The Rundown podcast transcript for a performance audit report titled ***Evaluating School Districts' Unencumbered Cash Balances*** – Released November 2020

**Brad Hoff, Host and Recruiting and Training Manager:** [00:00]
From the Kansas Legislative Division of Post Audit, this is The Rundown, your source for news and updates from LPA, including performance audits recently released to the Kansas legislature. I'm Brad Hoff. In November 2020, Legislative Post Audit released a performance audit evaluating school districts' unencumbered cash balances. I'm with Heidi Zimmerman, principal auditor at Legislative Post Audit who supervised this audit. Welcome to The Rundown, Heidi.

**Heidi Zimmerman, Principal Auditor and Supervisor:** [00:33]
Thanks for having me, Brad.

**Brad Hoff, Host and Recruiting and Training Manager:** [00:36]
So, let's begin with this. What is unencumbered cash and why do school districts maintain unencumbered cash balances?

**Heidi Zimmerman, Principal Auditor and Supervisor:** [00:48]
The school districts receive funding from a number of sources and through kind of a variety of mechanisms. When they receive that funding they transfer it into a fund and then they spend that money from that fund. So, when there's more transfers into a fund than spending, it creates a cash balance in that fund. Occasionally school districts will encumber or earmark a certain amount of money that's in that balances, it usually has to do with, if they have a bill that's going to come due after the end of the fiscal year, but they need to pay for it with this year's money. They'll earmark that little bit of money to make sure they have the money available to pay that bill. Everything else though is an unencumbered cash balance and everything that we looked at and this audit are those unencumbered cash balances, but districts maintain cash balances really for a few reasons. So, one is they maintain that money to pay for unexpected expenses. So, the furnace breaks down at the high school in the middle of the winter and they need to replace it. Another reason is to save over time for large projects. So, if the elementary school needs new windows, they might have to save for that for a number of years before they can do that project. A third reason is often to manage cashflow. So, school districts do not receive all of their funding at one time. Their funding comes in across the school year. So, you know, for example, school districts pay their special education teachers starting in August and they are buying equipment and supplies, but they don't get their first

special education funding until October. So, those cash balances help them pay those bills before the funding arrives. And the last reason that we found was that it helps them mitigate instability and funding. So, we saw that in 2009, the state delayed a state aid payment to school districts and districts could use their to help, you know, keep paying the bills while they were waiting on that funding to arrive. So there's, there's really a number of reasons that districts will want to maintain unencumbered cash balances.

**Brad Hoff, Host and Recruiting and Training Manager:** [03:12]
One of the audit objectives was to determine how school districts, unencumbered cash balances have changed over the last 10 years. What work did you do to answer this question? What did you find?

**Heidi Zimmerman, Principal Auditor and Supervisor:** [03:25]
So, we use Department of Education data from 2009 to 2019. Districts report their end of year cash balances by fund to the Department of Education. So, that was the data that we used and what we found was that after we adjusted for inflation, [we] found the unencumbered cash balances across the state grew by 35%. So, in 2009, again after adjusting for inflation, it was about $1.6 billion, but by 2019 it was $2.1 billion, which is a difference of about $547 million across those 10 years.

**Brad Hoff, Host and Recruiting and Training Manager:** [04:09]
So, the report notes that most of the growth in these unencumbered cash balances over the last 10 years has occurred in 10 of the 34 funds that K-12 school districts report to the Kansas State Department of Education. Talk a little bit about which funds these were and how much growth occurred in them.

**Heidi Zimmerman, Principal Auditor and Supervisor:** [04:35]
We looked at growth in each of the 34 funds that districts report to the Kansas Department of Education and we looked from 2009 to 2019 and what we found was that across those 34 funds, really just 10 funds accounted for 96% of all of that growth and really two funds accounted for about half of the growth. So, those two funds were bond and interest funds and the contingency reserve. So, just those two funds accounted for quite a lot of all the growth that we saw. Districts used bond and interest funds to pay off the bonds that they use to finance large projects and contingency reserve is for unexpected expenditures.

**Brad Hoff, Host and Recruiting and Training Manager:** [05:25]
So, going back on the bond and interest fund, which saw the largest growth, you talked to Department of Education officials to get their thoughts on this increase. What did they tell you?

**Heidi Zimmerman, Principal Auditor and Supervisor:** [05:39]
So, we did see significant growth over the last 10 years in that bond and interest fund as well as it's a large amount of the total growth that we saw. So, we did ask the Department of Education to kind of, what are some of the possible reasons why this is occurring and one that they noted was that building construction costs have just gone up. So, we looked at the Bureau of Labor Statistics and found indeed building

construction costs have increased by 32% from 2009 to 2019, which means that a building today is a 1/3 more expensive than the exact same building built 10 years ago so that accounted for some of that increase that we saw. The other reason was that legislative changes have changed how much districts receive in funding from bond and interest state aid. So, in 2015, the legislature changed the formula that determined how much bond and interest state aid a school district received and that change had the effect of reducing the amount of funding that districts received. So, because that funding amount decreased districts have to pay for a greater percentage of that project on their own and so to do that, they have to raise more revenue, which results in more money in that bond and interest fund over time.

**Brad Hoff, Host and Recruiting and Training Manager:** [07:12]
The report also looked at cash balance growth by restricted and unrestricted funds. What is the difference between these two types of funds and why does it matter?

**Heidi Zimmerman, Principal Auditor and Supervisor:** [07:27]
So, money in restricted funds can only be used for a very specific purpose and sometimes that's because the funding source has a restriction. So, for example, special education funding can only be used to provide special education services. The other possibility is that sometimes the law puts restrictions on the fund and says money in this fund can only be used for specific reasons. So, an example, there is bilingual funding, state law says money in the bilingual fund can only be used for bilingual education. So, restricted funds just means there is some sort of restriction on how school districts can spend that money. Conversely, money and unrestricted funds can be used kind of for general purposes and at the discretion of the district. So, we looked at unencumbered cash balances by restricted funds versus unrestricted funds and over the 10 years, what we found was that restricted funds consistently made up about 85% of the total amount of cash balances. So, no matter what year we looked in from 2009 to 2019, about 85% of all the cash balances in that year were sitting in restricted funds. And this matters because having a large amount of money in those restricted funds, really limits district's flexibility to meet needs, especially as the needs change in their school.

**Brad Hoff, Host and Recruiting and Training Manager:** [09:02]
The second objective of the audit was to determine how school districts have spent their unencumbered cash balances in the last 10 years. What work did the audit team do to determine this?

**Heidi Zimmerman, Principal Auditor and Supervisor:** [09:18]
So, the first thing we did was we chose 25 school districts to look at in depth, and we chose those districts for kind of good coverage across the state and just to get a good cross section of school districts. So, our results in this work cannot be projected because we did not choose those school districts randomly. So, we reviewed unencumbered cash balances in each of those 25 districts from 2009 to 2019, but we looked at just 10 funds and we looked at kind of the 10 funds where the majority of the money was sitting. So, what we looked for were decreases in unencumbered cash balances across those funds from one year to the next. So, if a fund decreased what that was to us was an indicator that the district may have spent some

unencumbered cash balances. So, when we had that indicator we would talk to the school district, ask them a little bit about what happened in those years, what did they spend that money on. We also looked at a number of different kinds of documents to understand kind of where that money went.

**Brad Hoff, Host and Recruiting and Training Manager:** [10:28]
So, for the 25 school districts that the audit team did review in depth, what did you find about how they spend their cash balances?

**Heidi Zimmerman, Principal Auditor and Supervisor:** [10:39]
The 25 districts that we looked at we identified about $152 million in cash balances decreases over the 10 years that we looked at and the 10 funds. So, we reviewed in depth about 90% of that money, or it's about $138 million. So, of that $138 million, we found that 77% was spent on a tangible purchase. So, that $76 million was spent on building construction or renovation or maintenance. Another $27 million was spent on regular operating expenditures, like salaries or supplies and about $3 million was spent on equipment, such as vehicles and copiers. So, the remaining $32 million were not spent on tangible purchases. What we found for that $32 million was that the year over year decrease that we identified simply occurred because the district had not transferred as much money into the fund as they had in previous years. So, there was no expenditure, but there was still a decrease as a result of that lack of transfer.

**Brad Hoff, Host and Recruiting and Training Manager:** [11:56]
In addition to looking at how those 25 school districts spent their cash balances, you also looked at whether their cash balances aligned with best practices. What did you find in this area?

**Heidi Zimmerman, Principal Auditor and Supervisor:** [12:11]
The Government Finance Officers Association has some best practices for school districts and they recommend that school districts maintain cash balances that are equal to at least two months of operating expenditures. They also recommend that districts assess their own risks and that they maintain more money commensurate with those risks. So, we looked to see if districts maintained just that minimum two months of operating expenditures in the 2019 school year. We did not assess their risks though because risks are a very subjective decision and risks are also constantly changing in the school district related to kind of a variety of funding things and kind of the local economic conditions in the community as well. So, we did not assess the risk. So, we just looked to see if they had maintained that minimum two months of operating expenditures. So, what we found though was that 15 of the 25 districts met or exceeded that minimum best practice amount, but there was a great deal of variation across those 25 districts. So, one district had cash balances equal to only 37% of that two months of operating expenditures. Although another district had 200% of that amount and so there's certainly a lot of differences across the school districts and how they're maintaining cash balances.

**Brad Hoff, Host and Recruiting and Training Manager:** [13:48]
Finally, what is the main takeaway of this audit?

**Heidi Zimmerman, Principal Auditor and Supervisor:** [13:52]
I think it makes it makes sense that districts maintain some cash balances. It's a good financial practice that they do so and it helps them address things like unexpected expenses and cash flow issues and best practices say that the districts should maintain those cash balances, but they should consider kind of their own unique financial circumstances in determining how much cash balance they should maintain. So, although we found that all 25 districts did maintain at least some balances, it is difficult to know whether districts really have too much or too little in reserve.

**Brad Hoff, Host and Recruiting and Training Manager:** [14:37]
Heidi Zimmerman is a principal auditor at Legislative Post Audit. She supervised a performance audit that evaluated school districts' unencumbered cash balances. Heidi, thank you for taking the time to walk me through the audit's findings.

**Heidi Zimmerman, Principal Auditor and Supervisor:** [14:51]
Thanks, Brad.

**Brad Hoff, Host and Recruiting and Training Manager:** [14:52]
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