Fiscal Note & Local Impact Statement

122 nd General Assembly of Ohio

BILL: **Am. Sub. H.B. 412 (LSC 122 0682-3)** DATE: **July 30, 1997**

STATUS: **As Passed by the Senate** SPONSOR: **Rep. Cates**

LOCAL IMPACT STATEMENT REQUIRED: **No** **No local cost in the as introduced version**

CONTENTS: **School district fiscal accountability**

State Fiscal Highlights

STATE FUND	FY 1998	FY 1999	FUTURE YEARS
General Revenue Fund – Office of Education Accountability and Productivity			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	$475,000 - $525,000 increase	$760,000 - $800,000 increase	$800,000 increase
Department of Education			
Revenues			
Expenditures	$164,000 to $273,000 increase	$164,000 to $273,000 increase	$164,000 to $273,000 increase
General Revenue Fund – Department of Education School Management Assistance or Controlling Board School District Financial Planning Commission			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	$70,000 to $400,000 depending on number of audits*	$70,000 to $400,000 depending on number of audits*	Up to $70,000 to $800,000 and more depending on number of audits
School District Solvency Assistance Fund			
Revenues	Indeterminate gain depending on amounts designated by the General Assembly	Indeterminate gain depending on amounts designated by the General Assembly	Indeterminate gain depending on amounts designated by the General Assembly
Expenditures	Indeterminate increase depending on amounts needed by school districts to remain solvent	Indeterminate increase depending on amounts needed by school districts to remain solvent	Indeterminate increase depending on amounts needed by school districts to remain solvent

*$800,000 for two years would cover audits of the school districts currently in fiscal watch or fiscal emergency.

- The Office of Education Accountability and Productivity is estimated to cost between $475,000 to $525,000 in its first year of operation. The cost for ensuing years is estimated at between $760,000 and $800,000. Eventually approximately 10 staff persons are estimated to be needed to staff the office.

- The Department of Education estimates that it will need approximately 6 – 10 part-time employees to annually review each district's 5-year budget plan, at a cost of $164,000 to $273,000.

- A new School District Solvency Assistance Fund is created to make advancements to school districts to enable them to remain solvent and pay for unforeseeable, emergency expenses.

- The office of the Auditor of State estimates that, given current resources, one performance audit will be undertaken in FY 1998 and another in FY 1999 at a cost of approximately $70,000 each. The money will presumably come from the General Revenue Fund, either the Department of Education's School Management Assistance line item or the Controlling Board's Emergency Purpose Fund - School District Financial Planning Commission, or a combination of the two. The Controlling Board line item has appropriations of $250,000 each year for FY 1998 and FY 1999.

- The state's expenditures could range from $140,000 to $800,000 over this biennium, depending on the number of audits conducted and whether additional appropriations are needed. This bill would authorize the Auditor to audit any school districts under fiscal watch or fiscal emergency. Performance audits have been conducted for Cleveland City Schools and Youngstown City Schools. According to the Auditor's office, in two years it would cost the state about $800,000 to complete audits on the remaining school districts. Moreover, Am. H.B. 215 of the 122nd G.A. authorizes performance audits for 21 urban school districts, including Cleveland City, Youngstown City, and Canton Local.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 1998	FY 1999	FUTURE YEARS
School Districts			
Capital and Maintenance Fund			
Revenues	- 0 -	Potentially up to 4 % of each district's annual general operating revenue, approximately $400 million statewide	Potentially up to 4 % of each district's annual general operating revenue, approximately $400 million statewide
Expenditures	- 0 -	Potentially up to 4 % of each district's annual general operating revenue, approximately $400 million statewide	Potentially up to 4 % of each district's annual general operating revenue, approximately $400 million statewide
Textbook and Materials Fund			
Revenues	- 0 -	Potentially up to 4 % of each district's annual general operating revenue, approximately $400 million statewide	Potentially up to 4 % of each district's annual general operating revenue, approximately $400 million statewide
Expenditures	- 0 -	Potentially up to 4 % of each district's annual general operating revenue, approximately $400 million statewide	Potentially up to 4 % of each district's annual general operating revenue, approximately $400 million statewide
Budget Reserve Fund			
Revenues	-0-	1 % of each district's annual general operating revenue, when district's general revenue grows more than 3 %	1 % of each district's annual general operating revenue, when district's general revenue grows more than 3 %
Expenditures	- 0 -	1 % of each district's annual general operating revenue, when district's general revenue grows more than 3 %	1 % of each district's annual general operating revenue, when district's general revenue grows more than 3 %
General Fund			
Revenues		Potentially up to 8% transfer - (4 % to the Capital and Maintenance Fund and 4 % to the Textbook and Materials Fund	Potentially up to 8 % transfer – (4 % to the Capital and Maintenance Fund and 4 % to the Textbook and Materials Fund
Expenditures		Capital and Maintenance Fund and 4 % to the Textbook and Materials Fund	Potentially up to 8 % transfer – (4 % to the Capital and Maintenance Fund and 4 % to

		the Textbook and Materials Fund

- Every school district is required to establish a Capital and Maintenance fund and deposit 4 % of all the money that would otherwise be deposited into the district's general fund into the fund. Statewide, this amounts to approximately $360,000 to $400,000. Moneys in each district's Capital and Maintenance Fund are to be used for acquisition, replacement, enhancement, maintenance, or repair of permanent facilities.

- Every school district is required to establish a Textbook and Materials Fund and deposit 4 % of the money that would otherwise go to the district's general fund into the fund. Statewide this amounts to approximately $360,000 to $400,000. Moneys in the fund are to be used solely for textbooks, instructional software, instructional materials, supplies and equipment.

- Every school district is required to establish a Budget Reserve Fund, which would eventually be not less that 5 % of the general fund revenues for the most recently concluded fiscal year. Beginning in FY 1999, and for each year until the Budget Reserve Fund reaches the 5 % requirement, if the growth in the district's total revenues received for current expenses is equal to 3 % or more, the board of education of the district must credit at least 1 % of the revenue received for current expenses to its Budget Reserve Fund.

Detailed Fiscal Analysis

Budget Reserve Fund

The bill requires each city, exempted village and local school district to establish a Budget Reserve Fund. The purpose of the fund would be to ensure that resources would be available to meet unanticipated financial emergencies and to avoid operating deficits. The following bullet points provide information on the composition of the fund and requirements for expenditures from the fund.

- Composition of the Budget Reserve Fund – At least 5% of the district's annual general fund.
- Requirements for deposit – Districts must put in 1% of the district's general fund each year that the school's general revenue grows more than 3%. In addition, districts may transfer any ending fund balance to the fund.
- Expenditures from the Fund – School board must approve expenditures by a 2/3rds vote.
- Limitations of Expenditures – Expenditures are limited to reasonably unanticipated funding shortfalls and other emergencies as authorized by joint rule of the Auditor of State and the State Superintendent of Public Instruction.
- Additional Time to Establish a Budget Reserve Fund – The Auditor of State and State Superintendent of Public Instruction may, by joint rule, allow districts with a spending reserve more time to establish a Budget Reserve Fund.

The spreadsheet at the end of the fiscal note shows each district's total revenue to the general fund for fiscal years 1993 to fiscal year 1996. The spreadsheet also shows the percentage of growth each year during this time frame, and shows the amount of the Budget Reserve Fund, based on FY 1996 General Fund Revenues.

From FY 1993 to FY 1994, 231 districts experienced general fund growth greater than 3 percent. From FY 1994 to FY 1995, there 252 districts with general fund growth greater than 3 percent, and from FY 1995 to FY 1996, there were 323 such districts. This data led LBO to wonder if there were a significant number of districts that experienced no growth greater than three percent in any of the three years. An examination of the data reveals that only 11 districts experienced no growth greater than 3 percent in any of the three years examined. Thus, the majority of districts should be able to establish a Budget Reserve Fund and might eventually get the funding level of the reserve fund up to 5 percent.

Capital and Maintenance Fund

Under the bill, each district would be required to have a capital and maintenance fund. Each year, each district would be required to deposit at least 4 percent of the district's annual general operating revenue into the fund. The district would be allowed to count revenue collected from a permanent improvement levy toward the four percent requirement. Any unused funds in the fund from any fiscal year would be carried forward to the succeeding fiscal year.

Expenditures from the fund could only be used for capital and maintenance items. The Auditor of State and the State Superintendent are permitted to determine by rule the definition of what is to be considered capital and maintenance items. The Auditor and the State Superintendent are also permitted to change the required percentage from four percent to some other percentage.

The spreadsheet at the end of the fiscal note shows the estimated amount that would have to be deposited into the Capital and Maintenance Fund based on FY 1996 data. Statewide, the total amount that would be deposited would amount to approximately $400 million. The average amount that would be deposited is $587,561 per district. The range is from less than $100,000 to $17 million for the Cleveland City School District. The statewide average is approximately $200 per pupil.

Textbook and Materials Fund

The bill requires each district to establish a textbook and materials fund. Each year, each district would be required to deposit at least 4 percent of the district's annual general operating revenue into the fund. Any unused funds in the fund from any fiscal year would be carried forward to the succeeding fiscal year.

Expenditures from the fund could only be used for instructional textbooks, software, materials, supplies, and equipment. The Auditor of State and the Superintendent of Public Instruction are required to define by rule the definition of what is to be considered instructional textbooks, software, materials, supplies and equipment. The Auditor and the State Superintendent are also permitted to change the required percentage from four percent to some other percentage.

Revenue in the Textbook and Material Fund could be used for other purposes only if the following occur:

a) the district superintendent, the president or designee of the teachers' organization, and a person designated by vote of the School Business Advisory Council certify in writing to the local board of education that the district had sufficient instructional materials, including textbooks, software, supplies and equipment, to ensure a thorough and efficient education within the district;

b) the board unanimously adopts a resolution finding that the district has sufficient instructional materials, including textbooks, software, supplies, and equipment, to ensure a thorough and efficient education within the district.

The spreadsheet at the end of the fiscal note shows the estimated amount that would have to be deposited into the Textbook and Material Fund based on FY 1996 data. Statewide, the total amount that would be deposited would amount to approximately $400 million.

School District Solvency Assistance Fund

The bill creates the School District Solvency Assistance Fund. The fund would consist of amounts designated for the purposes of the fund by the General Assembly. The purpose of the fund would be to make advancements to school districts to enable them to remain solvent. It would also be used to pay unforeseeable expenses of a temporary or emergency nature that districts are unable to pay from existing resources.

The Superintendent of Public Instruction and the Auditor of State would have to adopt rules specifying advancement approval criteria and procedures necessary for the administration of the fund.

The bill specifies that the fund would have to be reimbursed for any amounts advanced from the fund not later than the end of the second fiscal year following the fiscal year in which the advancement was made. If not, the Director of the Office of Budget and Management would be authorized to make reimbursements to the School district Solvency Assistance Fund from moneys the school district would otherwise receive from the state.

It is difficult to estimate how many districts would take advancements from the School District Solvency Assistance Fund. With an anticipated increase in funding for schools from the state, budget reserve fund provisions in this bill, and oversight of each district's five-year plan by the Department of Education and the Auditor of State, the number of districts taking loans is expected to decrease from current levels.

Office of Education Accountability and Productivity

The bill creates the Office of Education Accountability and Productivity (OEAP) within the Office of Budget and Management. The purpose of the office is to provide oversight over the collection and analysis of education performance and financial data.

An OEAP governing council, consisting of eight voting members, is established in the bill. The council would consist of the two appointed members of each house of the Legislature, the state superintendent, or designee, the director of OBM, or designee, the chairperson of the House Education Committee, and the chairperson of the Senate Finance Committee. The director of the Office of Education Accountability and Productivity would be hired by the Director of the Office of Budget and Management subject to the approval of the OEAP governing council. The director of OBM would be the chairperson of the council unless the council elects a different member to be the chairperson.

The Office would be required to do the following:

- Issue annual report cards for each district and for the state as a whole documenting academic and fiscal performance.
- Develop procedures to ensure that the data reported by school districts is accurate and reliable.
- Assist the Department of Education in developing and specifying standards for the hardware and software used by the Department of Education's Education Management Information System (EMIS) to ensure that the data can be analyzed with maximum utility and flexibility.
- Use data to establish benchmarks for academic and operational performance levels for school districts and for the state.
- Monitor the implementation of significant education legislation and report on the state's progress in achieving the goals of the legislation.
- Analyze, organize and report education and performance and fiscal data to assist the General Assembly, the Governor, the State Board of Education, and the State Superintendent of Public Instruction in the development of effective education policy.

Estimated Cost of the Office of Education Accountability and Productivity

It is estimated that the Office of Education Accountability would eventually consists of approximately 10 staff, including an executive director, executive secretary, an information systems analyst, management analysts, program analysts, researchers and a communications coordinator. Initially the office may start out with five to six staff members, with an estimated annual budget of $475,000 to $525,000. In the second year of operation, the estimated budget is $760,000 to $800,000, not including consultant contracts.

New Fiscal Watch and Fiscal Emergency Provisions

Under current law, school districts may be declared by the auditor of state to be in a state of **fiscal watch** if any of the following apply to the district:

1) all of the following conditions are met:

a) the district has an operating deficit in excess of 8 % of the district's general fund revenue;

b) the unencumbered cash balance in the school district's general fund, less any advances of property taxes, was less than 8 % of the expenditures made from the general fund for the preceding fiscal year;

c) voters have not approved a tax levy that the auditor of state expects will raise enough additional revenue so that the above two conditions would not apply.

2) The school district has outstanding securities and its financial planning and supervision commission has been terminated.

Under the bill, a third way for school district to be declared to be in a state of fiscal watch is added to existing law. If the district receives an advancement from the School District Solvency Assistance Fund, created in the bill, it also would be declared to be in a state of fiscal watch by the Auditor of State. Although there are currently no estimates of the number of school districts which would be eligible to receive funds from this assistance fund, there is a potential for more school districts to be declared under fiscal watch as a result of this provision. An increase in the number of schools under fiscal watch could increase the Auditor's services to the school district,

thus increase costs to the state. The office of the Auditor of State estimates a thorough audit of just one department within a school district under fiscal watch or emergency would cost about $70,000. An estimate of total costs at this time is difficult.

Under current law, school districts may be declared by the Auditor of State to be in a state of **fiscal emergency** if any of the following apply to the district:

1) all of the following conditions are met:
   a) the board of education is unable to demonstrate to the auditor's satisfaction, the district's ability to repay outstanding loans unless the board requests additional loans in an aggregate principal amount exceeding 50 % of the sum of the following:
      i) the aggregate original principal amount of loans received in the preceding fiscal year;
      ii) the aggregate amount borrowed by the district under the spending reserve provisions of law;
   a) the district has an operating deficit in excess of 15 % of the district's general fund revenue;
   b) voters have not approved a tax levy that the auditor of state expects will raise enough additional revenue so that the above two conditions would not apply.

Under the bill, a three additional ways for a school district to be declared to be in a state of fiscal emergency are added to existing law. They are as follows:

1) the school district board fails to submit a plan acceptable to the State Superintendent of Public Instruction within 120 days of the auditor's declaration of fiscal watch;
2) A declaration of fiscal emergency is required by section 3316.04 of the Revised Code;
3) The school district has received more than one advancement within a 2-year period from the School District Solvency Assistance Fund, created in the bill.

New provisions in this bill would make a school district eligible for fiscal emergency declaration if it meets any of the above points. Changes in this bill would probably increase the number of school districts which are declared to be in a state of fiscal emergency, and thus would increase costs to the state. There is currently no estimate of these costs.

Currently 11 school districts are under fiscal watch and four are under fiscal emergency. Ever since designations of fiscal watch and fiscal emergency began, no school district has been undesignated as such. More than half of these schools have been certified under fiscal watch or emergency since late 1996. The rest joined the Auditor's list in 1997. The following is a list of schools which have been declared under fiscal emergency and fiscal watch:

FISCAL EMERGENCY

SCHOOL DISTRICT	COUNTY
1. Youngstown City	Mahoning
2. Cleveland City	Cuyahoga
3. Ledgemont Local	Geauga
4. Osnaburg Local	Stark

FISCAL WATCH

SCHOOL DISTRICT	COUNTY
1. Bloom-Carroll	Fairfield
2. Canton Local	Stark
3. North Royalton	Cuyahoga
4. East Liverpool	Columbiana
5. Avon Lake	Lake
6. Switzerland of Ohio Local	Monroe
7. Massillon City	Stark
8. Groveport Madison Local	Franklin
9. Madison Local	Richland
10. Coventry Local	Summit
11. New Lexington City	Perry

Of the above school districts, only for Cleveland City and Youngstown City districts have performance audits been undertaken. H.B. 117 of the 121st General Assembly required the Auditor to complete a performance audit of the Cleveland City School District. After S.B. 310 of the 121st G.A., which established the Fiscal Watch/Fiscal Emergency Program, and after the Auditor's declaration of Youngstown City School District under Fiscal Emergency, the Youngstown City School District officials requested a performance audit be done for that school district.

Differences in Costs Between Previous Performance Audits and New Audits

The performance audits to be undertaken as a result of this bill are not expected to be as comprehensive, thus not as expensive, as previous audits. H.B. 215 of the 122nd General Assembly calls for performance audits of 21 urban school districts. In addition, given current resources, the office of the Auditor of State reports that its staff of eleven internal auditors would conduct one performance audit each fiscal year for school districts in fiscal watch or fiscal emergency. Although the Auditor's office estimates one performance audit per year, the bill authorizes the Auditor to audit any school districts under fiscal watch or fiscal emergency. The audits will focus on problems in one or a few departments within the school district and are estimated to cost about $70,000 each. The Cleveland and Youngstown City School District audits were long-term audits which dealt with problems in multiple departments and involved extensive research. Cleveland City School District's performance audit cost over $1,000,000 and the Youngstown audit cost over $150,000. According to the Auditor's office, over two years it would cost the state about $800,000 to complete audits on the remaining school districts on fiscal watch or fiscal emergency.

All expenses of the audits will be covered by the state either from the Department of Education or from the Controlling Board's Emergency Purposes Fund.

Five Year Budget Plan

The bill would require the Department of Education and the Auditor of State to jointly adopt rules to require each school district to prepare and submit to the Department of Education a 5-year budget plan. The rules would have to provide for the Auditor and the Department of Education to examine each district's plan and determine whether any additional fiscal analysis is needed to ascertain whether the district has the potential to incur a deficit during the first three years of the five-year period.

The Auditor and the Department of Education are permitted to conduct any further audits or analyses necessary to assess the district's fiscal condition. If either of the two agencies assesses that the district has the potential to incur a deficit, the agency must immediately notify the district.

Under the bill, if any school employee is found to have willfully contributed to erroneous, inaccurate or incomplete data being submitted in the five-year plan, the State Board of Education may suspend, limit, or revoke that school employees' license.

A spokesperson from the Department of Education estimates that approximately 6 – 10 part time individuals would be needed to carry out the new responsibilities assigned to the Department under the bill. The new personnel would particularly be needed in the time period from February to March. The School Management Assistance section of the Department of Education typically contracts for services at a rate of $160/day plus approximately $100/day for expenses. If the new individuals work every work day from February to June, costs for that time period could range from approximately $164,000 to $273,000 for six to ten employees.

A spokesperson from the Auditor of State's office stated that the auditor's office would be able to carry out the new responsibilities assigned to the office using existing staff.

Spending Reserve

The bill phases out the spending reserve authority districts now have. Currently, districts may include in their budgets a spending reserve. The spending reserve is limited to the amount of the spending reserve balance. A district's spending reserve balance is the amount by which 50 % of the district's estimated personal property taxes to be settled during the calendar year in which the fiscal year ends exceeds the estimated amount of personal property taxes to be so settled and received by the district during that fiscal year. When a board of education has included a spending reserve in its budget, it can, if approved the Superintendent of Public Instruction, borrow in anticipation of the receipt of personal property taxes.

The bill reduced the spending reserve balance from the current 50 % to 40 % in FY 1999, 30% in FY 2000, 20% in FY 2001, and 10 % in FY 2002. Currently, approximately 70 districts are using a spending reserve, that is, borrowing against future fiscal year receipts. According to a spokesperson from the Department of Education's school management assistance section, districts using a spending reserve are often steps away from having to take an emergency loan. By phasing out the spending reserve, districts may be prevented from getting into a fiscal deficit situation.

Certificate of Resources

Under current law, a certificate of resources must be signed by the treasurer, the president of the board of education and the superintendent of the school districts when any appropriation is adopted, any contract made, or when money is expended. Currently, such certificates must certify that resources are sufficient to provide the operating revenues necessary to enable school districts to "operate an adequate education program." Under the bill, the certificate would have to certify that sufficient funds would be available to operate all "personnel, programs, and services necessary to provide an adequate education program."

The new language would appear to make explicit that the school district's resources are intended to cover the costs of all personnel, programs, and services used in providing an adequate educational program, and that all uses of resources must be taken into consideration when the certificate is signed.

Temporary Law

The bill states that the responsibilities imposed on the Office of Education Accountability and Productivity and its director and governing board would not apply unless and until the General assembly makes appropriations sufficient6 for such purpose.

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