording devices (subject to reasonable rules of the board)
- There must be a reasonable opportunity for the public to give comment

If anyone believes there has been a violation of the Act, the individual may seek a remedy within 30 days at his or her county court. (Issues relating to state agencies are taken to Commonwealth Court.)

The court has the power to set aside any action taken by the board in violation of the Act. For example, if for some reason a contract was approved at a meeting that was not advertised, the Court could set aside or cancel the contract. The school board could subsequently re-enter into the contract, but only at a new public meeting held in conformance with the Act.

A violation of the Sunshine Act is considered a summary offense and can result in fines.

The Right to Know Law

The Right to Know Law gives citizens the right to inspect certain records of government agencies, including school districts. Records available for citizens to inspect include:

- Accounts, vouchers, and contracts for receipt or disbursement of money or the purchase, lease, or sale of supplies or services



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- Minutes, orders, or decisions affecting personal or property rights, duties, or obligations of any group

The records public officials do not have to make available include:

- Reports or communications on official investigations
- Any document prohibited from inspection by law or court order
- Any document that could harm a person’s reputation or personal security
- Any document whose inspection could cause the loss of Federal funds

Over the years numerous court cases have more precisely defined the types of records that must be made available for public inspection. The Governor’s Center for Local Government Services of the Pennsylvania Department of Community and Economic Development (DCED) has an excellent booklet called *Open Meeting/Open Records*, which provides an informative and readable account of these issues.

In general, the courts have attempted to balance the democratic goal of the peoples’ right to know the “hows and whys” of government operations with individual privacy rights.

The Right to Know law operates as follows:

- All Commonwealth citizens have the right to see eligible documents
- Public records are to be open for inspection at reasonable times
- Citizens have the right to make copies of public records; however, public agencies (including school districts) have the right to set reasonable rules and/or charges for this action.
- The Right to Know law does not require that the records be assembled or produced in a particular manner

If a citizen is denied access to information, the citizen may appeal the decision to the court, which can order compliance.



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Budgeting

Legal Requirements

The Pennsylvania School Code of 1949, as amended, requires that each school district prepare and adopt an annual budget. Although “budget” is commonly used in the singular sense, there are really two separate budgets: one for expenditures and one for revenues. The budget includes details on the expected costs of programs and services (expenditures) and identifies the sources of the funds needed to pay for them including taxes to be levied (revenues). The programs and services are the means used to achieve the district’s educational goals

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and objectives. The budget is the financial plan to produce the educational program of the school district, and it sets legal limits on how much may be spent for various purposes throughout the year. It also estimates the revenues to be received.

The Pennsylvania School Code clearly makes the local Board of Education (which is elected by the citizens of the district) responsible for conducting the financial affairs of the district. (An exception is Philadelphia, where the board is selected by the mayor with the approval of city council.) But there are other important participants in the process. These include the Pennsylvania State Legislature and the Governor, who determine state subsidies and regulations; Congress and the President, who determine federal subsidies and/or grants; superintendents; administrators; principals; teachers; voters; and of course, the district's pupils and their needs. Ultimately, the school board is responsible for the financial status of the district through the preparation, adoption, and execution of the budget.

The budgetary process is considered so important that the Pennsylvania State Legislature requires specific actions in conjunction with the budgetary appropriation and control process. Some of these are:

- A proposed budget must be prepared at least 30 days before final adoption using forms provided by PDE
- The proposed budget must be available for public inspection at least 20 days before the board meets to vote on its adoption
- There must be at least ten days' notice to the public before the board takes final action to adopt the budget
- The budget must be voted on at a public meeting
- The budget must be approved by an affirmative vote of at least 5 of the 9 board members
- The approved budget must be submitted to PDE within 15 days of its adoption.

Further, legislated restrictions prohibit school districts from:

- Approving a deficit budget; that is, a budget where the spending is expected to exceed the amount of funds available
- Expending any funds in the absence of an approved budget (July 1 is the beginning of the new fiscal year for most districts)
- Expending funds for which an appropriation has not been made or a reserve has not been set aside (except for "undetermined" state and federal grants)

The school board is also responsible for meeting the requirements of specific programs and/or grants, and these requirements in turn influence the board's



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decisions. In addition, local needs that the board believes are of critical importance are generally included in the budget. The budget becomes a process that must strike a balance between which programs to include and how much can be spent to pay for them — and particularly the amount of taxes which can be levied.

Budget Decision Factors

Various factors will affect budgetary decisions. Some of these include size of the enrollment; number and educational level of staff; the requirements of collective bargaining agreements; building needs (age, efficiency, and space requirements); pupil transportation costs (including transportation for non-public students); health and special educational programs; and changes in program requirements.

On the revenue side, influencing factors include the number of taxpayers; the assessed value of real estate and other tax-generating capacity; practical and legal limits on the rates of taxation; current and future debt; value of investments; various state subsidies and other funding (including building construction reimbursements); and federal and state grants.



The budget must develop and bring together all of these factors to provide a coherent plan. Choices need to be made between educational requirements and available funding. There are always competing interests.

A good budget will be able to relate the educational programs and services to the district's financial resources; provide for standards on which to evaluate various programs and services; maintain responsibility for stewardship of the public's money; provide for leadership and control; place current expenditures and revenues within the historical framework; and facilitate decision-making.

The Budget Cycle

Because the budget is the fundamental document from which all other aspects of the district's financial operation are measured, the development, adoption, and execution of budget is really a year-long process. The budget process can be broken down into various parts forming a cycle that repeats itself from year to year.



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Budget Administration

Although the school board has the ultimate responsibility for budget adoption and compliance, the day-to-day execution of the budget relies upon a number of participants. Key among these is the superintendent, who is the chief executive officer of the district. But often the individual most familiar with the financial implications of the budget will be the district's chief financial officer, normally its business manager. Others within the school district administration, including principals, staff, and teachers, are needed to make the budget a viable working document. And the public plays a role as well: it is the citizens, through the election process, who select the board members to be directly responsible for the financial affairs of the district.

Budget Changes

The budget by necessity is based on a series of estimates of future expenditures and revenues. It is not uncommon for actual revenues and expenditures to differ from the estimates. Therefore, it is usually necessary to make changes as the year progresses. These often take the form of transfers from one account to another. Such transfers, under the Pennsylvania School Code, can only take place after the first three months of the fiscal year and can only be made with approval of the board. In certain cases, prior board approval is required.

But there is also a provision in the School Code that allows the board to change the budget in an emergency situation that threatens the life or safety of school district children, staff, or others. In this case, if the budget does not have enough funding in reserve, the code authorizes the board to secure temporary loans to address the emergency.

Budget Evaluation

Throughout the year a district's finances should be closely monitored and evaluated for conformance to the budget. Generally, the superintendent or business manager submits monthly reports to the board members to allow them to compare budgeted funding with actual results. At the end of the year a portion of the Financial Statement compares the year-end actual results with the estimate in the budget. As a further control, all invoices payable by the district must be approved by the board.

In summary, the budget is both a financial plan to help achieve the educational goals of the district and a control mechanism to ensure that the policy objectives determined by the board (and, indirectly, the electorate) are achieved.



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Five Year Plan

Many of the factors which impact a district's annual budget must be considered well in advance. In particular, planning for issues such as additional classroom space, rehabilitation of buildings, and major equipment acquisition usually requires a long lead time. In addition, it may be beneficial to consider multi-year contracts for direct labor costs, medical benefits, and related factors.



In some districts student enrollment may be increasing, while in other districts it may be decreasing. These patterns should be studied because of their implications not only for facilities such as classrooms and buildings, but also for the number of teachers and staff.

For these reasons many districts develop a five-year plan or even a longer range plan. Though it cannot be as precise as the annual budget, a long-range plan can help document issues, identify general cost factors and project future revenue in order to provide an overall view of the district's financial and operational direction.

It is an early alert to key issues on the horizon. Long-range plans help set the stage for the specific planning and development of the annual budget.

Accounting and Reporting

Accounting Rules

School districts in Pennsylvania operate under specific accounting rules determined by the Labor, Education and Community Services (LECS) Comptroller's Office that are based on a number of sources including the Pennsylvania School Code and other state laws. The accounting rules also follow nationally established guidelines often referred to as Generally Accepted Accounting Principles (GAAP). There are a number of different sources for GAAP, but the primary source is the Government Accounting Standards Board (GASB).

Although school districts — like businesses — have accounting systems, the accounting systems for school districts are different from those used by commercial businesses. The basic accounting concepts or rules for school districts are summarized below.

Fund Accounting

State law and a school district's budget define very limited and specific ways in which public money can be spent. In order to closely measure and control these defined activities, government accounting transactions are restricted to



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separate specific accounting funds. An accounting fund is a set of self-balancing accounts (revenues, expenditures, assets, liabilities, and fund balance) used for a legally or accounting prescribed purpose. Most school district activities are accounted for in the General Fund. Other funds used by school districts may include a cafeteria fund (to account for the cafeteria operation), a debt service fund (used to pay off debt from borrowing), and capital reserve/improvement funds (used to accumulate funds for construction of buildings and the purchase of major equipment). Even though from an accounting point of view each fund is treated separately and accounted for like a separate business, the district is responsible for all funds. This document focuses primarily on the General Fund.



Financial Focus

Governmental accounting places the highest priority on assuring that the school district follows its adopted budget. Because the budget is developed and approved on a yearly basis, most transactions focus on the current year or short-term activities. The emphasis is on current financial

resources and spending. For this reason items like land, buildings, and equipment (often called capital assets), which cannot be quickly and easily converted to liquid resources such as cash, are not counted as assets in government funds such as the General Fund. Rather they are accounted for in a separate account group. Similarly, long-term debts are not counted as a liability in government funds, but are accounted for in a separate account group.

The cafeteria fund, however, is treated like a business and, therefore, it does record capital assets and long-term debt as assets and liabilities. The key point is that school districts' General Fund balance sheets look at the near term and focus on those assets and liabilities that are financial in nature rather than on capital items like land, buildings, and equipment and on long-term debt.

Timing of Transactions

The time when the financial activity or transaction is recorded also differs between a school district and a business. If an accounting entry is recorded when the transaction takes place, it is known as "accrual" accounting. If the entry is recorded when a payment is made or when cash is received, it is called a "cash" basis. GAAP requires school districts to record and account for transactions or financial activities in their general fund and other government type funds on what is called the "modified accrual" basis of accounting. Under modified accrual, a financial activity is accounted for when a purchase is made even if it is not paid



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for at that time. On the revenue side, the entry is made when the revenue is earned, provided there is an accurate estimate of the value of the revenue and it can be readily used to meet obligations. For non-government funds, the full accrual system is used which is similar to what private business uses — an expense is recorded when the obligation is incurred, and revenue is recorded when it is earned. The issue is important because the recognition of transactions can change the results that are reported in the financial statements.

School Accounts

In order to report and analyze various financial data, school districts must record and track the many different revenue, expenditure, asset, liability, and fund balance entries. These categories are called accounts. Accountants call the list of all accounts the “Chart of Accounts.”

The LECS Comptroller’s Office has developed a very detailed chart of accounts for local school districts to record and track the various accounting transactions in a standardized format. This precise and detailed chart of accounts may be found on the PDE website. The chart of accounts is more than 180 pages long and comprises Chapter 20 of the Comptroller’s accounting manual.¹² This approach provides an overall structure that can be used for reporting from district to district. It also promotes a general understanding of the financial picture of the district.

Account Types

School district accountants deal with five major account types. They are:

- Revenues—increases in the district’s financial resources, e.g. real estate taxes, state subsidies, and federal grants.
- Expenditures—decreases in financial resources that represent charges incurred by the district, e.g. paying teachers’ salaries and purchasing books.
- Assets—the resources the district owns, e.g. cash, investments, and accounts receivable.
- Liabilities—claims on the district’s resources or obligations (what the district owes), e.g. accounts payable, payroll payable, and current bonds due.
- Fund Balance (Net Financial Assets)—Assets less Liabilities = Fund Balance.

Reserved Fund Balance

Fund balance is a measurement of net-assets, equity, or accumulated savings. However, not all of these savings can be used to meet future obligations. For example, if the district has pre-paid its property insurance, the amount of the prepayment is not a usable financial asset like cash, and, therefore, it cannot be

¹² <http://www.pde.state.pa.us/pdeforms.html#MANUAL>



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used to pay for any other future obligation. Similarly, if the district has ordered books and supplies, but they have not arrived, funds would need to be set aside or reserved to meet this expected obligation. Therefore, certain portions of fund balance may need to be reserved. The amount of fund balance set aside for legal or accounting purposes is called the reserved fund balance. The reserved amount cannot be used to meet any obligations other than the ones assigned.

Unreserved Fund Balance

The amount or portion of the fund balance that has not already been set aside to meet potential accounting obligations or for legal purposes is called the unreserved fund balance. This amount represents financial resources that may be used for future spending and is further divided into two subcategories: designated and undesignated.

Designated (unreserved) fund balance is the portion of the unreserved fund balance that the local school board by its own action or policy decision sets aside or saves for some future purpose. Often, the district's board will plan ahead and set aside funds to meet a future specific need within the district. A policy decision, for example, to begin saving for a major new computer system might be made. Then, part of the fund balance is designated or saved for this specific policy goal and it should not be used for any other obligations. The key concept is that the decision to set aside these funds is at the discretion of the board; it is not required for accounting or legal reasons. Rather, the purpose is to earmark certain financial resources for specific expenses. The funds set aside based on board policy are called designated fund balances.

Undesignated fund balance is that portion of unreserved fund balance for which the board has made no specific plans or policy decisions.

An example demonstrates the concepts of reserved, designated, unreserved, and undesignated fund balances. If the general fund had \$8 million fund balance, if the district had \$1.5 million in books and supplies on order, and the board had set aside \$2 million for a future computer purchase, the fund balance calculations would be:



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Sample Illustration of Reserved and Unreserved Fund Balances	
General Fund Balance	\$8.0 Million <small>(Beginning Balance)</small>
Less Reserved Fund Balance	(\$1.5 Million) <small>(Set Aside for Books on Order)</small>
Unreserved Fund Balance	\$6.5 Million
Unreserved Fund Balance	\$6.5 Million
Less Designated Fund Balance	(\$2.0 Million) <small>(Set Aside for Computer Purchase)</small>
Undesignated Fund Balance	\$4.5 Million <small>(Remaining Balance)</small>

Figure 8 Sample illustration of reserved and unreserved fund balances

Annual Financial Report

The AFR presents accounting information for a one-year period, termed the fiscal year. For most school districts in Pennsylvania the fiscal year runs from July 1 through June 30.

By October 30 of each year school districts with the July-to-June fiscal year must submit their AFR in accordance with the guidelines established by the LECS Comptroller’s Office. The report includes reporting on all funds and account groups. The report consists of General Purpose Financial Statements, note disclosures (which explain these statements), and other supplementary information (which give additional financial data).

General Purpose Financial Statements include the following:

- Combined Balance Sheet, which provides assets, liabilities, and fund balances of various fund types
- Combined Statement of Revenues, Expenditures and Change in Fund Balance, again by fund types
- Combined Statement of Revenues, Expenditures, and Budget to Actual which compares what actually occurred to what was planned in the budget
- Statement of Revenue, Expenses, and Changes in Retained Earnings, which gives operational information for business-like funds such as the cafeteria fund.
- The Statement of Cash Flow, which gives a picture of the cash position of the relevant funds.

Importance of Financial Statements

The financial statements and, in particular, fund balances give helpful information on the financial position of the district and can help answer a variety of



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questions, particularly if comparisons are made from one year to another. In addition, they can help identify trends from year to year. Sometimes it is not enough to identify whether one of the four fund balances is positive or negative. If the unreserved fund balance is a negative, is there some specific reason why this is the case? Is the negative balance a result of a history of actual expenditures exceeding revenues or is it a result of a unique accounting issue? (Sometimes, the way construction contracts are accounted for may cause a negative unreserved fund balance.) In general, a negative unreserved fund balance means that the district's financial liabilities are greater than its financial assets and additional revenues will be required to meet this gap.

If the unreserved fund balance is positive, has it been decreasing year by year? Is there a sufficient unreserved fund balance to meet emergencies or unexpected demands on the district resources? All of these issues are relevant in understanding the district's financial position.

GASB 34

The requirement for accountability of school districts for the spending of public funds has led to the concept of fund accounting. The use of individual funds as required by the Pennsylvania School Code and GAAP permit close control of such district spending.

However, fund accounting has its limitations and does not provide for an overall unified picture of a school district's financial position. A simple summation of the individual fund balances does not adjust for transfers between the funds and can sometimes confuse the real picture. In addition, the accounting system used by school districts for the government funds does not count buildings, land, or equipment as assets, nor is long-term debt considered a liability in government-type funds.

In response to these issues and to provide a more comprehensive financial report that is more meaningful to the general public and other users of financial statements, the Governmental Accounting Standards Board (GASB) issued Statement 34, applicable for all governmental accounting.

GASB 34, while retaining individual fund accounting concepts, requires two additional financial statements. These statements cover all funds. They will give information on the district as one accounting entity—like one business. The new statements are:

- Statement of Activities, which presents information on revenues, expenses, and changes in net assets. The change in net assets is another type of measurement of the change in equity or net worth.



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- Statement of Net Assets, which gives the assets for the district as a whole including fixed assets (land, buildings, equipment) and liabilities (long term debt) for the district as a whole.

In addition to these two statements, GASB 34 requires that each district prepare a Management Discussion and Analysis (MD&A). This report will provide an objective and easily readable analysis of the district's financial activities in a narrative format.

GASB 34 will be phased in on a district-by-district basis during the period 2001 through 2004 starting with the districts that receive the largest amounts of total revenues. It is the biggest change in government accounting in several decades; it is designed to improve overall accountability for all government entities, including school districts.

Auditing

Audit Definition and Purpose



An audit is an examination in which an external person determines whether the financial statements produced by the school district fairly represent in material respects its financial position and operations. ("Material" is a technical term used by accountants that is similar in meaning to "significant.") The auditor then offers an "opinion" on this matter.

The opinion of the auditor is based upon a series of tests and evaluations carried out to verify the validity of the financial statements. Such tests include comparing the cash balances on the district's records with those shown on bank statements; verifying reported expenditures for salaries with payroll records; and independent confirmation of account receivable balances from those owing funds. The audit is performed by a CPA in all Pennsylvania districts except Philadelphia, where it is done by the City Controller.

The audit is of great importance because it gives all users of the district's financial statement (including the general public) an independent opinion that the financial information supplied by the district is accurate and reliable. The independence of the auditor is critical in this process.



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Types of Audits

Although the financial records and transactions of the district are the central focus of audits, different types of audits offer unique perspectives. In general, a school district has three principal audits. They are a:

- Financial Audit – an audit required under the Pennsylvania School Code conducted by a CPA who gives an opinion on the district’s general purpose financial statement
- State Audit – an audit required under state law conducted by the Auditor General to determine if the district received the proper allocation of state funds and whether the funds were used in conformance with state law
- Federal Audit – an audit conducted by a CPA who issues a report to the federal agency that federal funds were used in conformance with federal regulations

Auditor’s Opinion and Reports

The auditor’s report may be issued as a nonqualified opinion, a qualified opinion, or without an opinion. A nonqualified opinion indicates that the auditor believes the district’s financial reports present fairly the financial position and the results of the district’s operations. In a qualified report the auditor believes that the financial statements of the district do not exactly represent the district’s financial position or the results of operations. In these cases the auditor will list the specific exceptions or issues which caused the qualified opinion. An exception may be major (such as, the district’s internal controls cannot be relied upon), or it may be minor (like using a cash-based system which is not in conformance with GAAP standards). The auditor may also issue no opinion because a district’s records or data are deficient, leaving no basis upon which to render an opinion.

In addition to the opinion, the auditor will issue a report on internal controls. This report gives a judgment on the adequacy of methods used by the district to ensure that control processes are in place to protect the district’s net assets and to provide for reliable accounting data.

The auditor also frequently issues a management letter, which calls the district’s attention to any accounting deficiencies, which should be addressed either to avoid future difficulties or to enhance the accounting and financial reporting efficiency of the district. These may or may not be significant. The district, in turn, responds to and addresses any comments in the audit report, the internal control report, or the management letter.



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Auditor's Independence



For the public to have confidence in the auditor's opinion, it is essential that the auditor be independent. He or she can remain independent even though retained and paid by the school district because the auditor's professional reputation as a CPA stands behind the opinion, and the audit is performed in conformance with formally established independent auditing standards. Further, auditors are held accountable by peer review groups, licensing entities, and others. In an effort to ensure this independence, as well as to secure an auditor well versed in school district accounting, school districts often request proposals from various auditors. The ultimate selection of the auditor (except, of course, for the Pennsylvania Auditor General) is a local choice made by the school board. In the selection of the auditor the cost, experience, expertise, and independence of the firm need to be considered. It is not uncommon for school districts to select a different auditor every several years (5 to 6 is typical) in order to insure continued independence.

In summary, the audit function gives confidence to the users of financial statements—both internally (school district's administration, staff, and board), and externally (bankers, bondholders, contractors, students, parents, and the public)—that the district's financial statements are fairly presented and free from material error. It is considered a public document once finalized and formally accepted by the school board.

Tax-Related Issues

In addition to new construction, demolition, and the natural appreciation or depreciation of properties, other factors can influence the change in a school district's assessed valuation and real estate tax levy from year to year. Some of these include:

- Act 50 (which allows for an increased emphasis on the earned income tax while targeting the elimination of "nuisance" taxes and a reduced reliance on the property tax)
- Implementation of Pennsylvania's KOZ and Keystone Opportunity Expansion Zone (KOEZ) programs, both designed to encourage businesses and individuals to remain in or to move into designated areas by providing tax incentives including exemption from real estate taxation
- Pennsylvania's Clean and Green legislation, which provides for preferential assessment of certain farm and related property
- Special programs for forest and farmland assessments
- Tax abatement programs (such as LERTA) for deteriorated areas



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- Deregulation of public utilities in the Commonwealth (and the resulting shift in properties from tax-exempt to taxable status).

The specific impacts of these factors differ from district to district.

Act 50

Partially in response to citizen concerns that the local property tax was becoming burdensome, the legislature enacted Act 50 in 1998. Act 50 permits school districts to levy a new earned income and net profits tax at the rate of 1.0 percent, 1.25 percent, or 1.50 percent. This tax would replace most non-property taxes, including the earned income/net profit tax (from Act 511, the Local Tax Enabling Act of 1965, as amended), which is levied at the rate of 0.5 percent in most school districts. In theory, by levying this tax at a rate higher than previously allowed, additional revenue would be available — even after replacing the tax dollars lost by eliminating various non-property taxes — so that less reliance on property tax dollars would be needed. The net effect would be a decrease in the property tax. Act 50 requires that the reduction in the property tax be achieved first by excluding a portion of the assessed value of residential homestead and farmstead properties and, then, if sufficient funds remain available, by reducing the millage rate on all properties.

School districts can change their taxing mechanism only after obtaining voter approval in a referendum, as described below.

Assessment Exclusions

There are two types of exclusions from property assessments. The homestead exclusion involves a person's primary owner-occupied home, and the farmstead exclusion relates to certain farm property.

The amount of the exclusion is set by the local taxing body, in this case by the school board. For homestead property the exclusion cannot be greater than one-half of the median of the assessed values of property in the district. Median means the middle value of qualifying properties (one-half is above, and one-half is below).

For farmstead property, the exclusion may be any amount equal to or below the amount of the homestead exclusion.

Key Points

- The new earned income/net profit tax must replace not only the Act 511 earned income/net profits tax but also most other Act 511 taxes and the Pennsylvania School Code per capita tax
- In the first year under Act 50 total budgeted local revenue (essentially, local tax revenues with some exclusions) may be increased beyond the



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amount that was budgeted in the prior year, but only if this increase is specified in the “Act 50” plan, which requires voter approval in the “front-end referendum” described below. Because of the higher tax revenues, the increase in the earned income/net profits tax permitted under Act 50 may not be large enough to allow for the elimination of designated Act 511 and other non-property taxes and still produce a meaningful reduction in the real property tax.

- Once Act 50 has been implemented, the school board, in future years, may not increase the property tax rate beyond certain limits unless the voters give their approval through the “back-end referendum”

Voter Approval

In order for a district to move from its existing tax mechanism to that provided under Act 50, voters need to give their approval at the ballot box. Because this voter approval is needed prior to the system going into place, it is called a front-end referendum. The ballot question on which the public would vote includes the rate of the proposed new earned income/net profits tax, the names of the taxes to be repealed, the maximum percent increase in total budgeted taxes, and the maximum homestead and farmstead exclusion.

The back-end referendum refers to the required voter approval if — once Act 50 has been implemented — the school board decides a property tax rate increase is necessary and if, in general, the estimated total revenue from the rate increase along with increases in other local tax revenues would cause local tax revenue for the current year to exceed local tax revenue from the prior year by more than the rate of growth in Pennsylvania’s Statewide Average Weekly Wage.

Initiation and Implementation

The Act 50 process can be initiated either through the recommendation of a study commission appointed by the school board or through voter initiative. The voter initiative process is more involved and would require the board to appoint a commission when presented with petitions signed by at least two percent of the district residents who voted in the last governor’s election. A petition signed by five percent of the number of people who voted in the last governor’s election can force a commission report that recommends implementation of Act 50 as a front-end referendum even if the school board chooses not to take action.

As of the spring of 2001 only three school districts had instituted the Act 50 tax system.

Keystone Opportunity Zones

The KOZ and KOEZ programs are designed to help revive economically distressed urban and rural areas using a powerful market-based incentive of virtually no state or local taxes—in some cases for as long as 12 years. In a designated



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KOZ or KOEZ area, school districts and other local governments must forgo current and future real estate taxes, business gross receipts and mercantile taxes, occupancy and business privilege taxes, and earned income and net profits taxes. Similarly, the state forgoes corporate net income taxes, capital stock and foreign franchise taxes, personal income taxes, and the sales and use tax on purchases used and consumed by businesses in the zone. This can result in a loss in tax revenues for school districts and other taxing jurisdictions if there are existing tax-producing properties in the zone. In many cases, however, the land in the zone is vacant or unimproved and, therefore, creates a minimal direct and immediate loss in tax revenues.

Special Forest and Farmland Assessments

The Pennsylvania Farmland and Forestland Act of 1974 (known as the “Clean and Green” program) provides for preferential tax assessments for certain land involved in agricultural use, agricultural reserve, or forest reserve. Property owners who seek such preferential taxes apply to the county assessor, who uses soil quality data on the property and related information to determine the preferential assessed value.

Similarly, the Covenant Preserving Land Uses Act of 1966 authorizes all counties to enter into covenants with landowners for the preservation of farm, forest, water supply, or open space land in keeping with an adopted municipal, county, or regional plan. When the landowner voluntarily enters into a covenant and agrees that the land will remain in farm or open space use, the property tax assessment is adjusted to reflect the fair market value of the land as restricted by the covenant. The law requires that the county assessment appeals board take this restriction into consideration in fixing the assessment.

In both cases the taxable valuation is generally reduced, producing less real estate tax revenue for the school district.

Deteriorated Property or Areas

LERTA authorizes each local taxing authority to exempt from local property taxation the assessed valuation of new construction in deteriorated areas or improvements made to industrial, commercial, or other business property in these designated areas. The maximum length of the exemption is ten years, and the exemption is limited to the additional valuation attributable to the actual costs of new construction, improvements to the property, or some other cap determined by the local taxing jurisdiction.

The Improvement of Deteriorating Real Property or Areas Tax Exemption Act similarly permits school districts to exempt from local property taxation the assessed valuation of improvements made to residential properties within deteriorated



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rated neighborhoods for up to ten years. The county assessment office determines the amounts eligible for such an exemption.

Unlike the preferential assessment on farmland and open spaces, the net effect of these programs is not necessarily a reduction in assessed valuation and real estate tax revenue. Instead it is a limitation on the ability of school districts and other local governments to tax all or part of certain improvements and new construction activities for a given period of time.

Investments

Risk Versus Return

School districts like business often have cash or other financial resources that are not immediately needed. Good financial management requires that these resources be prudently invested. Since school districts are entrusted with the public's money, their goal is minimizing investment risk rather than maximizing investment return.



Forgoing a little extra return is acceptable when it minimizes the danger of losing part or all of the invested amount. There is a direct relationship between the rate of return (the earnings on the investments) and the potential risk of losing part or all of the investment. Generally the lower the risk, the lower the earnings. For example, the dollar return is generally lower for the most secure investments (U.S. government securities), where the potential risk of losing some of the money invested is essentially nonexistent, than for other investment categories (e.g. stocks).

Permitted Investments

The Pennsylvania School Code allows school districts to make only certain types of investments, including:

- U.S. Treasury Bills
- Short-term securities (having a maturity of less than 13 months) of the U.S. government, its agencies or its instrumentalities
- Obligations of the U.S. government, its agencies or its instrumentalities backed up by the full faith and credit of the U.S. government;
- Deposits in banks, credit unions, and savings and loans with insurance or collateral guaranteeing the deposits



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- Obligations of the Commonwealth of Pennsylvania, its agencies, or its instrumentalities backed up by the full faith and credit of the Commonwealth or its political subdivisions (counties, cities, boroughs, townships, school districts)
- Shares of investment companies, provided that they meet certain stringent requirements and that the underlying investments held by these companies are limited to the categories of securities listed above

No equity (stock) investments, corporate bonds, or related securities are allowed. The list clearly demonstrates that limiting risk is the highest priority.

A few other observations with respect to district investment practices are important to note.

- Under the Pennsylvania School Code the school board is responsible for all investment activities of school district assets
- Many school districts provide for an investment policy or plan that delegates the day-to-day investment activity to a board subcommittee and/or the business manager. However, investment decisions must still be made within the framework established by the board
- Many school districts retain a financial manager to invest their funds
- If there is not a defined investment policy or plan, the board must approve investments individually

Insurance and Collateral

The Federal Deposit Insurance Corporation (FDIC) guarantees up to \$100,000 on all combined checking accounts and up to \$100,000 on all combined savings deposits, including certificates of deposit, at most banking institutions. When a school district has deposits above this amount in banks, savings and loans, or credit unions, collateral is required. Collateral refers to the financial resources (such as cash or investment securities), which the banking institution pledges as a backup or a guarantee in case it cannot make payment to the school district. So the district's deposits in these institutions would be guaranteed by the FDIC up to \$100,000 and by collateral beyond that.

Each district should have a legal document (a contract) clearly defining the location of the collateral and the process by which collateral assets would be distributed to individual governmental entities who have invested in or with the financial institution.



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State law specifically permits banks and other financial institutions to pool collateral assets as the backup or pledge for the investments of a group of governments (including school districts). The holder or custodian of the collateral may be another Pennsylvania financial institution or the trust department of the bank, which holds the district's funds.

Investment Risk and Market Value

If the district is relying on an investment to pay for some anticipated cost, it must pay close attention to the date of the investment's maturity or the ability to secure or guarantee the investment value should it be sold prior to maturity. The failure to fully consider such time considerations puts the investments within mar-

ket risk, or the risk that the investment will need to be sold at less than its face value and thereby result in a loss to the school district.

The basic idea of market value is that at any given point in time the value of an investment is what one can obtain in a possible sale in the financial marketplace. Investments therefore should be valued at the market price often called "marking to market." Collateral backing on investment should also be valued at market price. Valuing the investment at market price rather than face value gives a true picture of the invested asset's worth. Additionally, GAAP accounting requires that investments be shown at the market value.

Safeguarding Investments

Because of the significant amount of funds involved, school districts need to establish a sound list of policies with regard to safeguarding investments. Some of the actions a board may utilize are:

- Establishing a defined, written investment policy
- Diversifying investments among different types of securities and/or institutions
- Reviewing audits and other information about the investment firms and institutions
- Having a full understanding of financial contractual agreements
- Accounting for all investments and collateral at their market value
- Ensuring that all investments are in conformance with the School Code
- Developing a defined investment plan
- Avoiding "get rich quick" schemes



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- Making prudent and reasonable investments
- Minimizing risk by conservative decision-making
- Matching the time period of investment maturities with the anticipated need for the funds

Investment Pools

School boards are authorized to participate in investment pools with other school districts or other governmental entities because the magnitude of the dollars invested collectively in these pools can often achieve a higher rate of return with little or no increase in risk. Some of the more frequently used investment pools whose underlying investments are in conformance with Pennsylvania School Code requirements include the Pennsylvania School District Liquid Fund, the State Treasurer's Invest Program, and the Pennsylvania Local Government Investment Trust. Members must follow rules and regulations as defined by each pool.

Borrowing

Other Financial Resources – Debt

School districts may need to obtain required financial resources by borrowing. Districts may borrow for long-term or short-term needs from banks, other lending institutions, or by issuing bonds. Of course, in each case the amount borrowed along with the cost of borrowing — the interest charged by the lender — must be repaid by the district. The reason a district decides to borrow funds and the nature, amount, and terms of borrowing are determined by numerous factors. Primarily, however, the type of borrowing depends on the intended use.

For example, the real estate tax is the main source of local revenue for school districts. Real estate tax revenues are generally received in a three- to four-month period each year. What does a school district do to cover its costs before this major revenue becomes available; that is between the time when the tax bills are issued and people begin to pay? The answer is a Tax or Revenue Anticipation Note (TRAN), generally obtained from a bank and used to pay current expenses until the time when the regular source of revenue (in this case, real estate taxes) becomes available. The TRAN is intended for short-term use and must be paid off before the end of the district's fiscal year. The TRAN is a kind of bridge loan to provide cash until the district's regular revenues become available. Because TRANs are short-term and generally a few million dollars or less, they are normally obtained from banks.



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School District Bonds

In other cases, especially for major construction projects such as a new school, borrowing from a bank may not be feasible or even desirable. School districts generally will issue government bonds for major construction projects. A bond is a written promise that the borrower will pay back a specified amount with interest at a fixed-rate to the lender at a certain time in the future. The interest is usually paid in equal time frames, which are described on the bond. For school districts, interest payments are generally paid twice a year with some of the principal, or the base amount borrowed, paid annually. Issuing bonds enables a school district to:



- Borrow large amounts of funds usually at a relative low interest rate compared with borrowing from a bank
- Specify the time frame for the borrowing (usually for a long period —legally up to 40 years)
- Determine within limits the amount of annual payments
- Design other factors to tailor the bond issue to the district’s needs

Issuing bonds is a complex procedure that generally takes at least eight weeks. The sale requires using financial advisors, underwriters, school district’s counsel, and bond counsel (attorneys versed in tax and other implications of bond financing). A series of financial documents including a Preliminary Official Statement (POS), similar to a prospectus in the private sector, are prepared and circulated to the potential buyers. The state also needs to approve the bond sale. Ultimately, the school board is responsible for incurring either bank or bonded debt.

Bond Proceeds

Bond proceeds are simply the resources received upon the sale of the bond. For example, assume the school district sells \$50 million worth of bonds and incurs \$1 million of expenses in issuing the bonds. The gross bond proceeds received by the district would equal \$50 million, but the net bond proceeds would equal \$50 million less \$1 million, or \$49 million. Also, it is not uncommon that the contract for the bond sale requires that some of the proceeds be set-aside in a reserve fund to protect the bondholders in case the district cannot make a bond payment. In this example, assuming the bond contract (“bond indenture”) requires a bond reserve fund of \$3 million, the amount of proceeds immediately



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available by the district to carry out its project would equal \$49 million less \$3 million, or \$46 million. Ultimately, when the bonds are paid off, the \$3 million is free from the reserve and then can be used by the district.

Debt Limitations

Whether a district borrows through the issuance of bonds, directly from a bank, or by some other means, there are limitations imposed on the amount of debt that can be borrowed without voter approval. Under state law debt not approved by the voters (also called non-electoral debt) cannot exceed 225 percent of the school district's borrowing base. The borrowing base is generally defined under law to be equal to the average of revenues received by the district in the prior three years. Voter-approved debt (also called electoral debt) can be any amount.

The process of borrowing funds by the district is controlled under the Local Government Unit Debt Act, which is administered by the state DCED. The specific procedures for borrowing funds are strictly controlled under this Act.

Bond Costs

Not all districts can borrow at the same cost, and in fact, the cost can vary between districts across time. Some factors that influence the cost of bonds are interest rates in the bond market; the amount being borrowed, the length of term for repayment; and the credit-worthiness of the district.

Rating agencies like Moody's and Standard and Poor's evaluate the credit-worthiness of a district and issue credit ratings. A district with a higher credit rating can issue bonds at a lower interest rate and thus incur lower costs. A district can increase its rating by securing underwriting insurance. This kind of insurance guarantees payment to the investors in case the district experiences financial difficulty. Of course, the insurance will increase the cost of issuing the bonds. Ultimately, the full faith and credit of the school district (i.e., its taxing ability) is the fundamental guarantee to the investors that the bonds will be repaid.

The interest earned by investors on bonds issued by school districts and other local governments is normally not subject to federal income tax. As a result, investors are generally willing to buy bonds issued by these governmental units even with a lower interest rate than those issued by the private sector. Therefore, school districts are generally able to borrow at lower interest rates than commercial businesses.



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School Buildings

State Approval

The Pennsylvania School Code requires that school districts provide necessary grounds and suitable buildings so that every pupil will have proper and healthful accommodations. Generally, the determination of what constitutes “necessary grounds and suitable buildings” is left to the determination of the local school board.

The School Code also provides that PDE shall review and approve any construction and reconstruction, as well as ordinary repairs in excess of \$15,000. The PDE is thus directly involved in any significant school construction project.

In order to comply with this requirement, the school district submits to PDE a self-certification application for any construction projects that the district plans to finance without state funding. The department then reviews the application to make sure applicable state requirements are followed.

State Reimbursement



The school district follows a different approach if it wishes to have the state reimburse some of the construction costs. In these cases a district must follow a process called Planning and Construction Workbook (PlanCon).

PlanCon is designed to document project planning, give justification to the public about the project’s need, provide for compliance with state laws and regulations, and establish the level of state participation for reimbursement in the project’s cost.

The PlanCon process is applicable to new construction, additions, renovations, or alterations of existing structures for which state funds are sought. More than 80 percent of all projects involve alterations to existing structures.

Three major limits on state reimbursement are:

- The Commonwealth will not reimburse for any alteration to a school building that is less than 20 years old or that has had a reimbursable pro-



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ject within the last 20 years unless a variance is requested and approved by the PDE

- The state also requires a district-wide facility study prepared by the district to justify the project
- Any renovations must not have a cost that is less than 20 percent of the replacement value of the existing facility unless a variance is requested and approved by the PDE

PlanCon is a comprehensive process with 11 steps. These include project justification, preliminary design, estimation of the state's reimbursement basis, detailed construction document review, and final project accounting.

Because the design process is complex the PlanCon process usually takes 9 to 12 months from the original submission of the project description to the securing of construction bids. In each case the PDE is involved in reviewing submissions made by the school district. To assist it in the design process, a school district may retain professional assistance (e.g. educational planners, architects, engineers).

The PDE does not make a judgment on the validity or appropriateness of the project assuming that the PlanCon requirements are met. Whether or not a new project is to be undertaken is a decision made by the local school board. The project must comply with applicable state, local, and regional requirements, but the decision to do the project is made at the local level by the board.

Amount of State Reimbursement

The amount of state reimbursement for construction depends, in general, upon the number of students, the type of facility (elementary, secondary, etc.), the construction costs, and the relative wealth of the district.

The Commonwealth first calculates a reimbursement percentage. This percentage equals the amount of eligible reimbursed costs divided by the total project cost less the bond discount.

The largest component of eligible reimbursed cost is the lesser of allowable construction costs or an amount equal to the capacity of the building times a reimbursable per pupil amount set by law. Project-related costs like rough grading, are then added to this figure.

The reimbursable percentage is then multiplied by a percentage, which measures the relative wealth of the district. This percentage is designed to produce a relatively higher state support for less wealthy districts.



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Bidding Requirements

In order to protect public funds and to ensure competitive prices, state law requires competitive bidding for certain school construction projects whether or not state reimbursement is sought. For projects under \$4,000, the district is not required to solicit quotations or to use a bid procedure. For projects between \$4,000 and \$10,000 the district is required to solicit three quotations or seek competitive bids. For construction in excess of \$10,000 the district is required to secure competitive bids.

Public Hearing on Construction Projects

Because of growing concerns on the magnitude of dollars expended for school construction, the Legislature passed Act 34 in 1973. This law incorporated into the Pennsylvania School Code a requirement that school districts hold public hearings and request comments and suggestions from the public with respect to new construction or substantial additions to existing structures. Act 34, also called the Taj Mahal Act, does not apply to alterations of existing structures.

Under Act 34 the school district must advertise 20 days before the public hearing and have available for public review the description of the project and its financial implications. In addition, if, after the initial hearing, certain costs exceed the original estimate by 8 percent or more, the district must convene a second public hearing to solicit comments on the project and address the increase. If certain construction costs exceed a specific level, the project must go to referendum by the voting public to determine if the project should proceed



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General Fund Expenditures

The figures shown represent the General Fund of Pennsylvania's 501 public school districts for fiscal year 1998-99. The General Fund (the focus of this analysis) is the main place where school districts record their revenue and pay their bills and therefore, accounts for most current operating expenses. School districts sometimes but not always record spending for things like food services, athletics, and capital needs in funds apart from the General Fund.

Instructional Expenditure per Pupil



*The middle value for all school districts; an equal number lie above and below

Expenditures By Cost Category (Function)

Instruction Costs

Figure 9 Instructional expenditure per pupil

Pennsylvania's school districts spend most of their funds on classroom instruction activities. These are known as Instruction Costs and include the salaries and benefits of teachers, supplies, books, certain maintenance costs and contracted services, and equipment. Specific subparts of Instruction Costs are discussed below, ranked in decreasing order as a percentage of total district spending across the state.

- Regular instruction programs involve educating students in grades kindergarten through 12. Spending for this purpose totals \$6.3 billion, which is 43.8 percent of total district spending.
- Special education programs are provided by school districts for all school-aged children residing in their district who have special needs. In keeping with state requirements, these programs involve the gifted and talented, mentally retarded, physically handicapped, emotionally disturbed, culturally different, those with learning disabilities, and bilingual students; it may also include special programs for other types of students. These special programs may be directly operated by the districts or contracted with other school districts, intermediate units, or other providers. They cost about \$1.4 billion and represent 9.8 percent of total district spending.



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- Career and technical (vocational) education programs are designed to prepare individuals for employment in various occupational fields including agriculture, business, distribution, health, home economics, and other endeavors. They are provided directly by a school district through an in-house program or by an area vocational technical school. Spending for career and technical education totals \$478.8 million or 3.4 percent of total district spending.
- Other instructional programs may include drivers' education, summer school, homebound instruction, and alternative education programs. They total \$300.7 million, which is 2.1 percent of total district spending.
- Select districts across the Commonwealth spend about \$12.1 million (less than 1.0 percent of all spending) on adult education programs and \$19.9 million (also less than 1.0 percent of the total) to support community colleges.

Support Services

Support Services Expenditures per Pupil

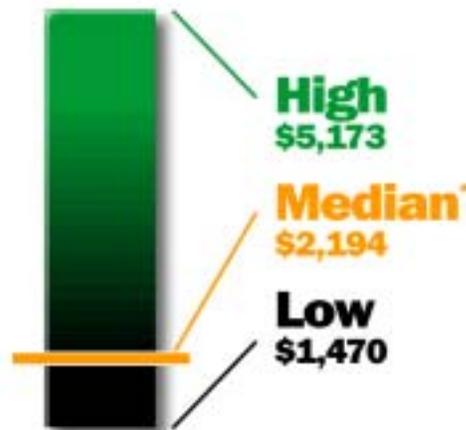


Figure 10 Support Services Expenditures per Pupil

After instruction costs, the second largest functional area of spending involves support of the overall instructional program. These activities—aptly called Support Services—include services designed to directly aid and benefit students (pupil personnel services); services which assist and support the instructional staff in carrying out the educational process; administrative services; pupil health services; business and related services; operation and maintenance of school buildings and grounds; pupil transportation; central support services; and other support services.

- Support Services designed to directly aid and benefit students are known as pupil personnel services. These include guidance services (such as counseling and placement); monitoring and enforcing attendance requirements; identifying students with psychological difficulties and providing services to them; aiding children with speech and hearing difficulties; pro-



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viding social services; and maintaining school attendance and related records. These activities cost school districts \$395.9 million or 2.8 percent of overall spending.

- Services that assist and support the instructional staff in carrying out the educational process include providing hardware and software for instructional programs; computer-assisted instruction; school library services; curriculum development services; and related costs. These total \$448.4 million and represent 3.2 percent of overall spending.
- Administrative services include those related to the school board; the superintendent; tax assessment and collection; legal services; principals; and various other administrative activities cost. These total \$897.4 million or 6.3 percent of overall spending.
- Pupil health services include medical, dental, nursing, and related services provided to both public and non-public pupils, as required by state law. These total \$141.9 million or 1.0 percent of overall spending.
- Business and related services include financial accounting and reporting, budgeting, accounting, payroll, purchasing, printing, and related activities. These total \$169.7 million or 1.2 percent of overall spending.
- Operation and maintenance of school buildings and grounds includes the cost of purchasing, maintaining, repairing, and replacing equipment and providing heat and light. These total \$1.3 billion or 9.1 percent of overall spending.
- Pupil transportation costs—specifically, the cost to a school district of transporting its pupils to and from school (including charter schools)—are incurred by almost all Pennsylvania districts. State law also requires that districts provide identical transportation services to resident nonpublic school students, including transportation to schools up to ten miles beyond the boundaries of the school district. The total cost for these transportation services is \$701.3 million or 4.9 percent of overall spending. The state specifically reimburses districts for a portion of these costs. Districts most often provide student transportation using district-owned equipment or by contracting with a vendor, but they can also use public transportation services (e.g. Philadelphia and Pittsburgh).
- Central support services include planning research, data processing and related services. These cost \$98.6 million or less than 1.0 percent of total spending.



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- Miscellaneous other support services cost \$29.3 million or less than 1.0 percent of overall spending.

Non-Instructional Services

Important school services not directly related to providing instruction include food services; school-sponsored student activities and athletics; recreation; public libraries; childcare; welfare; other services provided to students, staff, or the general community; and scholarships and awards. (Note: because spending for food services and athletic programs is often recorded in separate funds apart from the General Fund, the figures presented here do not include all district spending for non-instructional services.)

Facilities Acquisition, Construction and Improvement Service

Districts frequently pay for facilities and related expenses outside the General Fund. When they pay these costs from their General Fund, however, they record it as Facilities Acquisition, Construction, and Improvement Services. These expenses pertain to the acquisition of land and buildings, certain systems and equipment, and building construction and improvements. There are accounting rules for how to record these expenditures.

(Outside the General Fund, school districts frequently utilize a separate capital projects fund to account for large construction projects and often borrow to cover their cost. Because of this, the capital outlay figure reflected in the General Fund is not always a full picture of spending for these purposes.)

Other Expenditures and Financing Uses

Figure 11 Other Expenditures per Pupil

This category includes spending for debt service payments (principal and interest); transferring moneys from one fund to another (e.g., cafeteria, debt service, capital reserve) that neither increases nor decreases total spending; refunds of prior year's revenues; and disbursements which do not fit into any other functional category.

Nonpublic School Services

Public school districts are financially responsible for various services provided to non-public



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school students as required by state law. The level of spending will differ by district and is based on its characteristics including the number of non-public pupils serviced by the district. The primary areas of spending for non-public pupils include transportation; health services; remedial reading, math instruction, psychological evaluation, counseling and services for students with speech, hearing or visual impairments; career and technical education which enables nonpublic students to attend public vocation/technical schools for training in areas such as business, trade, technical and health careers; special education; and other programs.

Expenditures by Types of Items Bought (Object)

Expenditures are also measured by the type of service or commodity purchased (called objects of expenditure), including salaries; benefits; purchased professional and technical services; purchased property services; other purchased services; supplies; expenditures for property; other objects; and other financing uses.

- Salaries include payments of salaries and overtime to regular full-time and part-time employees, such as teachers, administrators, office and clerical staff, and building maintenance personnel. Spending for salaries is \$7.8 billion or 54.4 percent of all spending.
- Benefits and related cost of employment provided to these employees include such items as medical and life insurance, disability, Social Security contributions, retirement contributions, professional development costs/tuition reimbursements, unemployment compensation contributions, and workers' compensation. Spending benefits totals \$2.1 billion or 14.4 percent of all spending.
- The cost of architects, engineers, auditors, dentists, medical doctors, lawyers, accountants and other consultants, as well as contracted teachers, are known as purchased professional and technical services. Spending for these purposes totals \$747.6 million or 5.3 percent of all spending.
- Spending for cleaning and disposal, snow plowing, purchased custodial services, lawn care, utilities for lighting buildings and operating equipment, water and sewerage services, contracted agreements for the upkeep of buildings, equipment, and vehicles; rental of land, buildings, equipment, and vehicles; and expenditures for constructing, renovating, or remodeling facilities are called purchased property services. Spending for these purposes totals \$377.6 million or 2.7 percent of all spending.
- Other purchased services include costs associated with transporting pupils to and from school (when this service is not provided using district per-



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sonnel and equipment); various insurances including fire, automotive liability, general property and liability, and bonding; telephone and postage costs; advertising; printing; tuition to other school districts, charter schools, community colleges, career and technical schools; and the operation of the district's food service facility (if other than by employees of the district). Spending for these purposes totals \$1.2 billion or 8.1 percent of all spending.

- Supplies generally include books, calculators, diskettes, pencils, educational software; gas and electricity when used for heating and air conditioning; gasoline and diesel fuel; and food used in the district food service program. Spending for these purposes totals \$573.0 million or 4.0 percent of all spending.
- Property includes buying or improving land, buying pre-existing buildings, and purchasing new equipment, additional equipment or replacement equipment. Spending for this object also includes depreciation in certain cases and the cost of issuing bonds. These total \$222.9 million or 1.6 percent of all spending. (Note: new construction costs normally do not appear in the General Fund.)
- Other objects include miscellaneous spending for such things as dues and fees; claims and judgments against the district; interest expenses; refunds of prior years' revenues; etc. Spending for these purposes totals \$446.4 million or 3.1 percent of all spending.
- Other uses of funds reflects the retirement of principal on long-term debt, as well as fund transfers. Spending for these purposes totals \$934.9 million or 6.6 percent of all spending.

Combining spending by object into three groupings (Salaries and Benefits, Materials and Equipment, and Other Expenses) provides a more simplified view of this type of spending. It also reinforces the fact that, by far, the greatest portion of school district spending covers the salaries and benefits of employees — classroom teachers, administrators, clerical staff and maintenance employees.

Variations in Expenditures

The data for expenditures both by function and by object indicate a relatively wide range in spending on a per-pupil basis from district to district throughout the state. These ranges reflect in part the diversity of Pennsylvania's socio-economic, geographic, and demographic factors as well as the urban, suburban, and rural mix among school districts. In addition, the educational process is very labor-intensive, and as a result most school district costs are related to personnel. Thus, the variation in salaries and benefits paid throughout the state is reflected in the aggregate and per-pupil expenditures of each school district.



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Within this context, some of the specific factors that cause cost variations from district to district encompass the following major areas.

Salaries and Benefits

- **Collective Bargaining Contracts** – State law sets the guidelines for districts to negotiate and enter into collective bargaining agreements with their employees for wages, benefits, and working conditions. Because each district negotiates with its employees independently and each district is subject to a different mix of characteristics, variations will result from district to district with respect to pay rates, benefits levels, etc.
- **Service and Educational Level of Employees** – Generally speaking, employees with more years of service receive higher compensation than those with fewer years of service. Similarly, employees who have higher educational levels tend to receive higher wages than those with lower levels of education. Therefore, districts with an employee mix that has relatively more years of service and a higher educational level will tend to have high personnel costs, all other factors being equal.
- **Labor Market Conditions** – School districts located in areas where general wage rates tend to be high may need to pay higher rates of compensation to attract qualified employees. Similarly, in areas where there is a scarcity of teachers and other personnel, districts may also need to pay higher wages than those districts with an adequate labor pool. This factor may also be influenced by a rapid change in the district's enrollments. Such an increase in enrollment may force a district to pay higher wages to attract teachers from outside the district's normal labor pool.
- **Pupil/Teacher Ratio** – All things being equal, those districts with a lower pupil/teacher ratio will employ more teachers than would be the case if more pupils were assigned to each teacher. Consequently, in districts with lower pupil/teacher ratios, personnel costs will generally be higher.
- **Grade Level Mix** – As a general rule the cost of educating high school students tends to be greater than at the elementary level. Districts with a student enrollment weighted toward high school students will tend to be relatively more costly than those with more students at the elementary levels.



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Special Education

One of the major cost areas for most school districts deals with special education. Variables from district to district within this area include:

- **Number of students enrolled in special education relative to the total district enrollment**

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- Types of special education programs to be provided. There can be a wide range in the cost of these programs depending on the nature of the services required by the students.
- Degree to which special education programs can be provided within the local district versus purchasing the services from a non-district source

Transportation



- Geographic size of the district
 - Population groupings and density of students related to bus routes
 - Proportion of students in the district that need to be bused
- Urban, suburban, rural nature of the district
 - Number of schools and their configuration in relationship to population density
 - District policy on the maximum length of travel time for an individual pupil
 - Number of non-public students who must be bused by the district, especially to schools up to ten miles beyond the district's limits
 - Availability of vendors to provide transportation services as an alternative to the district operating its own buses
 - Fuel costs variances throughout the state

Building and Equipment Costs

- Age, quality, and efficiency of buildings
- Ability to adapt building space to changes in the educational program including use for special educational programs and computer technology
- Need for new buildings because of enrollment growth or out-dated structures. These can vary significantly from district to district.



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- Mechanical and heating efficiency especially in high energy cost environments—often related to the age of the system

Accounting and Statistical Approaches

Although the state requires school districts to account for expenditures in a relatively consistent way, variations can still occur. Because of this, it is possible that expenditures in some districts may be reflected in separate accounting funds or grouped in different account categories. This accounting difference may make it appear that spending is dissimilar when, in actuality, it is simply a matter of “grouping” expenditures in different ways from district to district.

Details on aggregate and per pupil spending on a district-by-district basis appear at the web site *Your Schools, Your Money*¹³.

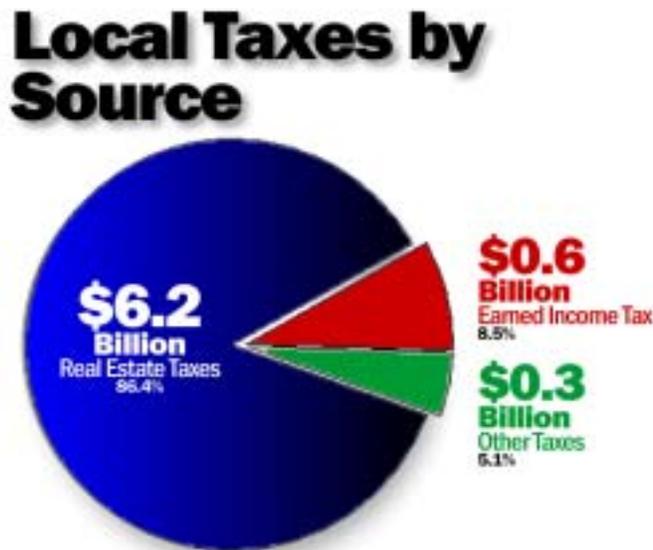
General Fund Revenues

Pennsylvania school districts receive their funds from local sources – mainly local taxes – and the state government. In districts across the state, local funding ranges from 20 percent to 85 percent of total district funding. State funding to any given district ranges from 15 percent to more than 70 percent of that district’s revenues. The reasons for these ranges relate to state funding policies as well as the decisions made by local school boards.

Local Revenues

Local revenues include the real estate tax, the earned income tax, and other non-property taxes, as well as payments of utility tax revenues from the state, payments in lieu of taxes, and various other types of income.

Figure 12 Local Taxes by Source



Real Estate Tax

The real estate tax is levied on the assessed value of land and buildings owned by individuals and businesses. These values are established by county assessment offices, which appraise each property for purposes of taxation at market value and then apply a predetermined assessment ratio which could range from 20 percent to 100 per-

¹³ <http://www.pde.state.pa.us/>



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cent. A uniform tax millage rate is then levied by the school district against the value of each property. One mill is equivalent to \$1 of tax for each \$1,000 of value. The millage rate times the sum of the values of all properties (known as the district's assessed valuation) produces the potential tax revenue of the district. For the individual taxpayer the millage times the value of the property produces the property owner's tax bill.

Various legislation such as Act 50 and programs which provide tax relief or exemptions, such as the state's Clean and Green program, the KOZ program and LERTA affect the district's total assessed valuation and the resulting tax real estate levy. Because of differences in assessment policies and practices (and for a number of other reasons), school district assessments and millage rates cannot be accurately compared from county to county. The real estate tax generates about \$6.2 billion or about 80 percent of all local taxes and 42.9 percent of total district revenues.

Earned Income Tax

The earned income tax (EIT) is levied on the wages, salaries, commissions, net profits, and other compensation of those who reside in the district; income from interest and dividends is not included. This tax applies to employed individuals, unincorporated businesses, partnerships, and professional persons, and in most cases the earned income tax is withheld from worker's paychecks. Most Pennsylvania residents pay 1.0 percent of their earned income to support school and municipal services; the school district and the respective municipalities generally share the revenues evenly. Exceptions exist in Philadelphia, Pittsburgh, and Scranton where school rates are higher; in the three districts which have implemented Act 50 and also have higher school EIT rates; and in many suburban districts in the Philadelphia area where this tax is not as widely used as in the remainder of the state. The Earned Income Tax produces \$612.5 million or 4.2 percent of total district revenues.

Occupation Tax

The occupation tax is levied on the assessed value of occupations. The county assessment office assigns a value to the "occupation" of each adult in the district — including those not employed — which is based solely on the type of occupation and without any direct relationship to the actual or potential earnings of the individual involved. As with the real estate tax, the district levies a tax rate in the form of a millage against these valuations, and each taxpayer in the district is sent a tax bill. Unlike other Act 511 taxes, this tax is not subject to sharing with the district's municipal governments, and under the terms of Act 511, there are no rate limits on the occupation tax other than the overall limit that applies to the total revenues from all Act 511 taxes. The amount of revenue generated by the occupation tax is about \$130.9 million or about 1.0 percent of all General Fund revenue.



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Occupational Privilege Tax

Occupational privilege taxes are levied upon individuals for the privilege of employment within the taxing jurisdiction. This is the only tax that a school district may directly collect from non-residents working within its borders. State law provides that any person subject to an occupational privilege tax is required to pay it only once per year. When a person resides in one jurisdiction and is employed in another or others during the year, state law assigns the order of priority as to which taxing jurisdictions may collect the levy. The enabling legislation sets a maximum rate of \$10, which like most other taxes levied under Act 511, is subject to sharing with the municipalities which constitute the school district. Thus, the limit would be \$5 for a school district and \$5 for a municipality, if both levy the tax. This tax generates about \$15.2 million or less than 1.0 percent of all general fund revenue.

Real Estate Transfer Tax

The real estate transfer tax is imposed on the selling price of real property when it changes hands. The tax is paid by the purchaser at the time of transfer, and the county is the agent for the collection of the tax. Act 511 contains certain limitations and restrictions on the imposition of this tax on the transfer of property within families or in estate cases or other circumstances; it also sets a maximum rate of 1.0 percent. (The state also levies a 1.0 percent tax.) This tax produces about \$137.7 million or about 1.0 percent of all General Fund revenue.



Per Capita Tax

The Per Capita Tax is a flat rate tax levied on each adult resident within the taxing district and is levied under the authority of the Pennsylvania School Code and Act 511. As with most Act 511 taxes, the Act 511 portion of the Per Capita Tax is subject to sharing between the taxing school district and the municipal government(s) of its geography. The amount of revenue generated by this tax is \$35.5 million or less than 1.0 percent of General Fund revenues.

Mercantile Taxes

Mercantile taxes are imposed on the gross receipts of wholesale and retail businesses. The business privilege tax is similar but broader in application in that it is levied against the gross receipts of all who have business transactions within the taxing jurisdictions, which expands the base from sales of commodities to include services. These taxes generate about \$36.9 million or less than 1.0 percent of all General Fund revenue.

Amusement Taxes

Amusement taxes are levied on the privilege of engaging in an amusement and are based on admission prices to places of amusement, entertainment or rec-



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reation. Admissions taxes are somewhat more general, being levied on admissions to all places or events whether or not they constitute amusements. Act 511 restricts these taxes to a maximum rate of ten percent. When both the municipality and school district levy the tax, it is subject to sharing provisions. There is considerable case law on what constitutes an amusement and numerous specific exclusions and exceptions (e.g., admissions to movie theaters are excluded, and admission to ski facilities, golf courses, and bowling alleys are capped at 40 percent of the cost of admission). This tax produces about \$5.0 million or less than 1.0 percent of all General Fund revenue. Legislative changes in 1998 limit the use of this tax to those districts which levied it at the time the new law was passed and prohibit these districts from increasing the rate of the tax.



Mechanical Devices Tax

Taxes on mechanical devices are essentially amusement taxes levied against coin-operated machines. The “admission fee” is defined as the amount of money required to operate the machine. The tax is restricted to machines providing amusements; such as jukeboxes, pinball machines, video games, and coin-operated pool tables. The tax can be measured by the gross receipts from such machines; however, it cannot exceed the sum of ten percent of each individual price to activate the machine. This tax produces about \$130,000 or less than 1.0 percent of all General Fund revenue.

Special City Taxes

Special taxes for Philadelphia and Pittsburgh include current earned income taxes, current business use and occupancy taxes, current non-business income taxes, current liquor sales taxes, and current mercantile taxes. These generate \$190.5 million or 1.3 percent of all school district revenues.

Other Taxes

Other taxes that are used on a very limited basis across the state include:

- Taxes on the gross receipts of commercial parking lots
- Receipts from landfill operations (actually, a host municipality benefit fee of \$1 per ton which is paid by operators of landfills or resource recovery facilities)
- Taxes on signs attached to the exterior of any structure or to a pole/post for purposes of display or advertisement



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- Recreational use taxes (usually a flat rate charge levied against structures used for seasonal or recreational purposes, such as hunting and fishing camps in forested areas)

These sources combined generate about \$585,000 or well under 1.0 percent of all school district revenues.

Limits on taxes are found in the Pennsylvania School Code and Act 511. Although state law limits school district real estate taxes in general, it does not limit taxes used to pay the following: minimum salaries and increments of teaching and supervisory staff; the rentals due any municipal authority, nonprofit corporation, or the State Public School Building Authority; sinking fund charges in connection with school building projects; or any other debt service requirements. As such, there is no practical limit.

Act 511 provides specific limits on the rates of most of the individual tax levies and also limits the collective yield of the school district's Act 511 taxes.

In addition, there are several other sources of revenue for school districts, as noted below.

- Delinquent taxes, which are received by a district in a given fiscal year which should have been paid in a prior year. They produce \$411.9 million or 2.9 percent of all school district revenues.
- Public Utility Realty Tax Act (PURTA) funds. School districts receive revenues from the state as part of a statewide tax on utility property, which is exempt from local taxation. The state allocates funds to the jurisdictions on the basis of a formula which considers the total local taxes they actually collect. Distribution of PURTA funds is unrelated to the presence of public utility property in the school districts receiving the aid. These revenues total \$92.2 million or less than 1.0 percent of total General Fund revenue. The recent deregulation of public utilities in the Commonwealth resulted in a shift in electric generation properties from exempt status to taxable status at the local level. This increased the assessed valuation of taxable property and the potential real estate tax revenue for school districts where generating facilities are located.
- Voluntary contributions from governmental entities and/or organizations exempt from real estate taxation are known as payments in lieu of taxes. For example, school districts (as well as counties and townships) receive a fixed amount per acre for all state parks and forests and all federal forests that are exempt from taxation. The Commonwealth also reimburses school districts and local governments for the loss in taxes from property acquired for flood control or water conservation purposes. Payments in



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lieu of taxes produce about \$19.7 million or less than 1.0 percent of all General Fund revenues received by Pennsylvania school districts.

Miscellaneous Local Sources

Revenues at the local level also include investment income [See also *Investments on page 36*], rents, tuition payments, receipts from the sale of materials and supplies, and other miscellaneous sources. These revenues total \$381.2 million or 2.6 percent of total General Fund revenues.

State Sources

Basic Education Funding (Basic Instructional Subsidy)

The Commonwealth distributes Basic Education Funding (BEF) to each of its 501 public school districts to help meet instruction costs. Until 1992 this major state subsidy used a formula that took into account several factors in determining the amount distributed to each school district. Since then, the amount determined by that formula has served as a base which has been supplemented by annual percentage increases as determined by the State Legislature. This appropriation is the largest subsidy provided by the Commonwealth to support local school districts. It totals more than \$3.5 billion or almost two-thirds of all state funds made available to districts. It makes up about 25 percent of all General Fund revenues for Pennsylvania school districts. It is the largest single appropriation in the Commonwealth's budget.

The Performance Grant Incentive Program rewards schools that improve their effort or achievement. Effort is measured by student attendance and achievement is measured by improvement in reading and math scores on the Pennsylvania System of School Assessment (PSSA). In addition, schools that consistently maintain high standards in either of these categories are eligible to obtain grants. In the latest round, 808 schools were recipients. In each school a committee chaired by the principal and including parents determines how the funds are to be spent, but at least 50 percent of the award must be spent on improving instructional programs. School performance awards total \$7.9 million or less than 0.1 percent total school district revenues.

Other instructional and operational subsidies involve charter schools, \$6.6 million, and tuition payments for orphans and children placed in private homes, \$31.6 million.

Special Education and Career and Technical (Vocational) Education

The state provides support for exceptional children served by the public school districts, intermediate units, approved private schools, private residential facilities, and state centers throughout the Commonwealth. In the case where the public schools cannot provide appropriate educational programs for severely disabled children, the district receives a special state subsidy to cover the major por-



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tion of the tuition and related costs to place them in licensed private schools. Special consideration is also provided for children with severe disabilities who are placed in state centers and hospitals. Reimbursements for special education programs (including early intervention programs) total about \$641.2 million or 4.4 percent of total district revenue.¹⁴ (State special education appropriations are also paid directly to intermediate units as funding for core services designed to support special education programs in their areas.)

The state makes subsidy payments to school districts that provide career and technical instruction. The method of calculating this subsidy varies slightly depending on whether students participate in an approved curriculum in their home high school or attend an area career and technical school. This subsidy is intended to reflect the fact that operating vocational programs is generally more costly than offering the regular education curriculum. Reimbursements for career and technical education totals \$13.2 million or less than 0.1 percent of total General Fund revenues. (Note: the state also makes subsidy payments directly to career and technical schools; this figure is here.)

In 1998-99, the Commonwealth also provides funds to school districts for a number of other programs and services using a variety of reimbursement mechanisms. These include programs involving homebound instruction, \$707,000; driver education, \$968,000; migratory children, \$174,000; Job Training Partnership/ Workforce Investment Act, \$3.4 million; adult literacy, \$3.2 million; and other program subsidies, \$6.9 million.

Subsidies for Transportation and Educational Support Programs

The Commonwealth reimburses public schools for costs incurred in transporting children between home and school and also for transporting non-public school children. The reimbursement is for transportation at the elementary level of not less than 1.5 miles from the school and at the secondary level, not less than two miles from the school. There is also special consideration for transporting pupils who would have to walk through hazardous areas. Non-public school children must be transported to schools up to ten miles from the border of the district. The state calculates reimbursements to school districts based on the age and size of the vehicles used, the mileage that the vehicles travel, how efficiently the vehicles are used, the type of service provided (contracted, district-owned, fare based, etc.), and other considerations. The resulting calculation is then adjusted by a cost index and the relative wealth of a district, as measured by the Market Value Aid Ratio. There are other adjustments including one that limits the amount a district has to raise locally to cover the cost of transportation services. A separate appropriation provides additional state aid for non-public pupil transportation at a guaranteed level. Transportation reimbursements total \$388 million; this represents about 2.7 percent of all district revenues.



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¹⁴ <http://www.pde.psu.edu>

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The state also reimburses school districts for certain costs incurred when a school district constructs, acquires, or renovates a building, acquires a site, or leases facilities; this is known as Rentals and Sinking Fund Payments/Building Reimbursement Subsidy. The State Board of Education and the PDE set standards for the specific kinds of projects eligible for reimbursement. The reimbursement factor is then adjusted by the relative wealth of the district. Rentals and sinking fund reimbursements generate about \$246.0 million or 1.7 percent of all General Fund revenues for school districts.

Certain medical, dental, nurses, and related health services are reimbursed by the state on a per pupil basis according to the type of service provided by school districts. These include medical examinations, dental examinations, and the services of dental hygienists and school nurses. These reimbursements total about \$38.6 million or 0.3 percent of total district revenues.

Other subsidies for non-instructional programs include sewage treatment operations, \$601,534—a negligible percentage of all General Fund revenues.

- Subsidies for Employee Retirement Benefits. Retirement costs are borne by the Commonwealth, local school entities, and school district employees. The employer's portion of these costs is shared by the Commonwealth and school districts. Reimbursements for retirement costs total \$231.4 million or 1.6 percent of total district revenues.
- Payroll taxes. The Commonwealth also reimburses schools for at least one-half of the employer's share of the Social Security/Medicare Tax paid for each employee. The state's portion of this cost is \$294.4 million and represents 2.0 percent of total district revenue.
- Technology Grants. This source totals \$28.7 million or 0.2 percent of total district revenues. For example, the Link to Learn initiative is designed to integrate technology in schools across the state.¹⁵
- For a detailed look at Governor's 2000-01 Budget for the PDE, please visit: <http://www.state.pa.us/PAPower/>



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¹⁵ [HTTP://WWW.L2L.ORG/](http://WWW.L2L.ORG/)

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Federal Sources

In 1998-99, federal education funding was categorized as follows.

- Unrestricted Grants in Aid directly from the federal government, \$6.9 million
- Unrestricted Federal Grants passed through the Commonwealth, \$112,000
- Restricted Categorical Grants directly from the federal government, \$32.9 million
- Restricted Categorical Grants passed through the Commonwealth, \$358.6 million. This is mainly funding appropriated via Elementary and Secondary Education Act (ESEA), Education Consolidation and Improvement Act (ECIA) and Individuals with Disabilities Education Act (IDEA), \$330.3 million.
- Restricted Categorical Grants through the Commonwealth (Driver Education; Headstart; Work Force Investment Act, etc.), \$54.9 million
- Medical Assistance Reimbursement, \$9.8 million

The Federal Title I Program¹⁶ is a 100 percent federally funded supplemental education program that provides financial assistance to local school districts to improve educational opportunities for educationally deprived children. Title I programs are designed to help children meet the state content and performance standards in reading, language arts, and mathematics. In buildings with 50 percent or more poverty, a district may use the funds in school-wide programs to upgrade the entire curriculum of the school; in buildings with less than 50 percent poverty, programs are designed to help specific children.



The federal government also provides funding for special education programs (to help local schools develop and implement individualized education plans to meet each child's educational needs); local school to work partnerships, grants that focus on career and technical education and work site-based experiences; the Technology Literacy Challenge Fund, (which supports efforts to meet the national technology goals of modern computers, quality education software, skilled teachers and af-

¹⁶ <http://www.pde.psu.edu/fedprog.html>



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fordable connections to the Internet for all schools); and E-rate (the Schools and Libraries Universal Service Fund which is designed to ensure that all eligible schools and libraries have affordable access to modern telecommunications and information services).

Other types of federal funding include: the safe and drug-free schools program that supports locally developed strategies to make schools safe and drug free; the bilingual education program that is designed to help students with limited English proficiency; the immigrant education program that helps eligible districts address the costs of educating immigrant children in elementary and secondary schools; and the 21st Century Community Learning Centers that targets resources to inner city and rural schools to provide learning activities before and after school in a safe environment with adult supervision. In addition, federal funds provide for the administration of the Child Nutrition Programs, including the National School Lunch Program, School Breakfast Program, Special Milk Program, Child and Adult Care Food Program, Summer Food Service Program, and the Nutrition Education & Training Program. Federal funding available for schools can come from a number of sources including the U.S. Department of Education, the U.S. Department of Health and Human Services (Headstart), and the U.S. Department of Agriculture (school lunches).

Other Sources of Revenues

Other sources of revenues include the sale of fixed assets and refunds of prior years expenditures. These normally produce a very small portion of total district revenues; the total is \$182.1 million or 1.3 percent of total district revenues.



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Appendices

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