BACKGROUND

In the summer of 2015, the KCCD Chancellor asked the District Consultation Council to assemble a workgroup to conduct a third evaluation of the District-wide Unrestricted Fund Budget Allocation Model (BAM). The District Budget Committee was established in fall 2017 per the BAM Evaluation III Committee's ("BEC") recommendation. Subcommittee #2's responsibilities include the review of District-wide processes related to budget development to make recommendations to impact long term operations or allocations. Sub Committee #2 charge was to:

- Review annual District-wide budget development premises
- Review long-term trends in District-wide fiscal health

The review of the annual District-wide budget development premises necessitated a detail analysis of the California Community College Chancellor's Office funding CCCCO (Schedule C Allocation to audited financials), KCCD District carryover, and annual allocations. To discuss the trends impacting the long-term District-wide fiscal health, the subcommittee focused on maintaining KCCD's fiscal stability while ensuring adequate college funding levels. Simply put, the discussion evaluated the process of aligning financial capacity with long-term service objectives. The evaluation process included reviewing all the California community colleges ending fund balance for the last three years for benchmarking purposes. KCCD is consistently ranked as having one of the top five highest ending unrestricted fund balance. However, some of the comparison multi-college districts have allocated a significant portion of their fund balance (reserves) to hedge against long term obligations (i.e. San Diego Community College District).

Additionally, the subcommittee conducted a fiscal risk assessment based on fiscal best practices (i.e. GFOA, FCMAT, PARS, NACUBO, and Community College League of California) to identify fiscal strengths and liabilities to recommend strategies for the management of long -term obligations. The analysis revealed that despite increased revenues, escalating fixed expenditures are increasingly difficult to manage and, accordingly, may ultimately threaten fiscal well-being of districts. Maintaining fiscal health while maximizing services to students with available financial resources will be a continuing challenge primarily due to:

- Annual COLA maybe be insufficient to fund the annual cost increases associated with step and column, health benefits, and the escalating retirement system rates
- Projected expenditure increases (ex. minimum wage, technology enhancements, etc)
- Economic forecasts and new funding formula volatility

Also, the KCCD Board 15% District Reserve Policy (3A1A6-revised March 2014) and the CCCCO minimum fund balance (reserve) requirement were discussed. The Governor's January budget proposal assumes continued economic expansion, yet the Governor continues to stress that fiscal restraint has never been more important. By the end of 2018-19, the expansion will have matched the longest since World War II. To buffer the state against uncertainty and future budget cuts, the Governor proposes to fund the Rainy Day Fund in 2018-19 at 100% of its constitutional target (10% of expenditures), bringing total state reserves to approximately $15.7 billion. According to the Governor, even a mild recession could result in lost revenue of $20 billion annually, and recovery takes years.

RECOMMENDATION

The District Budget Committee's fiscal analysis reveals the following needs with respect to the annual District-wide budget development premises and campus stakeholders.

- Improve clarity of model components
- Promote transparency of the KCCD budgeting process and fiscal matters
- Foster an environment of understanding by communicating linkage between FTES generation and allocations

Also, the District Budget Committee recommends that the District establish a formal framework and process for analyzing the long term fiscal health of the District. This analysis should take into account potential financial risks, legislative mandates, and educational program needs in the foreseeable future. Also, the review should be applied within the context of long-term forecasting, thereby avoiding placing too much emphasis upon any one time. In establishing the framework, a variety of factors should be considered, including:

1. The predictability of revenues and the diversification of revenue
2. The perceived exposure to significant one-time outlays (e.g., disasters, immediate capital needs, state budget cuts), volatility of expenditures, and potential drain upon general fund resources from other funds
3. The potential impact on the entity's bond ratings and the corresponding increased cost of borrowed funds;
4. Cash flow requirements and the relationship between budgeted reserves and actual cash on hand;
5. Regulatory commitments and assignments;
6. Benchmarking with the other California community colleges.

Appropriate Reserve Level

After completing the long term fiscal health analysis, the policy governing the general fund unrestricted fund balance (reserve) should be reviewed. The Government Finance Officers Association (GFOA) and Fiscal Crisis & Management Assistance Team (FCMAT) recommend, the adequacy of general fund unrestricted fund balance take into account each institution's own unique circumstances. At a minimum, the California Community College Chancellor's Office (CCCCO) recommends a 3% -5% fund balance. Other best practices and regardless of size, the maintain unrestricted budgetary fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.

However, district's circumstances often may require a level of unrestricted fund balance in the general fund significantly in excess of this recommended minimum level.

The District Budget Committee recommends the established framework should provide broad guidance on the increase or decrease the reserve level over a specific time period based on industry best practices. A prudent reserve affords KCCD time to thoughtfully identify and implement budget adjustments over time. Inadequate reserves force districts to react quickly, often causing significant disruption, sometimes unnecessarily, to student programs and employees.

An extensive review of the historical usage of the District reserves is being conducted. However, during the most recent recession reserves were used to fund:

- Unfunded liabilities
- Pay COP debt obligations
- Backfill for reductions in various categorical allocations
- Operational cashflow

A minimum District-wide unrestricted reserve of 15% and a cap of 18% is recommended. College budgeted reserves will not be considered as part of District-wide reserves. Each of the colleges shall maintain a minimum reserve of three percent (3%). These reserves will be established as unrestricted reserves for obligations and contingencies. The college reserves shall be calculated on the same basis as the District-wide reserves and will be applied to each institution. However, it should be determined how resources will be directed to replenish fund balance should the balance fall below the level prescribed. Also, a process should be established for circumstances when the amount of the general fund unrestricted fund balance is greater than the board reserve requirement even after taking into account potential financial risks in the foreseeable future.

Budget Allocation Model (BAM) Review

The District Budget Committee recommends the KCCD Chancellor asked the District Consultation Council to assemble a workgroup to conduct a fourth evaluation of the District-wide Unrestricted Fund Budget Allocation Model (BAM) Taskforce after the new state funding formula is adopted. This BAM Committee should be a subcommittee of the District-wide Budget Committee and include subject area and stakeholder groups (ex. human resources, CCA, etc).