



**Sub. S.B. 345\***

123rd General Assembly

(As Reported by H. Finance & Appropriations)

**Sens. Gardner, Cupp, Finan, Harris, Wachtmann, Drake, Oelslager,  
Mumper, Blessing, Nein**

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**BILL SUMMARY**

- Establishes two accounts within the School District Solvency Assistance Fund: (1) the School District Shared Resource Account, to be used for solvency assistance to school districts in fiscal emergency, and (2) the Catastrophic Expenditures Account, to be used generally for grants to districts faced with a catastrophic event.
- Eliminates the requirement that each school district maintain a budget reserve ("rainy day") fund.
- Reduces and makes uniform the amount of money a school district must deposit into both its textbook and instructional materials fund and its capital and maintenance fund from 3% of all revenues to 3% (or another percentage designated by the Auditor of State) of the state base-cost formula amount for the preceding fiscal year multiplied by the district's student population for the preceding fiscal year.
- Provides a 90-day period after the start of each fiscal year during which a school district may elect to follow the current law requirements for deposits into its funds for textbooks and maintenance instead of the bill's requirements for those deposits.
- Creates the category of fiscal caution for school districts that the Superintendent of Public Instruction determines are employing unsound fiscal practices that could produce a state of fiscal watch or fiscal emergency.

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\* *This analysis was prepared before the report of the House Finance and Appropriations Committee appeared in the House Journal. Note that the list of co-sponsors and the legislative history may be incomplete.*

- Provides for performance audits of school districts in fiscal caution.
- Modifies the conditions for placing a school district in fiscal watch by (1) granting the Auditor of State discretionary authority to declare a fiscal watch for an operating deficit of 2% to 8% of the district's general fund revenue for the preceding fiscal year, and (2) adding a new mandatory trigger based upon a reasonable determination by the Superintendent of Public Instruction that the district has not corrected unsound fiscal practices.
- Modifies the conditions for placing a school district in fiscal emergency by (1) granting the Auditor of State discretionary authority to declare a fiscal emergency for an operating deficit of 10% to 15% of the district's general fund revenue for the preceding fiscal year, and (2) adding a new trigger based upon a reasonable determination by the Superintendent of Public Instruction that a district in fiscal watch is not complying with an approved financial plan.
- Permits the dissolution of a financial planning and supervision commission for a fiscal emergency school district upon a joint determination by the State Superintendent and the Director of Budget and Management that the commission has not produced an acceptable recovery plan or is not materially complying with its plan.
- Permits the Superintendent and Director of Budget and Management to jointly appoint a "fiscal arbitrator" to succeed to the powers and duties of a dissolved commission.
- Allows a school district to apply the proceeds of a half-mill maintenance levy toward infrastructure improvements on or leading to a project site funded by the Ohio School Facilities Commission.

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## CONTENT AND OPERATION

### *School District Solvency Assistance Fund*

(sec. 3316.20)

#### *Background*

The School District Solvency Assistance Fund was created for the purpose of providing interest-free advancements to school districts to enable them to remain solvent and to pay unforeseeable expenses of a temporary or emergency nature that they are unable to pay from their existing resources. The Fund currently consists of all funds appropriated by the General Assembly for the Fund's purposes. Under current law, advancements from the Fund are made by the Superintendent of Public Instruction in accordance with rules jointly adopted by the Superintendent and the Auditor of State specifying approval criteria and procedures necessary for administering the Fund. Current law also requires the school district to repay any advancement, or if the district fails to do so, the Director of Budget and Management must repay it from state funds the district would otherwise receive under the School Foundation Program or other direct appropriations from the General Assembly. The deadline for repayment is the end of the second fiscal year following the fiscal year in which the advancement was made.

#### *Changes made by the bill*

The bill creates a two-tiered structure within the School District Solvency Assistance Fund by dividing the Fund into separate accounts:

(1) The School District Shared Resource Account provides the short-term emergency solvency assistance payments to school districts for which the Fund was originally established. Deposits into the account consist of funds appropriated by the General Assembly. The bill specifies that districts must be in a state of fiscal emergency to qualify for payments.

(2) The Catastrophic Expenditures Account provides funds for the following purposes: (a) grants to school districts that suffer an unforeseen catastrophic event that severely depletes the district's resources as recommended by the Superintendent of Public Instruction and authorized by the Controlling Board, and (b) temporary solvency assistance payments to fiscal emergency districts if funds from the School District Shared Resource Account have been exhausted. Account deposits consist of any appropriations by the General Assembly for the account plus the combined investment earnings from both accounts in the Fund.

As under pre-existing law, school districts must repay solvency assistance, interest-free, by the end of the second fiscal year following the year of payment. All repayments of solvency assistance must be credited to the account from which the funds were originally loaned. *Grants* awarded to a district from the Catastrophic Expenditures Account do not have to be repaid unless a school district receives money from a third party specifically for the purpose of compensating the district for expenses incurred as a result of the catastrophic event.<sup>1</sup>

The bill eliminates the requirement that rules governing solvency assistance payments be jointly adopted by the Superintendent of Public Instruction and the Auditor of State. Instead, the Director of Budget and Management is solely responsible for adopting such rules, after consulting with the State Superintendent.

**Elimination of budget reserve fund requirement**

(secs. 3315.18, 5705.13, 5705.29, and 5705.38; Section 3)

Current law requires every school district to establish and maintain a budget reserve fund, sometimes referred to as a "rainy day" fund, to cover unanticipated revenue shortfalls and other emergencies. Generally, the balance in a budget reserve fund must be increased each year that the district's revenue growth is at least 3% until the fund balance equals at least 5% of the preceding fiscal year's general fund revenue. The balance may be less, however, if a district is in a state of fiscal watch or fiscal emergency. Appropriations from the fund may be made for unanticipated deficiencies in revenue or other emergencies. However, all appropriations must be approved by two-thirds of the membership of the district board of education, and any such expenditures cannot occur until the

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<sup>1</sup> For example, if a district received an insurance payment for a boiler that blew up or federal aid for a disaster, such funds would be required to be used to reimburse the fund for money the district received from the catastrophic account for the boiler or to alleviate the disaster.

Superintendent of Public Instruction approves the district's schedule for replenishing the fund.

The bill eliminates entirely the requirement that school districts maintain a budget reserve fund. A district, however, retains the authority to establish a reserve balance account under its taxing power as a political subdivision (sec. 5705.13).

Each district with money in its budget reserve fund on the effective date of the bill may either deposit the money in its general fund, leave it in the account to offset any future budget deficits, or transfer all or part of it to a separate account within its capital and maintenance fund. Any money deposited in a district's capital and maintenance fund, as well as all interest on that money, must be used only for meeting the district's local share of the costs of a construction or repair project funded by the Ohio School Facilities Commission. However, the bill stipulates that any portion of the money in the reserve fund on the effective date of the bill that came from a refund from the Bureau of Workers' Compensation must be used solely to offset a budget deficit or for expenditures on school facility construction or renovation; textbooks or other instructional materials, including science equipment or laboratories; school bus purchases; or professional development for teachers.<sup>2</sup>

**Classification of school districts with financial difficulties**

(secs. 3316.03 and 3316.031)

Under continuing law, the Auditor of State must declare a school district to be in a state of "fiscal watch" or "fiscal emergency" if the district meets certain "triggers" that threaten its financial solvency. A declaration by the Auditor that a district is in either state has legal consequences for the district and prompts different levels of fiscal intervention to restore financial integrity to the district. A fiscal watch district must develop a financial plan, approved by the Superintendent of Public Instruction, to address its financial problems. For a fiscal emergency district, the Auditor's declaration results in the creation of a financial planning and supervision commission, which has broad authority to manage the district's financial problems.

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<sup>2</sup> Division (I) of section 5705.29 and Section 39 of Am. Sub. H.B. 770 of the 122nd General Assembly required all refunds of workers' compensation premium overpayments received by a district to be deposited in the district's rainy day fund, unless the fund already had an amount equal to 5% of the district's prior year's operating revenues.

### **Creation of "fiscal caution" classification**

(sec. 3316.031)

The bill creates a third classification of "fiscal caution" for school districts that face potential financial problems in the future and establishes a procedure for earlier intervention. Under the bill, the State Superintendent, in consultation with the Auditor of State, must develop guidelines regarding fiscal practices and budgetary conditions that could contribute to a future declaration of fiscal watch or fiscal emergency for school districts. If the State Superintendent, upon examination of a district's five-year budget projection or, upon a report from the Auditor of State, finds that the district is engaged in unsound fiscal practices or that unstable budgetary conditions exist, the State Superintendent, after consulting with the district board of education, may declare the district to be under a fiscal caution.

The bill requires the Superintendent to declare a fiscal caution when a district has a certified operating deficit between 2% and 8% of the district's general fund revenue for the preceding fiscal year and the district's voters have not approved a tax levy that will raise enough money to eradicate the deficit in the next fiscal year, unless the Auditor has already elected to place the district under fiscal watch.

A declaration of fiscal caution requires the State Superintendent to request the district board to provide written proposals for correcting the harmful fiscal practices or budgetary conditions and for preventing further financial decline. To help fiscal caution district implement its proposals for eliminating questionable fiscal practices, the Department of Education must provide the district with technical assistance and may also make recommendations regarding the district's proposals. Also, the State Superintendent, or a designee, may visit and inspect a fiscal caution district. The State Superintendent may advise the Auditor of State to place a district in a state of fiscal watch if the State Superintendent determines that the district is not correcting harmful fiscal practices or budgetary conditions and considers the downgrade necessary to avoid additional financial problems.

### **Triggering conditions for state of fiscal watch**

(sec. 3316.03(A))

**Current law.** Under current law, the Auditor of State must declare that a school district is in a state of fiscal watch if any of the following triggers are met:

(1) The Auditor determines that (a) the district has an operating deficit for the current fiscal year that exceeds 8% of the district's general fund revenue for the

preceding fiscal year, (b) the unencumbered cash balance in the district's general fund at the end of the prior fiscal year, less any advances of property taxes, was less than 8% of the district's general fund expenditures for that year, *and* (c) the district voters have not passed a tax levy that the Auditor expects will raise enough additional money to eradicate the conditions described in (a) and (b) in the next fiscal year;

(2) The district was under a fiscal emergency at one time and still has outstanding securities issued for the purpose of restructuring debt; or

(3) The district has received an advancement from the School District Solvency Assistance Fund.

***The bill.*** The bill makes several changes to these triggering conditions. First, although the bill retains the operating deficit trigger of 8% for mandatory placement in fiscal watch, a deficit of 2% or more may be a triggering condition for a fiscal watch declaration if the Auditor finds that there is no reasonable cause for it or the declaration is necessary to prevent further fiscal decline.

Second, it eliminates the condition described above in (1)(b) concerning the unencumbered balance of a district's general fund. As a result, the first possible triggering condition will depend only on the percentage of the district's operating deficit and whether a sufficient tax levy has recently passed.

Third, the bill eliminates the triggering condition regarding districts that have received an advancement from the School District Solvency Assistance Fund. However, any district that is currently under a fiscal watch because it received solvency assistance before the bill's effective date remains under that declaration and must continue to comply with the laws governing districts under fiscal watch (Section 4 of the bill).

Finally, the bill adds a new triggering condition. The Auditor of State must declare a district to be in fiscal watch if the district is currently under the bill's new state of fiscal caution (see "***Creation of 'fiscal caution' classification***" above), the State Superintendent finds that the district has not acted reasonably to ameliorate its fiscal condition, the Superintendent determines that a fiscal watch is necessary to prevent further fiscal decline, and the Auditor confirms that the Superintendent's finding is reasonable. If the Auditor concludes that the Superintendent's decision is not reasonable, the Auditor must provide the Superintendent with a written explanation of the disagreement.

### **Triggering conditions for state of fiscal emergency**

(sec. 3316.03(B))

**Current law.** Under current law, the Auditor of State, after consulting with the Superintendent of Public Instruction, must declare a school district to be in a state of fiscal emergency if any of the following triggers are met:

(1) The Auditor determines that (a) the district board of education cannot demonstrate to the Auditor's satisfaction that it can repay its existing emergency school loans, or the tax anticipation notes it issued against its approved spending reserve balance, without having to engage in additional such borrowing that would exceed 50% of the amounts previously borrowed pursuant to such loans and notes, (b) the district has an operating deficit for the current fiscal year that exceeds 15% of the district's general fund revenue for the prior fiscal year, (c) the district, at the time of the Auditor's determination, had an average daily membership (ADM) of more than 10,000 students, *and* (d) the district voters have not passed a tax levy that the Auditor expects will raise enough additional money to eradicate the conditions described in (a) and (b) in the next fiscal year;

(2) The district was previously in a state of fiscal watch, and it failed to submit an acceptable financial plan within the prescribed time;

(3) A declaration of fiscal emergency is required due to debt restructuring provisions of the school solvency law; or

(4) The district has received more than one advancement from the School District Solvency Assistance Fund within a two-year period, or has received only one such advancement but also has an operating deficit for the current fiscal year of 15% of the district's general fund revenue for the prior fiscal year.

**The bill.** The bill makes several changes to these triggering conditions. First, the bill eliminates the elements described above in (1) regarding the school district's ability to repay its existing emergency loans and the minimum ADM. The bill also grants the Auditor of State discretionary authority to declare a fiscal emergency if a district's operating deficit is between 10% and 15% of the district's general fund revenue for the preceding fiscal year and the Auditor determines that such a declaration is necessary to correct the district's fiscal problems.

Second, the bill adds a new triggering condition. The Auditor of State must declare a fiscal watch district to be in fiscal emergency upon receipt of a State Superintendent's report that the district is not "materially complying" with the provisions of an approved financial plan and that the Superintendent determines that a fiscal emergency is necessary to prevent further fiscal decline, unless the

Auditor finds the Superintendent's report to be unreasonable. If the Auditor concludes that the Superintendent's decision is unreasonable, the Auditor must provide the Superintendent with a written explanation of the disagreement.

Any district that is currently under a fiscal emergency because it received solvency assistance before the bill's effective date remains under that declaration and must continue to comply with the laws governing districts under fiscal emergency (Section 4 of the bill).

### **Dissolution of Financial Planning and Supervision Commission**

(secs. 3316.06 and 3316.061)

**Current law.** Under current law, when a school district is placed in fiscal emergency, a five-member financial planning and supervision commission is appointed to oversee the financial recovery of the district. The commission consists of the Director of Budget and Management, or a designee; the Superintendent of Public Instruction, or a designee; one member appointed by the Governor; one member appointed by the Superintendent of Public Instruction; and one member appointed by a local official (either the mayor of the largest city or the county auditor if there is no municipal corporation in the district). The member appointed by the Superintendent must be the parent of a student in the district and the other two appointed members must have ties to the district through their residency or business.

Each commission is required to adopt a financial recovery plan for the district and must determine a level of fiscal and management control of the district it wishes to assume. The statute permits the commission to take over any of the powers and duties of the school board it considers necessary to successfully implement the financial recovery plan.

**The bill.** The bill requires any commission to submit its proposed recovery plan to the State Superintendent for approval immediately following its adoption or updating. The Superintendent must approve or disapprove it within 30 days. If the plan is disapproved, the Superintendent must suggest modifications to render it acceptable.

Under the bill, if the commission does not submit a plan acceptable to the Superintendent or if the Superintendent and the Director of Budget and Management jointly determine at any time that the commission is not "materially complying" with the provisions of its adopted plan, the Superintendent and Director may jointly dissolve the commission and instead jointly appoint an individual to act as the "fiscal arbitrator" of the district. The bill requires the

Superintendent to issue guidelines establishing criteria for the selection of qualified fiscal arbitrators.

A fiscal arbitrator would have all the same rights, powers, and duties as the commission had, including the right to amend the plan and assume additional powers of the school board. All actions of the commission prior to dissolution would continue to be valid until legally altered by the arbitrator and no contractual or other rights would be lost by virtue of the replacement of the commission by the arbitrator.

### **Performance audits of school districts**

(sec. 3316.042)

Current law permits the Auditor of State to conduct performance audits of school districts in fiscal watch or fiscal emergency to identify areas of operation in which the Auditor believes greater operational efficiencies or better financial results can be achieved. These performance audits cannot include an evaluation of a district's academic performance.

The bill adds districts in fiscal caution to the list of school districts with financial difficulties for which the Auditor is permitted to initiate performance audits. In addition, the bill *requires* the Auditor to conduct a performance audit of a district in any one of the three categories of financial difficulty upon the request of the Superintendent of Public Instruction. All costs of such performance audits are paid by the Department of Education.

### **School district set-asides for textbooks and maintenance**

(secs. 3315.17, 3315.18, and 3315.19; Section 5)

Current law requires the board of education of each city, local, exempted village, and joint vocational school district to establish a textbook and instructional materials fund and a capital and maintenance fund, each to consist of a certain annual set-aside of a percentage of the district's revenues. The statute currently requires each district to annually deposit 4% of its operating revenues into each fund, but the Auditor of State has adopted rules as permitted by the statute reducing the required deposit to 3% of operating revenues.<sup>3</sup>

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<sup>3</sup> *Ohio Administrative Code § 117-6-03 and 3301-92-01. The revenues that the district must use in determining the amount that must be set aside are limited by this rule to roughly the state funds a district receives for regular (non-special education or vocational) students plus general fund revenue from property and school district income taxes.*

Uncodified law in the bill indicates that the General Assembly, in response to the Ohio Supreme Court's conclusion that these two mandated set-asides constituted "unfunded mandates upon school districts," utilized evidence presented to the Joint Committee to Examine the Base Cost of an Adequate Education to arrive at the changes the bill makes to the set-asides. Specifically, the evidence demonstrated that the set-asides would not be unfunded if they were adjusted to require only that 3% of the base cost formula amount per pupil be set aside (rather than 3% or 4% of a district's total operating revenue). The bill states that a study of the 103 districts that were utilized to develop the base cost formula amount used in the current state funding system found that the model districts in fact did spend at least 3% of their base cost amount (which amount is guaranteed to every district in the state for basic education costs under the state funding system) on instructional materials and maintenance.

In view of these findings, the bill changes the required annual deposit for both funds to 3% of the state base-cost formula amount for the preceding fiscal year, times the number of students in the district's student population during the preceding fiscal year. (The bill defines "student population" as the average, daily, full-time-equivalent number of school-aged students during the first full school week in October who receive any educational services from the district, including students from other districts attending under open enrollment, a compact, or tuition payment.) The Department of Education must determine the student population for each district based on data reported to it by the district. The state-base cost formula amount is a per pupil amount prescribed by statute.<sup>4</sup> The following chart shows the amount each district would be required to budget per pupil for the two set-asides in the next four years:

<b>Fiscal Year</b>	<b>Base-Cost Formula Amount Per Pupil</b>	<b>Required per pupil fund amount (3% of formula amount)</b>
FY 2001	\$4,294	\$128.82
FY 2002	\$4,414	\$132.42
FY 2003	\$4,538	\$136.14
FY 2004	\$4,665	\$139.95

For example, a district with a student population of 1,000 students in FY 2001 would be required to deposit \$128,820 into *each* fund in FY 2002 (3% x

<sup>4</sup> Secs. 3317.012(A) and 3317.022(B), neither section in the bill.

\$4,294 x 1,000 students). The amount varies from district to district based only on enrollment; it does not vary depending on a district's wealth, revenues, or on what percentage of the district's state formula payments are paid for with state versus local tax revenue.

The bill, however, retains the Auditor of State's authority to impose a different percentage than 3% that must be deposited.

**Option to continue set-asides under current law**

(sec. 3315.19)

Under the bill, school districts may *annually* elect to comply with the set-aside amounts required by current law instead of the amounts required by the bill. Any district that chooses to comply with the current requirements must notify the Auditor of State of its decision within 90 days after the beginning of the fiscal year and must specify whether it intends to follow the current requirements for its textbook fund only, for its maintenance fund only, or for both funds.

**Textbook "opt-out" not affected by the bill**

(sec. 3315.17(D))

The bill does not change the provision of current law allowing districts to use money in their textbook and instructional materials fund for other purposes, if so recommended by the district's superintendent, business advisory council, and any teachers' organization and unanimously approved by the board of education.

**Use of half-mill maintenance levy for infrastructure improvements**

(sec. 3318.053)

The bill permits a school district board of education to apply the proceeds of the half-mill levy for maintenance, which it must submit to its voters to qualify for state school facilities assistance, for infrastructure improvements on and leading to a project site when those improvements are not included in the basic project cost. Proceeds of the tax can only be used for infrastructure improvements during the three-year period following the execution of the district's agreement with the Ohio School Facilities Commission for the construction of the project. If the board chooses to use the proceeds of the tax for infrastructure improvements, it must indicate this intention in the ballot language proposing the levy.

**Mandated increase in academic units**

(Section 4)

Law enacted by Am. Sub. S.B. 55 of the 122nd General Assembly phased in an increase in the number of academic units required for graduation from high school. The required units increased from 18 to 21. Uncodified law in the bill specifies that the General Assembly determined through its Joint Committee to Examine the Base Cost of an Adequate Education that this increase imposed a partially unfunded mandate on school districts, to the extent that the 103 model districts (whose expenditures determined the state's base cost level of guaranteed funding for school districts) required only an average of 19.6 academic units to graduate at the time the funding formula was calculated (1996). The additional 1.4 units required by Am. Sub. S.B. 55 were, accordingly, unfunded.

The bill includes uncodified language expressing the intent of the General Assembly to increase the base cost formula amount in future funding legislation to provide money for the unfunded 1.4 units.

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**HISTORY**

ACTION	DATE	JOURNAL ENTRY
Introduced	11-14-00	p. 2216
Reported, S. Finance & Financial Institutions	11-16-00	pp. 2252-2253
Passed Senate (21-12)	11-16-00	pp. 2264-2265
Reported, H. Finance & Appropriations	---	---

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