FUND STRUCTURE TASK FORCE REPORT
TO THE
QUALITY SCHOOLS INTERIM COMMITTEE

NOVEMBER 2, 2005

INTRODUCTION

Senate Bill No. 152 provided, " By July 1, 2007 the legislature shall consolidate the budgetary fund structure to create the number and types of funds necessary to provide school districts with the greatest budgetary flexibility while ensuring accountability and efficiency."

The fund structure changes proposed in the 2005 Legislature Joint Select Committee's report were presented to the Quality Schools Interim Committee (QSIC) in our report dated July 21, 2005. A task force representing school business officials from large and small districts, county superintendents, school district auditors, MtSBA and the QSIC working group was convened to review the Joint Select Committee's proposed fund structure changes and make recommendations to the QSIC. Task force members are listed individually in the fund structure report that was presented to the QSIC on July 21, 2005. To provide continuity, many of the members were also on the fund structure working group that was convened by the Governor's Advisory Council on School Funding in 2001, and the majority of the fund structure changes recommended in this report are consistent with the changes that were recommended by the fund structure working group.

The task force held two meetings in July and August to discuss the fund structure used by schools and other related school finance matters. Members also completed a short survey on the Retirement Fund last week. The results of that survey are detailed in the back of this report in Appendix A. Task Force members were also sent a draft of this report for comment.

WHEN IS A SEPARATE FUND NECESSARY?

The general fund is the chief operating fund of a school district. Generally accepted accounting principles (GAAP) prescribe that the general fund be used to "account for all financial resources except those required to be accounted for in another fund." In other words, GAAP presumes that all of a government's activities are reported in the general fund unless there is a compelling reason to report an activity in some other fund type.

Examples of "compelling reasons" to report an activity in a fund other than the general fund include:

1. An intent to cap expenditure levels for the activity at a different level than general fund activities are capped, or not cap them at all.
2. To account for and accumulate the proceeds of a revenue source that, by law, must be used for a specified purpose(s).
3. GAAP require that certain activities be accounted for in another fund type. For example, moneys accumulated for the future payment of bond principle and interest must be accounted for in the debt service fund type.

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RECOMMENDATION - SEPARATE FUNDS

THE TASK FORCE BELIEVES THERE ARE COMPELLING REASONS TO RETAIN THE FOLLOWING SPECIAL REVENUE FUNDS and not "roll" them into the general fund:

1. The transportation fund - to account for all money from state, county and local sources that is earmarked for the purpose of paying the costs of transporting students to and from school and home, excluding the cost of school district general administration, school administration and business office support services because those costs are funded in the new general fund components.

NOTE: The Joint Select Committee report proposes to roll the transportation fund into the general fund, but there are large disparities in the amounts that district spend on transportation, making it difficult to design a funding formula that works for all.

______2. The tuition fund - to account for money earmarked for the purpose of paying the cost of tuition paid by the district under an approved out-of-district attendance agreement;

______3. The school food services fund - to account for federal, state and local money earmarked for the purpose of paying the costs of operating the district school lunch and breakfast programs.

______4. The impact aid fund - to account for federal funds received and expended under the provisions of 20 U.S.C. 7701, et seq..

______5. The miscellaneous programs fund should be retained, renamed and divided into two new funds:

a. The federal programs fund - to account for money from federal sources, excluding impact aid monies and medicaid reimbursements.

b. The state and private programs fund - to account for all money from state grants, private grants and private donations that are not required to be accounted for in another fund.

6. The interlocal cooperative fund - to account for money earmarked for the financial administration of an interlocal cooperative agreement including federal, state, or other types of grant payments in direct support of the agreement and the financial support provided by cooperating agencies.

RECOMMENDATION - RETAIN FUNDS UNTIL 2007

Because of the assessment needed for facilities, THE TASK FORCE RECOMMENDS the following school district funds be retained until July 1, 2007. Upon completion of the facilities assessment, the Legislature can revisit the issue of whether the following funds should be consolidated into one Capital Projects Fund, a funding formula for school district capitol projects developed, and existing voted levies in these funds replaced with another funding source.

1. Building Fund - accounts for moneys that are expended for building, enlarging, remodeling or repairing a school or other building of the district.

2. Building Reserve Fund - with the approval of voters, a district may establish a building reserve for the purpose of raising money for the future construction, equipping, or enlarging of school buildings, for the purpose of purchasing land needed for school purposes in the district, or for the purpose of funding school transition costs

3. Bus Depreciation Fund - a district owning a bus or a two-way radio used for purposes of transporting students to and from home, or for purposes of conveying pupils to and from school functions or activities, may establish a bus depreciation reserve fund to be used for the conversion, remodeling, or rebuilding of a bus, for the replacement of a bus or radio, or to purchase an additional bus.

4. Lease-Rental Agreement Fund - Trustees of any district that provides pupil or teacher housing in district-owned buildings under a lease or rental agreement, or rents or leases any buildings, land, facilities, or personal property of the district, may establish a lease or rental agreement fund. All money received from the lease or rental agreements is credited to the lease or rental agreement fund, general fund, the debt service fund, or any other appropriate fund. Any expenditure of money from a lease or rental agreement fund must be made for the maintenance and operation of the district-owned buildings to which the lease or rental agreements apply or for the acquisition of additional housing or dormitory facilities.

THE TASK FORCE RECOMMENDS that **the compensated absences fund** be retained until July 1, 2007. The compensated absences fund accounts for transfers from the general fund that are used for the purpose of paying any accumulated amount of sick leave that nonteaching or administrative school district employee is entitled to upon termination of employment with the district and any accumulated amount of vacation leave that a nonteaching or administrative school district employee is entitled to upon termination of employment with the district. Several members of the task force feel this reserve could be accounted for in the general fund but we have not had time to work out the details of this change.

RECOMMENDATION - ELIMINATE FUNDS IN 2006

THE TASK FORCE RECOMMENDS that the following school district funds be eliminated effective July 1, 2006:

1. The flexibility fund - established to account for "one-time-only" state aid payments to schools for general operating costs.

2. The technology fund - Salaries and operating costs recorded in this fund have been built into the general fund components. Districts should be allowed to continue levying technology levies already approved by voters, depositing the proceeds into the Building Reserve Fund until the new Capital Projects Fund is created, and using the proceeds for major technology projects involving capital outlay. Separate accounting for levies in this fund would be accomplished using "project reporter codes."

   If "timber money" continues to be earmarked for major technology projects involving capital outlay, the Technology Fund should be renamed the "Capital Projects Fund" and the "timber money" deposited in that fund along with the proceeds from technology levies.

3. The litigation reserve fund - Only 1 to 3 districts use this fund each year for accumulating cash outside the general fund for potential payments required by specific legal judgements.

4. Traffic education fund - account for this program in the district's State and Private Programs Fund.

5. Metal mines fund and mining impact fund - account for these resources in the district's State and Private Programs Fund. Law allows use of the money, which come from mining impact fees and royalties, for any district purpose.

PROS AND CONS OF ELIMINATING THE RETIREMENT FUND

Background

The district Retirement Fund accounts for the employer share of contributions to TRS, PERS, social security, medicare and unemployment insurance (i.e, “benefits”) for employees paid from the general fund, impact aid fund and school lunch fund. The Table below shows the current rates for each of these payments.

	TRS	PERS
RETIREMENT	.0758	.068
SOCIAL SECURITY	.062	.062
MEDICARE	.0145	.0145
UNEMPLOYMENT (MSUIP average FY06)	.003	.003
Total	.1553	.1475

A district estimates these costs for the next school year and gives their budget to the county superintendent. The county superintendent totals the retirement fund budgets for all districts located in the county and the commissioners set a county levy to fund the cost. The county mill levy is mandatory, not capped, and is subsidized in eligible counties by state guaranteed tax base support.

The QSIC sent a survey to Task Force members, asking them to respond to the following three questions. The complete text of the responses received is included in Appendix A of this report.

(1) Assuming the new general fund is adequately funded, as a school finance official, do you favor "rolling" retirement costs into the GF or keeping retirement as a separate fund? (Yes - 6; No - 2)

(2) Do you agree or disagree with this statement: "Rolling" retirement into the GF will subject retirement to collective bargaining." (Agree - 1; Disagree -7)

(3) Do you agree or disagree with this statement: "Rolling" retirement into the GF may jeopardize retirement benefits. " (Agree - 1; Disagree -7)

Of the eight task force members who responded to the informal Retirement Fund survey, six felt there is no compelling reason to retain the Retirement Fund, provided the new general fund is adequately funded now and in the future. The general fund components are calculated to provide adequate funding for these costs at a rate of 16.5% of salaries, which is slightly higher than current rates.

What are some benefits of "rolling" retirement into the general fund?

1. It can be argued that, paying employee benefits for general funded employees from the general fund is rational, and as a result, may be more defensible as good public policy. Paying for these benefit costs from the general fund is consistent with how other states account for school district employee compensation, and is consistent with the way other state and local government employees are paid in Montana.

2. Paying employee benefits from the general fund would make Montana's funding formula less complicated. It eliminates the need for one district fund, one county fund, a separate guaranteed tax base calculation, and a separate property tax calculation and distribution.

3. Paying employee benefits from the general fund is more equitable. The Retirement Fund is not capped and there are currently large disparities in the amounts expended by district per ANB. [See Appendix B]

4. It can be argued that the current method of funding these costs is poor tax policy. Property taxpayers in one school district shouldn't be responsible for paying the salary and incentive decisions made by another school district just because they happen to be located in the same county. Those taxpayers have no representation on the other school district's board. Because it's a countywide levy for all school districts located in a given county, neither the county nor the school districts are accountable for increases in the levy.

5. Moving retirement into the general fund gives schools more flexibility because the new general fund components for payment of benefits are not earmarked for that purpose. Districts that pay salaries in an amount less than funded by the new general fund components can use the amount saved in both salaries and related benefits for another purpose.

6. When districts negotiate employee retirement incentives, the districts should be required to pay the entire cost of their negotiations from district resources, rather than passing the related benefit cost of retirement incentives onto county taxpayers without a vote and without limits.

What are the concerns of "rolling" retirement into the General Fund?

1. "Rolling" retirement into the General Fund will subject retirement to collective bargaining.

2. "Rolling" retirement into the General Fund may jeopardize retirement benefits.

NOTE: Seven of the eight task force members responding to the survey disagreed with these two statements. The employer shares of retirement, social security, medicare, and unemployment benefits are rates set by state and federal laws. Changing the fund that a district uses for paying those benefits in no way threatens an employees' right to those benefits. School employees' retirement benefits are not negotiable.

3. The employer share of employee termination payouts can be very expensive and difficult to pay under the general fund budget caps. A simple 16.5% added to the salary line item will not be adequate to pay these costs.

THE TASK FORCE RECOMMENDS that if the Retirement Fund is eliminated, in order to ensure districts have funding available to pay the employer share of employee termination payouts, allowable uses of money transferred to the compensated absences reserve should be expanded to apply to any school district employee paid from non-federal funds.

4. If benefits are paid from the general fund and rates increase, districts will have to cut programs to pay benefits at the higher rate, since these payments are mandated by law.

If the Retirement Fund is eliminated and the employer rates for benefits are increased in state or federal law, THE TASK FORCE RECOMMENDS the Legislature should ensure the general fund components that include salaries and benefits are adjusted to fund benefits at the new, higher rate.

5. Districts that, in total, pay salaries at a higher amount than is included in the general fund components will also have to finance the related increase in benefits from district resources.

Currently districts can increase salaries or offer retirement incentives and pass the related increase in benefit costs onto the county taxpayers without a vote.

6. Putting benefits into the general fund will negatively influence the bargaining process. A school board may think, for example, that since it has already spent a significant amount of its general fund dollars on retirement, that it should not have to do so for other benefits.

7. Over time, rolling retirement into the general fund could provide an increasing incentive to strip down retirement benefits for future members and/or people not yet vested, particularly if the general fund is inadequately funded as it has been for the last several years.

8. Given past history, it is difficult to trust that the Legislature will "adequately" fund the general fund. With increased pressures from medical insurance, another one-time separate

fund, we don't need any more requirements for the general fund.

OTHER SCHOOL FINANCE ISSUES

Task force members also discussed a number of related school finance issues such as budget amendments, cash flows and the disposition of fund balances in closed funds. Our recommendations on these issues will be presented to the committee in the future.

APPENDIX A

THE "RETIREMENT IN THE GENERAL FUND" ISSUE

Responses of Fund Structure Task Force Members

(1) Assuming the new general fund is adequately funded, as a school finance official, do you favor "rolling" retirement costs into the GF or keeping retirement as a separate fund? Please provide a brief explanation for your answer. (Yes - 6; No - 2)

- Yes, I am in favor of not only consolidating the retirement fund into the general fund, but also other funds as well. The accounting structure should be a tool to provide the necessary accounting for school finance not a block to preventing the evolution of the accounting field to provide better and faster information to school administrators and state officers. Although "adequate" funding seems to be morphing into a nebulous phrase which any position could claim achievement, I believe that legal language should be added to prevent the use of unexpended general fund moneys to be used to backfill retirement costs and in the reverse, too - where districts could not use retirement levies for traditional general fund expenditures.

- With the assumption that the new general fund will be adequately funded and we will not have to cut other programs to fund the retirement costs, I would support the consolidation of the funds. If this consolidation does not simplify the accounting for these costs (i.e. we are required to keep a bunch of subledgers) I would not support it. Also, a simple 16.5% added to the salary line item will not be adequate. With Option 1 retirements coming at the end of the year amounts are often not known until the last minute. At the same time, we are trying to spend down our general fund on prioritized needs. I envision the retirement related expenditures being over and above any mandated budget caps.

- I agree with response above from (named business official-see second response).

- I favor rolling the retirement into the general fund. I agree with (named business official-see second response) that hopefully that a bunch of subledger accounts won't be required.

- Assuming the new GF is adequately funded, I am in favor of "rolling" retirement costs into the GF. Perhaps the original purpose of the Retirement Fund has been altered over the past years to cover retirement incentive costs. But, it is my opinion, that those "additional" costs should not be milled permissively. Therefore, it wouldn't matter which fund handled retirement costs, because in either case the voter should have a say in the "additional" expenses.

- I would strongly resist any attempt to roll the retirement fund into the general fund. I see no positive result from doing so. It complicates funding calculations, assuming the county/state will still be responsible for this funding. Given past history, it is difficult to trust that the Legislature will "adequately" fund the general fund. With increased pressures from medical insurance, another one-time separate fund, we don't need any more requirements for the general fund.

- We do not favor rolling retirement costs into the general fund. There would really be no purpose, as the general fund has traditionally been used, and should continue to be used, to provide a school board of trustees with wide discretion and latitude in allocating revenues to locally-controlled spending decisions. As we understand it, the retirement obligations of a district are controlled by the constitution and could not be spent in any way other than as allocated. As such, what is the point of putting it into the general fund as opposed to leaving it out? As long as there is no discretion on how to allocate these funds, putting it into the general fund, even if adequately funded, doesn't make a whole lot of sense.

- My understanding of this suggestion is that it was introduced four years ago when the Fund Structure Task Force first went to work. At that time, one of the charges to the committee was to "propose modifications to the existing school fund structure that will simplify fund accounting and provide more flexibility to school districts…." Those of us "in the trenches" see the logical and practical rationale for including the Retirement Fund in the General Fund—salaries and benefits are tied together. It seemed to me then and still does today that there are good practical reasons for combining the two funds.

(2) Do you agree or disagree with this statement: "Rolling" retirement into the GF will subject retirement to collective bargaining." (Brief explanation of your answer)

(Agree - 1; Disagree -7)

- I understand the concern, but do not believe that retirement dollars have been, will be or should be subject to bargaining. Again, legal language should be developed to assure teachers and their union (as well as other bargaining groups) of this protection.

- No, I do not agree with this statement. The accounting for the expenditures is completely separate from bargaining for the benefits. If districts are being accountable to the taxpayers they should already be considering the retirement costs when costing out salary proposals. If the laws are not already strong enough regarding the retirement benefits that will be provided to school employees they should be modified to clearly state that these benefits are not negotiable.

- The retirement should be included in the cost of negotiations. I'm not sure it is always done. Retirement costs would be similar to worker comp which is tied to salary costs. Year end retirement costs are always an unknown, the legislature needs to recognize the need for flex with this issue.

- I fail to understand the basis for the argument that retirement would be subject to collective bargaining. Obviously, an increase in salary carries with it an increase in retirement dollars but the latter is in statute.

- Yes, perhaps "rolling" retirement costs into the GF will subject retirement to collective bargaining, but I feel that is as it should be. The retirement incentives that are negotiated should not be a "gift" at voter expense.

-It is not the retirement that will have to yield to collective bargaining, it is all other forms of compensation and benefits that will come to be compromised by inclusion of the retirement obligation in the general fund. Again, trustees are accustomed to having wide latitude in how they spend general fund monies. By including a significant cost for a key benefit in the general fund without any latitude as to how the district can spend it, it will inevitably lead to the issue coming up in the process of negotiations. A school board may think, for example, that since it has already spent a significant amount of its general fund dollars on retirement, that it should not have to do so for other benefits. In summary, putting retirement into the general fund will not subject IT to bargaining, but will negatively influence the bargaining process.

- I do not believe that "rolling" retirement into the GF will subject retirement to collective bargaining. These benefits are required by statute and the fund structure is simply an accounting means. I do think that if the Retirement Fund was rolled into the General Fund it would subject the costs of retirement to greater public scrutiny—especially retirement incentives and option 1 retirements.

(3) Do you agree or disagree with this statement: "Rolling" retirement into the GF may jeopardize retirement benefits. " (Brief explanation of your answer)

(Agree - 1; Disagree -7)

- Retirement benefits are determined by TRS, PERS, Social security etc and are not subject to a Board of Trustees decisions. I disagree with the statement. Although Boards have the ability to use general funds for incentives (and indirectly then the retirement benefits that attach and follow) I don't believe that this strategy would change by having the retirement funds merge with the general funds.

- State and federal laws requires certain items to be funded. I don't think this proposal would jeopardize retirement benefits.

- No, State Law requires the benefits, they have existed for decades and I do not believe the Legislature will ever take them away.

-I don't think retirement benefits would be jeopardized, but other benefits like health insurance might.

- Provided the GF is adequately funded, I can't see how the retirement benefits would be jeopardized. I understand that the problem lies with the calculation of Teachers' Retirement termination pay, but we should be able to foresee and budget for those possibilities based on our current staff.

- Retirement benefits are guaranteed by statute, and must be maintained on an actuarial sound basis per our constitution. As such, present retirement benefits in which employees are already vested could not be negatively impacted without violating the constitution. Over time, however, rolling retirement into the general fund could provide an increasing incentive to strip down benefits for future members and/or people not yet vested, particularly if the general fund is inadequately funded over time as it has been for the last several years.

The whole idea for rolling the retirement fund into the general fund originated with [former budget director and staff.] They approached us when the courts were dealing with the issue of requiring impact aid districts to pay for their retirement out of the federal funds/general fund, and suggested that if they rolled the retirement fund into the general fund, they could continue with their practice of requiring the impact aid and other districts to pay for the retirement of federally-funded employees with general fund/impact aid money. This is a real problem and if this philosophy is still alive and well in the budget office, it is bad public policy and should be avoided for that reason alone. Additionally, by rolling the retirement fund into the general fund, the state will have to come up with over $100 million dollars. If they do so, that additional funding will go solely to tax relief at the county level, when those funds are sorely needed for the adequacy of overall funding. This also would be bad public policy and would also not convince anyone that the state had "increased" funding for schools when the money simply changes who pays for what is already there.

Finally, if you review the history of increases in the county taxes for schools over the last several years, you will find that those taxes have not risen beyond the rate of inflation. In fact, as of two years ago, as reflected in a chart by Jim Standaert, those taxes were about $5 million per year behind inflation, computed since 1994. If there is to be a significant effort to reduce taxes, it should come at the district level, not at the county level. It is the district level where there is unacceptable variation in taxation (see Greg Petesch's memo from August), and where taxes have gone up substantially in excess of inflation.

- No, I do not.

Comparison of Spending per student in the Retirement Fund FY 2004

size	Average number of ANB in the size group	Highest Spending of a District / ANB	Lowest Spending of a District / ANB	Average Spending of a Districts / ANB	Difference between Highest and Lowest Spending Districts
E1	5,655	722	544	621	33%
E2	1,247	1,062	462	606	130%
E3	558	1,256	491	660	156%
E4	261	1,038	247	568	320%
E5	86	1,194	352	642	239%
E6	13	1,433	233	635	515%
H1	3,253	699	561	628	25%
H2	578	807	533	633	51%
H3	284	1,036	521	695	99%
H4	130	1,318	277	772	375%
H5	46	1,883	706	1,152	167%
K1	864	742	479	595	55%
K2	148	2,130	442	918	382%
Grand Total	**341**	**2,130**	**233**	**705**	**813%**