

Appendix D Financial Policies

Chicago Public Schools (CPS) is responsible for providing pre-k 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 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, which begins July 1 and ends June 30. 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, other financing sources, and spendable prior-year fund balances, equal or exceed the total budgeted expenditures and other financing uses, and a "structurally balanced budget" as when the total projected revenues and other financing sources that the Board accrues in a fiscal year are equal to or greater than the total expenditures and other financing uses. 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 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 five 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/Tort Fund can be used only for expenses specified by the Illinois School Code 105 ILCS 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.

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.

Fund Balance Policy

Section 5/34-43 of the Illinois School Code authorizes the Board to accumulate fund balance in the General Operating Fund. The stated goals of maintaining a fund balance are to provide adequate

working capital, ensure uninterrupted services in the event of unfavorable budget variances, provide for capital improvements, and achieve a balanced budget within a four-year period. Sufficient funds must be maintained in a reserve account to achieve these goals for operating funds. To facilitate the establishment and maintenance of such a reserve account, CPS adopts the following policy objectives for governmental funds. The District governmental funds are the General Operating Fund (including the Workers' Compensation/Tort Fund), Capital Projects Funds, and Debt Service Funds.

Fund Balance Target

Fund balance targets are established for the General Operating Fund (including the Workers' Compensation/Tort Fund), Debt Service Funds, and Capital Project Funds. The set amounts differ for each fund and will require an annual review. Factors in determining fund balance targets include predictability of revenues, legal requirements, bond indentures, potential volatility of expenditures, and liquidity requirements.

The operating and debt service budget for the new fiscal year is the basis for calculating the ratio of unrestricted fund balance to proposed expenditures. In essence, the current fiscal year's budgeted expenditures will determine the prior fiscal year's designated fund balance.

- **General Operating Fund**

- **Assigned Fund Balance (Stabilization Fund)**: This policy will require the Board to maintain an assigned fund balance totaling 15 percent of the operating and debt service budget (net of any budgeted non-cash expenditures or budgeted expenses derived from the dedicated Chicago Teachers' Pension Fund property tax levy) for the new fiscal year as a stabilization fund in the General Operating Fund at the annual adoption of the budget.

The 15 percent is estimated to be the historical minimum cash required to provide sufficient cash flow for stable financial operations and to reduce short-term borrowing costs. 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 Board members.

- **Criteria to use Stabilization Fund and Unassigned Fund Balance**: Notwithstanding any other provision of this policy, unassigned fund balance, if sufficient and available, should be used before the use of funds from the Stabilization Fund. Further, the use of unassigned fund balances should only be for one-time expenditures. If necessary, an amount from the Stabilization Fund can be appropriated in the following budget year for one-time expenditures or under the following circumstances:
 - To offset the temporary reduction in revenues from local, state, and federal sources
 - When the Board decides not to 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
- **Assigned Fund Balance Replenishment:** It is the policy of the Board to maintain 15 percent of its operating and debt service budget in the stabilization fund and to allow the Stabilization Fund to be used for the purposes listed in the policy.

In the event that the assigned stabilization fund decreases below 15 percent of the upcoming operating and debt service budget, the Chief Financial Officer (CFO) must prepare and present to the Board a plan to replenish the stabilization fund as part of the annual statement the CFO submits to the Board in conjunction with the annual budget (see the Monitoring and Reporting section of this document). If necessary, any surplus CPS generates must first go towards replenishing the stabilization fund until the 15 percent goal is achieved and then to the unassigned 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 reserve cannot be accomplished within this period without severe hardship, then the CFO, Deputy CFO, or Controller may request that the Board approve an extension of this restoration deadline.

- **Workers' Compensation/Tort Fund:** The restricted fund balance target for the Workers' Comp/Tort Fund is no less than one percent and no more than two percent of the operating budget. This fund balance must only be used for expenses specified by the Illinois School Code 105 ILCS 5/2-3.170, such as unanticipated large tort, property loss, workers' compensation, or liability claims.
- **Capital Projects Funds:** Restricted fund balance must equal the unused bond proceeds, revenues, and available fund balance from the previous fiscal year. All 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 escrow agents. Assigned funds in the Debt Service Funds represent the Board's efforts to cover increases in future debt service requirements. The Office of Treasury must determine the proper level of funds needed for this purpose each fiscal year.

Monitoring and Reporting

In conjunction with the presentation of the recommended annual budget, the CFO must annually prepare a statement about the status of the fund balance in relation to this policy and present this statement to the Board. Should the CFO disclose that the stabilization funds have less than 15 percent of

the upcoming operating and debt service budget, a recommendation for fund balance accumulation shall be included in the annual statement.

One-time Revenue

Revenue shall be considered 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. CPS must 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. One-time revenues would only support the 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' stabilization fund

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 FY20, revenues are recorded when they become measurable and available. Property taxes are typically 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, as well as expenditures related to derivatives, compensated absences, claims and judgments, other post-employment benefits, and pollution remediation obligations, 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 Funds and Workers' Compensation/Tort Fund revert to the fund balance at the close of a fiscal year. Unexpended capital funds are carried forward yearly 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 controls. 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.

The appropriated budget is prepared by fund, unit, and account. The legal level of budgetary control is at the account level, except for school-based discretionary programs. CPS maintains budgetary controls to ensure that legal provisions of the annual budget are in compliance and expenditures cannot legally exceed the appropriated amount. Personnel expense accounts, including salary and benefits accounts, use budget balancing accounts known as "pointer lines" to ensure budgets remain sufficient to cover expenses. Full annual salary and benefit costs are budgeted for every position to start the fiscal year. Any adjustments to expected salary and benefit costs drive automatic adjustments to the respective salary and benefit accounts, with an offsetting transaction occurring on an associated pointer line account. The district manages balances on pointer line accounts to ensure that sufficient funds are available to cover all personnel costs. Non-personnel expense accounts use budgetary controls in the purchasing process to ensure that budgets are sufficient to cover expenses. To incur an expense in a non-personnel account, users must first open a purchase order. If sufficient funds are not available, the system will not allow a purchase order to be created.

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. OBGGM reports transfers of over \$1,000 to the Board for approval.
- 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 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 to 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 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. For additional detail, please review the Cash Management chapter of the budget book, as well as the Investment Policy: <https://policy.cps.edu/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 financial 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 the average useful life of the projects financed 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.

Every project should also 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 the risks and benefits associated with each type of debt. For additional detail, please review the Debt chapter of the budget book, as well as the Debt Management Policy: <https://policy.cps.edu/download.aspx?ID=42>.