

SCHOOL DISTRICT FINANCIAL MANAGEMENT: PERSONNEL, POLICIES, AND PRACTICES

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EXECUTIVE SUMMARY

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Executive Summary

This study examines financial management in California school districts, including how districts vary in the qualifications and stability of the responsible personnel, the nature of their governance and leadership, and their management practices. It also looks at the relationship between those aspects of district operations and a measure of district fiscal health. In addition, it examines the extent to which conditions outside of a district's control relate to fiscal health.

A state-controlled school finance system limits options for districts

To understand the study's findings, it is important to keep in mind the California context regarding school district revenues and expenditures. The overarching reality is that the school revenue system in California is state controlled, with districts having very limited options for increasing the funds they receive. Further, revenue amounts are closely tied to the number of students a district serves, a number that can be somewhat unpredictable and over which districts have little control.

In reaction to fiscal crises in a very small but visible number of districts since about 1990, the state has created a set of requirements for fiscal accountability, including an important oversight role for county offices of education. The system, which was first created by Assembly Bill (AB) 1200 in 1991, was significantly strengthened by AB 2756 in 2004.

The timing of this study is important in relation to its findings. During the period for which we collected fiscal data—2002–03 to 2004–05—the state's financial situation was particularly volatile and the number of districts identified as having serious fiscal health worries increased. In 2005–06 the new set of regulations referenced above went into effect, further increasing these oversight requirements. In addition, 2005–06 marked a turning point in a two-decade increase in student enrollment. Projections are that enrollment in California's K-12 schools as a whole will actually decline in 2006–07 and increases, if there are any, will remain modest for several years. Districts vary in their experiences, however, with about half experiencing declining enrollment but about a third—generally in areas with lower housing costs—expecting growth to continue.

Another major consideration for California school districts is that they are legally required to bargain with employee unions if district employees choose to be represented. State law and bargaining agreements control a variety of compensation practices, such as the use of a specified salary structure for teachers based on years of service and courses completed. With the preponderance of school district expenditures devoted to personnel, these dynamics can have a tremendous effect on district fiscal health. In addition, new federal requirements related to the recognition and funding of retiree health benefits are increasing concerns about the benefits some districts provide.

The research team for this study was able to draw on state-collected data for some information about districts. However, such data do not address most of the variables we hoped to examine. Thus, a central component of the study was a survey administered to chief business officers (CBOs) in a sample of 135 school districts of varying sizes. A review of both legal requirements and professional standards for the financial management of school districts guided the survey's development. Although we acknowledge that the capacity and practices of both the school district superintendent and governing board play a crucial role in district financial management, we limited the scope of this study to the information CBOs could provide, augmented by state and proprietary databases.

Findings examine factors related to financial management and fiscal health

This study:

- describes the fiscal health of California school districts;
- examines the relationship between fiscal health and conditions over which districts have limited control;
- describes a variety of school district personnel qualifications, policies, and practices; and
- analyzes the relationship between these factors and district fiscal health.

Our findings include the development of a district fiscal health measure against which we analyze both state data and survey responses. In addition, we use the survey results to describe the general state of personnel, policies, and practices related to financial management in California school districts.

A new measure provides a clearer picture of district fiscal health

One of the central questions in the study is the relationship between a district's fiscal health and various other factors. We gathered information on these factors from both our survey and state data. We first attempted to develop a measure of fiscal health using the state's reporting system of positive, qualified, and negative certifications of districts' fiscal solvency, a system based on periodic review of district financial documents. However, we found that this system does not adequately identify districts that are "at risk" for financial trouble. We believe that point, in and of itself, is an important finding of our study. To evaluate fiscal health more effectively, we developed a more robust measure that also considered patterns of deficit spending and reserve levels over time.

Using this measure, we categorized districts in the state as a whole, and in our sample, as fiscally healthy, marginal, and unhealthy. Statewide, more than half of school districts fit the healthy category, while almost three out of 10 fall into the marginal category. As the table shows, our sample included an over-representation of districts in the unhealthy category. This oversampling was purposeful and enabled us to draw some conclusions about the "unhealthy" group of districts within our relatively small sample.

Fiscal health categories based on Study Fiscal Health Index (Reserve, deficit, and AB 1200 status from 2002–03 to 2004–05)	Districts Statewide		Districts in Study Sample	
	Frequency	Percent	Frequency	Percent
Not Available	12	1.20%		
Healthy	520	52.90%	53	39.30%
Marginal	275	28.00%	46	34.10%
Unhealthy	176	17.90%	36	26.70%
Total	983	100.00%	135	100.00%

Districts that face enrollment declines, that are unified, or that have lower revenues are more likely to be fiscally unhealthy

The state provides extensive data regarding school district enrollments and revenues, two factors over which California school districts have limited control. Districts in California also fit three different types of configurations: unified (grades K–12), high school (9–12) and elementary (K–8). We analyzed these characteristics and others, such as student demographics, against the fiscal health categories described above for the years 2002–03 to 2004–05. Holding constant for each characteristic, we found the following relationships to be statistically significant:

- declining-enrollment districts are more likely to be fiscally unhealthy, and growing districts are more likely to be healthy;
- unified districts are more likely to be marginal or unhealthy; and
- higher-revenue districts are more likely to be fiscally healthy, and this relationship is strongest among districts with higher levels of general purpose (revenue limit) funding.

School district personnel, policies, and practices include some notable variations

The balance of the study depends for the most part on survey responses to illuminate various aspects of school district financial management. These included personnel characteristics, practices related to governance and decision-making, accounting, compensation, resource allocations, and maximizing resources. We also asked CBOs about any perceived threats to fiscal health in their districts.

The vast majority of California school districts have stable leadership and well-educated CBOs

Based on data collected by EdSource over several years, 39% of California school districts had the same superintendent from 2001–02 to 2005–06, and another 46% had only one leadership change in that time. In other words, about 85% of school districts in the state had relative stability at the top during that period.

We also found that the CBOs in our sample are generally well educated. The vast majority of survey respondents report holding at least a bachelor’s degree, and most say they have a degree in a finance-related field. Further, the majority of CBOs report participating in

some voluntary training. The districts in our sample also appear to have an experienced cadre of CBOs, with the average experience reported to be 10.5 years. However, the average reported tenure within a district was just 4.7 years.

Based on state staffing data, the majority of districts in our sample (58%) report a staffing ratio of between 75 and 125 students per administrative staff (district office administrators plus employees in the office/clerical category).

School board members often do not receive high quality training, according to the CBO survey

While the vast majority of respondents say their school board members receive some training on school district budgeting and finance, only a quarter of them characterize that training as being of high quality. And 39% characterize the general orientation board members' receive as high quality. (We recognize that individual board members might rate the quality of their training and orientation differently than their CBOs do.) Most CBOs also report that their school boards formally evaluate the superintendent's performance but that few boards conduct formal self-evaluations.

Respondents report that boards receive good quality financial information and that written district policies and regulations are of high quality, even though they are not always promptly updated.

CBO responses vary widely regarding the extent to which finances are linked to priorities

CBO responses vary more widely on questions regarding how strategically districts make their financial decisions. Substantial proportions say their district, to a great extent:

- follows a strategic plan (31%),
- links its financial plan and budget to priorities (37%),
- regularly adjusts its budget to meet priorities (42%), and
- considers goals closely when implementing a new program (47%).

Conversely, between 20% and 35% of respondents answer in the negative regarding these same practices.

Two other questions about strategic decisions were markedly less positive. Just 23% of CBOs said their districts had to a great extent established procedures for evaluating budget amendments against district goals, or that they were able to cut programs that did not further those goals.

CBOs say they have appropriate financial control procedures, but fewer take advantage of some cost-cutting strategies

Almost all of the CBOs who answered the survey report that they follow appropriate financial control procedures, meet both legal and professional standards for debt management, and satisfy legal requirements for purchasing. They also report using cost-cutting strategies, such as "piggyback bidding," to cut the cost of some purchases. Somewhat fewer respondents said their district always or often used two other cost-cutting strategies—

joint power authorities and direct delivery of supplies to schools (at 75% and 64% respectively)—as part of their purchasing practices. Respondents are also overwhelmingly positive about the use of high quality estimating and budgeting procedures, but a substantial minority (30%) report that their enrollment projections are not necessarily accurate.

Likewise, while respondents largely reported that their district's financial software met basic accounting requirements, they were less likely to say it provided capital project tracking or that the format for financial reports was easy for the board to understand and helpful for their decision-making, with about six out of 10 agreeing with those statements.

CBOs were also asked a few questions about the systems in place in their district to control, plan for, and set quality standards for the maintenance of facilities. Their responses to these questions were substantially less positive than was the case for most other areas of the survey.

Compensation trends show consistent salary increases but restraint on retiree benefits

In general, respondents reported meeting professional standards for collective bargaining procedures and having positive relationships with their districts' primary teachers union. While the vast majority of CBOs report good quality preparation for bargaining, quality training and support for bargaining teams is reported slightly less often.

A comparison of state data regarding compensation increases from 2002–03 to 2004–05 showed that the state's statutory cost-of-living adjustments (COLAs) resulted in an increase in revenues of 4.1% in the average district in our sample. During the same timeframe, increases in salaries and benefits averaged a relatively uniform 7.2% among our sample districts, a difference of 3.1%. However, in regard to their most recent contract (generally 2005–06), only 19.3% of survey respondents reported that their district had granted a salary increase larger than COLA. The majority of respondents also said their district follows recommended practice by negotiating total compensation (salary plus benefits) and having a hard cap on the per-employee cost of health and welfare benefits.

Slightly more than 10% of the districts in our sample (and a similar proportion statewide) have granted the most costly postretirement benefits—lifetime healthcare benefits.

Site leader financial training appears to be lacking in many districts

The survey asked a number of questions that explored the relationship between the district office and school sites as it pertains to financial management and resource allocation.

There appears to be some disconnect between districts' expectations of site leaders and the training provided to them. The vast majority of CBOs report that their district clearly communicates to principals the scope of their financial authority, and three-quarters say principals are held accountable for sound financial management. However, only 58.6% say that principals receive training on financial management and budgeting to either a good or great extent, and just 38.5% say the same is true for site-level budget and policy groups (such as school site councils) in regard to their responsibilities.

Our respondents also indicate that site-level allocation policies generally place more emphasis on district control and guidelines than on site flexibility. The majority (77.1%) report that their district office determines the number of teachers, administrators, and support staff a school has and gives the school discretion over how it spends funds allocated for nonpersonnel costs. More specifically, while respondents report that districts decide the number of teachers, schools have more voice in which teachers are assigned to their sites and the grade level in which they work. District control over both the number and type of other staff is greater. And while schools are given considerable control over their supply purchases, they appear to have limited authority over other nonpersonnel expenditures, such as equipment, professional development, and facilities maintenance. Respondents also indicate that staff allocation decisions often take school and student characteristics into consideration but are less likely to consider the level of experience of a school's current teaching staff.

CBOs report effective maximizing of public resources, but they are split regarding private resources

As noted, California school districts have few options for raising revenues. We polled CBOs to explore this topic in more detail and asked them to what extent they felt their district was successful at maximizing revenues where it could. Respondents generally report success maximizing public funds, including unrestricted state funds and categorical state and federal funds to a somewhat lesser degree. They were split, however, regarding their success at maximizing interest income and securing extra revenues from private sources. Few CBOs report success maximizing revenues from property (such as lease income) or services.

Among respondents who said their district was successful at securing private contributions, there was variation based on whether the source was private foundations, community foundations, or business partners. These variations reflected differences in who secured the funding and the types of districts that reported success.

CBOs raise concerns about rising costs and enrollment declines

We also asked CBOs about the threats they saw to fiscal health both in the recent past and in the future. Looking back, they reported that rising costs had been the most common threat to their districts' fiscal health, particularly cost increases related to Special Education, transportation, and staffing. Looking forward, they project the same to continue; but nearly a quarter also mention enrollment changes, most notably declines, which leads by law to revenue declines as well.

Among our sample districts, enrollment expectations for the next three years indicate:

- 51.5% are planning for enrollment declines in the next three years;
- 32.1% are planning for increases; and
- 16.4% expect no change.

These percentages roughly mirror statewide projections of enrollment change.

The relationship between fiscal health and district personnel, policies, and practices produced significant findings

This study used various comparative statistics to test for relationships between the three fiscal health categories described above, the survey responses and, in a few cases, state data. For some of the variables, we found a statistically significant difference based on the fiscal health of the district. Those included the following findings.

Fiscally healthy districts are more likely to have stable leadership in the superintendency

We found that fiscally healthy districts are more likely to have stable leadership at the superintendency. Data for the sample districts and the state as a whole both showed this relationship.

Based on survey responses, the level of CBO education or training is not clearly related to fiscal health among our sample districts, but healthy districts are more likely to have had the same CBO for a decade or more.

Districts in our sample that, based on state-collected data, have administrative staffing ratios below 125:1 were more likely to be healthy (includes district office administrators plus office/clerical employees).

Fiscally healthy districts have well-trained board members, high quality policies, and the ability to cut programs not aligned with their goals

CBOS in healthy districts were more likely to:

- characterize the general orientation that board members receive as high quality;
- report that their district has high quality policies and regulations;
- report that their district has to a great extent established procedures for evaluating the financial impact of budget amendments and has been able to cut programs that are not aligned with strategic goals.

CBOs from unhealthy districts say their software does not track capital projects and is not easily understood by board members

CBOs from unhealthy districts were less likely to say that their district's financial software systems provided capital-project tracking or that the format for financial reports was easy for the board to understand and helpful for their decision-making.

Certain other financial control practices set fiscally healthy districts apart, including: (1) complete agreement that they analyze significant expenditure processes to ensure appropriate controls; and (2) that they analyze significant contracts, financial negotiations, and expenditures for unusual cost fluctuations.

Lifetime health benefits for retirees was correlated with poor district fiscal health

Related to collective bargaining practices, healthy districts are more likely to report high quality cost estimates and bargaining team training.

The one area of compensation practice that was significantly correlated with fiscal health was if a district reported granting lifetime health benefits to retirees. Districts in our sample

that reported having lifetime benefits are more likely to be unhealthy. Statewide data revealed similar results.

Fiscally healthy districts are more likely to report an emphasis on site leaders' financial skills

Our analysis also indicates that fiscally healthy districts are more likely to emphasize site-level capacity, accountability, and flexibility. We see a difference in fiscal health in those districts that pay attention to school site leaders' capacity for financial management, expect principals to link fiscal decisions to student performance, and provide sites with budget flexibility.

Topics for further study include the financial training of district leaders other than CBOs, planning for facilities, and lifetime health benefits

Our research illuminated several issues that we believe warrant further study. The first concerns the financial training, stability, and fiscal practices of school district leaders beyond the CBO—in particular the superintendent and school board.

We are also intrigued by the relatively negative responses in the study on the few questions we asked about systems in place to control, plan for, and set quality standards for the maintenance of facilities. Further study could help determine how school districts' practices could be strengthened.

Our findings in regard to site-level budgeting and financial management also suggest the need for more information. The state could benefit by learning more about ways that districts can effectively empower their school site leaders in the area of financial management.

We identified 72 districts statewide that have granted lifetime health benefits to their retirees. These districts serve 1.4 million students (about 24% of the students in the state). A closer look at them might be in order, with the proviso that the leaders who negotiated the benefit may no longer be the ones at the district helm.

Better district financial planning and better COE oversight could improve on California's financial safety net for districts

We believe that the state has created a safety net with AB 1200 and AB 2756 that has reduced the number of school districts that would have otherwise fallen into fiscal crisis. However, those systems could be made more effective through better financial planning on the part of districts and better oversight on the part of county offices. But even if those improvements were made, California school districts confront revenue and expenditure issues that can make it difficult to maintain fiscal health and even more daunting to strategically allocate resources in ways that further student performance goals.

Our findings make it clear that it is easier for some California school districts to stay fiscally healthy than it is for others. Districts that have lower revenues are more likely to be unhealthy as are those experiencing declining enrollment. With about half of California districts projecting enrollment declines going forward, this could represent an important and continuing problem. But our findings also suggest that these external conditions are not the

whole story. Districts that vary in their fiscal health also report differences in their financial practices and their personnel.

We believe that leadership stability is of particular importance for school districts because it provides an environment in which district goals and priorities can be consistent and clear, allowing professional practices to take root and flourish. Further, these leaders need to be well prepared for their financial management responsibilities. Based on our survey findings, training could be improved in several areas, including:

- school district budgeting and finance for school board members;
- the negotiating process generally for collective bargaining teams; and
- fiscal management and budgeting for school site administrators.

Given the inability most school districts in California have to raise significant revenues, a key to their fiscal health is controlling their expenditures. The need to do so creates a dynamic tension between their responsibility to deliver sound, effective educational services to their students and to reasonably compensate their employees. Some fiscally healthy districts may maintain their fiscal status by scrimping on the services they provide. Others may risk being fiscally unhealthy in the name of educational quality. And some districts are apparently able to strike the delicate balance between these two extremes through a combination of effective financial practices and perhaps some good fortune in terms of the amount of revenues they receive.

This study illuminates some possible strategies for improving districts' ability to be in this latter group, but it also sheds some light on the complexities involved in doing so in California. In addition, it raises some important issues related to school district financial management that warrant more study, including further examination of district leadership as a key factor that, at least in some cases, can overcome weak financial fundamentals.