APPENDIX D
FINANCIAL POLICIES

Chicago Public Schools (CPS) is responsible for pre-school through 12th grade education in the City of Chicago. It is an independent local government entity with its own authority to levy property taxes. The fiscal year starts July 1 and ends June 30. The Board of Education is directed by the Illinois School Code (105 ILCS 5/34-43) to adopt an annual school budget for each fiscal year no later than 60 days after the beginning of the fiscal year. The annual budget includes a set of policies to be followed in managing financial and budgetary matters, allowing the Board to maintain its strong financial condition now and in the future.

Balanced Budget Policy

The Board is required by the Illinois School Code to balance its budget each year within standards established by the Board, consistent with the provisions of Article 105 ILCS 5/34-43. The Board defines a "balanced budget" as when the total resources, including revenues and spendable prior-year fund balances, equal or exceed the total budgeted expenditures, and a "structurally balanced budget" as when the total projected revenues that the Board accrues in a fiscal year are equal to or greater than the total expenditures. Revenues and expenditures are defined in accordance with Generally Accepted Accounting Principles (GAAP). The Board's current policy is that all funds should be structurally balanced unless they include the spendable prior-year fund balance that is available under the terms of the Board's Fund Balance Policy.

- General Fund: Although a structurally balanced budget is the goal for the General Fund, the prior-year spendable fund balance can be appropriated in the following budget year for one-time expenditures or under certain circumstances if the spendable fund balance exceeds 5 percent of the operating and debt service budget for the new fiscal year. The one-time expenditures are listed under the Fund Balance and Budget Management Policy.

- Workers' Compensation Tort Fund: The restricted fund balance in the Workers' Compensation Fund can be used only for expenses specified by the Illinois School Code 105 ILSC 5/18-8.05, such as unanticipated large tort, property loss, workers' compensation, or liability claims.

- Grant Funds: All grant funds shall be structurally balanced.

- Supplemental General State Aid Fund (SGSA): The Illinois School Code 105 ILSC 5/18 requires that all spendable fund balances be re-appropriated in the subsequent year to each school that did not spend its allocation in the prior year.

- Capital Projects Funds: All spendable fund balances in the Capital Projects Funds will be re-appropriated in the following year for eligible construction and renovation projects.

- Debt Service Funds: Funds restricted for debt service are monies held as required by a bond indenture or similar agreement and maintained mostly with bond trustees. Assigned fund balances represent reserves to cover potential risks related to swaps or variable-rate bonds.

Fund Balance Policy

Section 5/34-43 of the Illinois School Code authorizes the Board to accumulate a fund balance. The stated goals of maintaining a fund balance are to provide adequate working capital to ensure uninterrupted services in the event of budgetary shortfalls, to provide for capital improvements and to achieve a balanced budget within a four-year period. It is the policy of the Board to retain sufficient funds to achieve these goals for operating funds. To achieve this stable financial base, CPS manages its financial resources by establishing fund-balance policies for governmental funds, which consist of the Operating Funds (General Fund and Special Revenue Funds), Capital Projects Funds and Debt Service Funds.

Fund-Balance Target

Fund-balance targets are established for the General Fund, the Tort Fund, the Supplemental General State Aid Fund, Debt Service Funds, and Capital Projects Funds. The set amounts differ for each fund and require an annual review. Factors included in the determination of fund-balance targets include predictability of revenues, legal requirements, bond indentures, potential volatility of expenditures, and liquidity requirements. The stabilization fund target is a percentage of operating and debt service budget.

- **General Fund**
  - **Stabilization Fund Balance (Assigned Fund Balance):** The policy requires the Board to maintain an assigned fund balance of a minimum of 5 percent and a maximum of 10 percent of the operating and debt service budgets for the new fiscal year as a stabilization fund in the General Fund at the annual adoption of the budget. The 5 percent is estimated to be the historical minimum cash requirement to provide sufficient cash flow for stable financial operations. The Chief Financial Officer (CFO) will propose to the Board a reasonable target amount that is within this range during the budget process. It is the Board's goal that this stabilization fund will not be utilized unless there is an unforeseen financial emergency and a corresponding consensus decision among the Board members.

  - **Stabilization Fund Balance Replenishment:** In the event that the stabilization fund decreases below 5 percent, the CFO will prepare and present to the Board a plan to replenish it. If necessary, any surplus that CPS generates will first go toward replenishing the stabilization fund until the minimum 5 percent goal is achieved and then to the fund balance. The Board must approve and adopt a plan to restore these balances to the target levels within a 12-month period. If restoration of the stabilization fund cannot be accomplished within such a period without severe hardship, then the CFO or Director of Office of Management and Budget may request that the Board approve an extension of this restoration deadline. Because of the financial stress the District is facing, the CFO and Budget Director will request an extension of the deadline for FY15 while they develop a long-term plan to restore the fund balance.

  - **Use of Excess Fund Balance above the Stabilization Fund:** When the stabilization fund is adequately established, any excess above the required stabilization funds can be assigned for appropriation in the following budget year for one-time expenditures or under certain circumstances as outlined below:

- To offset a temporary reduction in revenues from local, state and federal sources
- When the Board decides to not increase the City of Chicago property taxes to the maximum allowable property tax cap
- To retire the Board's debt
- To fund major legal settlements or liability claims made against the Board
- To fund necessary one-time equipment or capital spending required for the Board
- To pay for costs related to an unforeseen emergency or natural disaster
- To pay for specific education initiatives lasting no more than three years

- **Workers' Compensation/Tort Fund:** The fund balance target for the Workers' Compensation/Tort Fund shall be no less than 1 percent and no more than 2 percent of the operating budget. The FY15 budget will not use any fund balance. However, the fund is still below the target.

- **Supplemental General State Aid Fund (SGSA):** The fund balance shall equal the unspent amounts from the previous year. According to the Illinois School Code 105 ILSC 5/18, all spendable fund balance will be re-appropriated in the subsequent year to each school that did not spend its allocation in the prior year.

- **Capital Projects Funds:** Fund balance shall equal the unused bond proceeds, revenues, and available fund balances from the previous fiscal year. All spendable fund balance in the Capital Projects Funds will be re-appropriated in the following year for eligible construction and renovation projects.

- **Debt Service Funds:** Funds restricted for debt service are monies held as required by a bond indenture or similar agreement and maintained mostly with escrow agents. Assigned funds in the debt service funds represent the Board's efforts to cover risks and shall be sufficient to cover potential risks such as termination, counterparty, and basis points. The Treasury Department will determine a proper level of fund balance each year.

Monitoring and Reporting

In conjunction with the submission of the annual budget, the CFO shall annually prepare a statement about the status of the fund balance in relation to this policy and present the findings to the Board. Should the CFO disclose that the stabilization funds will decline below 5 percent of the upcoming operating and debt service budget, a recommendation for fund-balance accumulation shall be included in the annual statement. For FY2015, with the known reduction of the stabilization fund below 5 percent, the CFO will develop a long-term plan to replenish fund balance to the prescribed 5 percent level.

One-Time Revenue

The Board Policy states that revenue shall be considered to be one-time if it was not present in the prior fiscal year and if it is unlikely that it will be available in the following fiscal year, and further states that CPS shall not use one-time revenues to fund ongoing expenditures. To do so might mean that CPS would be unable to make up the gap created by the expiration of the one-time revenues in the next budget period, a situation that could lead to service cuts. Under the policy, one-time revenues would support only one-time expenditure items described below:

- To retire the Board's debt
- To fund major legal settlements or liability claims made against the Board
- To fund necessary one-time equipment or capital spending required for the Board
- To pay for costs related to an unforeseen emergency or natural disaster
- To pay for specific education initiatives lasting no more than three years
- To increase the size of CPS's budget-stabilization fund

However, due to the financial condition of CPS, the FY15 budget will rely on one-time revenues to support operating expenses, and CPS will seek approval from the Board to do so. The long-term plan to replenish the fund balance also will include strategies to reduce reliance on one-time revenues.

Basis of Budgeting and Revenue Recognition
The budgeting and accounting policies of the Board are based on GAAP. The Governmental Accounting Standards Board is the standards-setting body for governmental accounting and financial reporting. These governing bodies require accounting by funds so that limitations and restrictions on resources can be easily explained.

Budgets are presented using the modified accrual basis of accounting.

Under the revenue recognition policy adopted in FY2015, revenues are recorded when they become measurable and available. Property taxes are recognized as current revenues as long as they are available within 60 days after a fiscal year ends. Federal, state and local grants are recognized as revenues when eligible requirements imposed by grantors have been met and as long as they are collected within 60 days of the end of a fiscal year.

Expenditures are recorded when the related liability is incurred, regardless of the timing of related cash outflows. One exception is that debt service expenditures are recorded only when payment is due. Only revenues and expenditures anticipated during the fiscal year are included in the budget. Unexpended funds in the General Fund, Workers' Compensation/Tort Fund, and SGSA Fund revert to the fund balance at the close of a fiscal year. Unexpended capital funds are carried forward from year to year until projects are completed.

Budgetary Control and Budget Transfer
Budgetary control is exercised at the school, department, and system-wide levels with the adoption of the budget, and at the line-item level through accounting control. The monitoring of expenditures and revenues is a crucial component of the management of the budget. In the event of an unexpected decline in revenue, certain non-essential expenses would be the first to be identified and frozen to ensure a balanced budget at year-end.

Because a budget is only a plan, transfers between line items during the year are permitted. All budget transfers follow an established fund-transfer policy and approval process. All transfers requiring Board approval will be reported at the monthly Board meeting. The following are a few of the guidelines for making transfers:

- Funds may be transferred within a fund, between units, accounts, programs, or, in certain circumstances, grants. Transfers over $1,000 must be recommended by the Office of Management and Budget, reported to, and approved by the Board.

- No transfer may be made between any of the statutory funds supported by property taxes.

- Transfers shall not exceed 10 percent of the fund during the first half of the fiscal year, and no appropriation shall be reduced below an amount sufficient to cover all obligations that will be incurred against the appropriation, consistent with statute (105 ILCS 5/34-50).

Budget Amendments/Supplemental Budgets

The Illinois School Code (105 ILCS 5/34-47 and 48) authorizes the Board to make additional or supplemental expenditures rendered necessary to meet emergencies or unforeseen changes. After the adoption of the annual school budget, the Board may, by a vote of two-thirds of its voting members, pass an additional or supplemental budget, thereby adding appropriations to those made in the annual school budget. Such a supplemental or additional budget is considered an amendment of the annual budget for that year. However, any appropriations thus made shall not exceed the total revenues that the Board estimates it will receive in that year from all revenue sources and any fund balance not previously appropriated. In case of emergencies such as epidemics, fires, unforeseen damages or other catastrophes happening after the annual school budget has been passed, the Board, by a concurring vote of two-thirds of all the members, may make any expenditure and incur any liability. The Board is required to hold two public hearings both on budget amendments and supplemental budgets.

Cash and Investment Management Policy

In accordance with the Illinois School Code (105 ILCS 5/34-28) and Public Funds Investment Act (30 ILCS 235/1), the Board adopted an investment policy that provides guidelines for the prudent investment of all public funds and outlines the policies for maximizing efficient cash management. The ultimate goal is to manage public funds in a manner that will meet cash flow needs, ensure security and provide the highest investment return while complying with all state and local requirements governing the investments of public funds. To achieve these goals, the Treasury maintains cash-flow forecasts that closely match cash on hand with projected disbursements. To minimize the potential risk and losses, the Board limits investments to the safest types of securities, pre-qualifies the financial institutions, and diversifies the investment portfolios. The Treasury evaluates and monitors the portfolio regularly. The Investment Policy detail can be accessed by going to http://policy.cps.k12.il.us/download.aspx?ID=27

Debt Management Policy

The Board established a debt management policy that sets forth the parameters for issuing debt and managing the outstanding debt portfolio. Additionally, the policy provides guidance for the debt-payment structure that directly affects the Board's finances, the types and amounts of permissible debt, the timing and method of sale that may be used, the structural features that may be incorporated, and the selection of swap advisors. The purpose of this policy is to enhance the Board's ability to issue and manage its debt in a fiscally conservative and prudent manner and to ensure the Board's continued access to the capital markets. The Board will match the term of the borrowing to a useful life of projects and will seek the best possible credit rating in order to reduce interest costs. Every project proposed for debt financing should be accompanied by amortization schedules that best fit within the existing debt structure and minimize the impact on future operating and maintenance costs of the tax and debt burden on the General Fund and the overlapping debt of other local governments. The Treasury will determine the mix of variable- and fixed-rate debt that best manages its overall interest costs while considering risks and benefits associated with each type of debt. The following link provides details about the debt management policy; visit http://policy.cps.k12.il.us/download.aspx?ID=42