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Performance Audit Division Brief:
The Myth of School Rainy Day Funds
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Introduction

The Office of the State Auditor (OSA) received a legislative request to examine school “rainy day funds.” In the course of researching the topic and the potential use of such funds, OSA’s Performance Audit Division found that school districts generally do not utilize them. They do, however, often maintain a “cash flow reserve” fund for a different purpose. In fact, when asked, school district financial staff generally agreed that, while they believed they have the authority to have a rainy day fund, they could not afford to set aside that revenue.

This briefing paper first defines the differences between the two funds and then compares the concept of a rainy day fund to a cash flow reserve in Mississippi public school districts. In addition, this brief provides comparative survey results from other states.

Rainy Day Funds vs. Cash Flow Reserves

In order to properly address and provide comparisons on rainy day funds versus cash flow reserves, one must first understand the difference between the two. Rainy day funds are generally set aside for unplanned financial emergencies and are considered unallocated or unbudgeted funds. They are funds normally used only after all other resources have been exhausted. Further, they are not tied to any recurring event or situation.

In contrast, cash flow reserves are funds specifically set aside and allocated to cover known or expected revenue shortfalls during the year. These allocated funds cover a school district’s operation from one period to the next for anticipated times when local revenues are not available.

Understanding how local, State, and federal revenues are received by the districts will help explain why cash flow reserves are needed in school districts. State revenues are apportioned to school districts at a rate of 1/12 per month. Federal revenues are a reimbursable revenue source—that is, local and State funds must be spent first in order to get federal reimbursement. However, local revenues are received differently.

While school districts receive revenue by the 20th of each month from the city or county, the bulk of all local revenue is received between February and April, when most property taxes are paid. Throughout the rest of the year,

there may be smaller amounts sent. When there is a shortage of local revenue, there may be a barrier created to federal reimbursement, so the district may have a revenue shortage for which a cash flow reserve fund should help.

It is important to note that §37-61-19 Mississippi Code of 1972 imposes personal liability on school board members for deficit fund balances. The State Department of Education (DoE) and the Mississippi Association of School Business Officers (MASBO) strongly recommend that each district set aside at least 7.5% of their general fund revenue in a cash flow reserve fund to cover these expected shortages. Some districts are able to do this and others are not. Some districts may have more than 7.5% set aside. In reality, 7.5% of a school district’s general fund revenue will rarely cover payroll for one month.

Based on the difference between the two types of fund set asides and their uses in Mississippi, OSA surveyed 14 states to determine whether or not school districts are allowed to use rainy day funds or cash flow reserves, any limitations and responsibilities on the funds, and what statutes or regulations govern the use of such funds. Of the states surveyed, ten responded that they allow or require some form of cash flow reserves or rainy day funds, or a combination of both.

Virtually all the states that responded do not require each school district to establish a rainy day fund. However, they do recommend a higher cash flow reserve percentage than Mississippi’s recommended 7.5% (as high as 15% in states surveyed). Some respondents had financial controls in place to facilitate some level of reserves for their school districts. The chart on the next page details the results of the OSA survey.

Conclusion

Unlike the State Rainy Day Fund defined in State law, Mississippi does not have legislation or DoE mandate regarding school district rainy day funds or cash flow reserve funds. That is not to say school districts do not have them, just that such funds are not required by law or regulation. Additionally, there are currently no set limitations on the amount of fund balances that a public school district can have here—only on the amount of revenue they may receive. In Mississippi, it could be considered very good management practice to have at least 7.5% set aside to cover expected revenue shortages.

Other States – Rainy Day Reserve Funds vs. Cash Flow Reserve Funds at the School District Level

State	Rainy Day Reserves	Cash Flow Reserves	Allocation Basis	Statute/Regulation
Alabama	Recommended, but not required or prohibited by Department of Education. State is required to set aside Rainy Day Funds for schools.	Required by state. "School Fiscal Accountability Act" to have 1 month operating balances. State Superintendent can withhold state funds if local board doesn't comply and it is to be placed under close financial scrutiny.	Required Cash Flow Reserve is to be one month's operating balance.	Alabama Code of 1975 Section 16-13A-9 School Fiscal Accountability Act 2006.
Arkansas	Allowed, but not required.	Allowed, but not required.	Not specified.	
Florida	Allowed, but not required. Must be used for educational purposes only.	Allowed, but not required. Must be used for educational purposes only.	Subject to the School Board's discretion up to limits. Average over the last 2 years was 8% set aside. No difference between Rainy Day and Cash Flow Funds.	Rule 6A-1.004(1)(e) Florida State Board; 10% limit on un-appropriated funds for budget purposes.
Georgia	Allowed, but not required.	Allowed, but not required to have a single reserve fund.	Not to exceed 15% of current year's total budget.	OCGA 20-2-167(a)(5) – Cannot exceed 15% of current year's total budget.
Kansas	Allowed, but not required. No more than 6% of general fund. Any expense local board deems necessary.	Allowed, but not required. Unlimited amount of cash carryover, except for the general fund which must be "0" and food service, which can carry 3 months worth of expenses.	No more than 6% of the general fund for Rainy Day Funds. Unlimited for Cash Flow Reserves, given the exceptions stated in prior column.	Kansas Code 72-6426
Missouri	Allowed, but not required. No differentiation between Cash Flow and Rainy Day Funds for purposes of Reserve Funds.	Allowed, but not required.	Requires notice to the board if fiscal year end balance of classroom and incidental funds are less than 1% of prior year amount expended from the funds.	161.520, 161.525
South Carolina	Allowed, but not required.	Allowed, but not required.	Determined by local school board. Recommended 1-2 months expenditures.	
West Virginia	Allowed, but not required.	Allowed, but not required, because state aid comprises 56% of district revenues, aid is distributed 4 times a month all twelve months.	Recommends that 3% - 5% be set-aside by the district for Rainy Day reserves. Advances can be provided for districts by the State with a serious cash flow problem, as needed.	
Oklahoma	Allowed, but not required.	Allowed, but recommends that a school district participate in the cash management program which facilitates cash flow reserves. School districts also may have carryover funds, but they are subject to subject state statute.	Districts can use carryover funds for emergencies, reductions in state aid, as well as start up funds for the next fiscal year. Carryover funds are subject percentage restrictions specified in statute. If district participates in the state's cash management program, their data is subject to review by The Commission on School and County Funds Management.	Title 70, Section 18-200.1 of the Oklahoma statutes. The Oklahoma School and County Funds Management Program (a.k.a. The Cash Management Program) requirements are described in Title 60, Section 177.2.
Tennessee	Allowed, but facilitated through a hybrid system of both types of funds.	Facilitated through a hybrid system of both funds. Rainy Day is established at the state level; whereas, the same general fund facilitates the school districts' needs for operating cash flow.	The "undesignated fund balance" known as the "dedicated education fund" is required of each school district as a special revenue account. The account must maintain a balance above 3% for operation and districts can only expend 3% for emergencies.	Section 49-3-352