Agenda Topic: School District Financial Profile (Update)

Materials: Explanatory Exhibits

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Purpose of Agenda Item

- Provide the board a status report since our initial presentation in October on progress in developing:
  - An expanded system for analysis of school districts’ financial condition (see Exhibit A);
  - An expanded financial condition reporting system, including a proposed “School District Financial Profile” for all school districts;
  - Continuous improvement to the Financial Assurance and Accountability System (FAAS); and
  - Options relative to districts and agency implementation of the Governmental Accounting Standards Board (GASB) Statement 34.

- Provide a clear understanding of the method for the School District Financial Profile. It will be piloted simultaneously with the March announcement of the 2002 Financial Watch List. In addition, districts designated under the modified FAAS ratio analysis will be listed.

Expected Outcome(s) of Agenda Item

- General concurrence by the Board on the following:
  - Proposed elements of the School District Financial Profile, modifications to FAAS ratio and the 2002 Financial Watch List criteria;
  - Potential linkages to the State Board’s current academic accountability and designation systems;
  - Continued engagement with the public and educational stakeholders;
  - Projected timelines: for piloting and public awareness; and
  - Governmental Accounting Standards Board (GASB) Statement 34 guidance.

Background Information

In October of this year, the State Board of Education directed staff to continue their collaboration with the Illinois Financial Advisory Committee (IFAC) to develop a conceptual framework for determining proposed elements of a School District Financial Profile (previously referred to as a “financial report card”) and make modifications to
enhance the FAAS ratio analysis and the Financial Watch List criteria. These efforts have drawn input from a cross-section of interests due to IFAC’s diversified make-up. Some of the data elements as originally suggested are not available currently but with Board concurrence, essential data will be collected and a database established to allow for the “piloting” of available key data elements with selected large unit districts. This pilot test of available data will include the following modifications since our initial October presentation:

**CURRENT IMPLEMENTATION (See Exhibit B)**

- **FAAS Ratio**  
  **Modification:** *Add district type dimension.*  
  **Rationale:**  
  - Provides ability to assess if an inordinate level of a particular type of district is experiencing financial difficulties.  
  - Provides a more equitable means of comparing like groups.  
  - This is quite typical when the agency makes data analyses and comparisons.

- **Tax Rates**  
  **Modification:** *Yield Analysis*  
  **Rationale:**  
  - Illustrates disparity between districts of the same type by incorporating the yield of a standard $0.10 tax increase. This will allow the public to better understand a district’s capability to generate local revenues.  
  - Provides a more accurate picture of potential local tax burden should property taxes be increased to address operating shortfalls.

- **Equalized Assessed Valuation (EAV) Analysis**  
  **Modification:** *Determine EAV per Pupil (Based on Best 3 Months Attendance)*  
  **Rationale:**  
  - Divides the most current EAV by the district’s same attendance factor used for computing General State Aid.  
  - Provides another comparison benchmark between districts and serves as a major barometer as to a district’s local wealth.

- **Results of Operations Analysis**  
  **Modification:** *Calculate a “Days Cash On Hand”*  
  **Rationale:**  
  - Demonstrates how many days of operations can be funded from existing cash reserves.  
  - Converts existing cash plus other investments into available days of cash to meet operational needs. The public will better
appreciate why a district may be forced to rely on short-term debt.

- Divides expenditures by 360 to determine a school district’s average daily expenditure. Divide their cash balance plus investments by the average daily expenditure rate to determine the number of “Days Cash on Hand”.

Other Major Considerations:

- The modified 2000-2001 AFRs are providing this information now. This will not require any modifications until we fully evaluate the FAAS data for this coming year.

FUTURE IMPLEMENTATION PLANS

Short-Term Debt Analysis

- On the 2001-2002 AFRs, we plan to collect more detailed data regarding school district short-term debt to distinguish between borrowing to address delays in revenue collection (e.g., delayed property taxes, etc.) and short-term borrowing to fund operating deficits.

Long-Term Debt Analysis

- We plan to distinguish between various obligations like general obligations (funded by debt service taxes) from those that are funded by operating taxes or other revenue sources (reimbursements, grants, etc.).

- Identify those school districts that have used operating funds to meet debt service obligations.

ADDITIONAL DIMENSION

GASB 34

- The Governmental Accounting Standards Board (GASB) established a new reporting model for all governmental units. The vehicle for that reporting model is GASB Statement 34. It is a departure from traditional reporting models in that major fund structures, classifications and other valuations and disclosures are redefined. When this model is implemented, a comparable data base would not be readily available until full implementation occurs in fiscal year 2004. Therefore, it appears that trend data derived pre and post GASB 34 implementation would present incomparable data analysis.

However, the GASB Statement 34 model does have positive enhancements to any reporting system. These include management’s discussion and
analysis (MD&A), comparisons of budget to actual data, standardized note presentations, and standardized valuation and reporting of fixed assets.

Currently, Illinois school districts submit financial reports prepared on a state regulatory basis. It should be noted that GASB Statement 34 does not apply if a governmental entity only prepares statements on a regulatory basis of accounting.

Currently, there are 79 (8.8%) school districts reporting on a modified or full accrual (GAAP) basis of accounting versus the large remainder of districts reporting on a cash basis of accounting. Converting to GASB 34 and full accrual accounting will prove to be costly to school districts and state as well. The recent study completed by Tim Custis, CPA with Gorenz and Associated, Ltd., has given the State Board sound guidance on how to address this GASB mandate.

**Analysis and Implications for Policy, Budget, Legislative Action and Communications**

No legislative action is required to implement the proposed School District Financial Profile or the enhanced FAAS ratio and Financial Watch List criteria.

Based on a longitudinal analysis using multiple indicators to evaluate school district’s financial conditions, the Board may seek legislative action to amend Article 1A-8 to modify the criteria for certification of districts as being “in financial difficulty” and possibly the powers of a financial oversight panel.

This proposal raises at least three policy issues:

- **Standards to differentiate between financial health and financial difficulty**

  Developing standards is an important aspect to the proposed School District Financial Profile system; it is necessary for reporting purposes and it would provide a common frame of reference for the public, school administrators and boards of education. Setting standards will not be easy. For example, the answer to the question of “what level of long-term debt represents significant trouble” is complicated by the fact that not all long-term debt is “bad.” Debt may have been issued for school construction or may be off-set by anticipated revenues. In addition, a debt level that is acceptable in one community may be unacceptable in another. These are variables that must be evaluated as this process evolves. In addition, critical considerations with respect to analysis of the proposed variables will need to be viewed from multiple perspectives (e.g., relative to FAAS, an individual district, or statewide).

  The following summarizes the key ingredients of the FAAS and proposed School District Financial Profile system. What is important to understand is that
this will be a continuous improvement and evolutionary process. We intend to engage IFAC and other critical partners as we move forward.
FAAS Analysis

- Calculate Fund Balance to Revenue Ratio by using four operating funds in FY 02 (i.e., Education, O&M, Transportation, Working Cash and exclude IMRF/SS henceforth)
- FAAS Ratio (same 4 funds)
- Tax Rate Analysis
- EAV Analysis
- Results of Operations Analysis (Revenues to Expenditures)
- Short-Term Debt Analysis
- Long-Term Debt Analysis

District Profile

- Six Designations
- Recognition
- Technical Assistance (improving conditions)
- Technical Assistance (declining conditions)
- Watch List
- Certification (Sec. 1A-8 criteria)
- Oversight

Link to Academic Accountability and Designation Systems

Although there is no direct or absolute correlation between a district’s finances and its academic performance, there is a common belief that financial capabilities can have a significant impact on the educational opportunities and resources that a school district can offer. A district’s deliberations over the allocation of its financial resources can have an adverse or positive effect on basic educational programs. Conversely, we know a district’s desire for quality teachers and programs can have a profound affect on their financial position.

The State Board for years has sought to align its financial and academic reporting and accountability systems. We plan to move forward with enhancing the ISBE’s current financial analysis and reporting systems while we explore options for further connectivity. This and other linkage strategies (e.g., Standard and Poors’ – School Evaluation System) will be shared with the Board periodically as we continue to pilot the School District Financial Profile system.

Governmental Accounting Standards Board (GASB) Statement 34 Options

The GASB is responsible for developing standards for state and local governmental accounting and reporting. We understand a limited number of school districts have begun to convert their accrual accounting systems to be in compliance with GASB Statement 34. Staff plan to return in mid 2002 to advise
the Board on whether to mandate such a standard for all districts. Our study of the issues and the implications of this being imposed statewide will be continued by the same CPA firm.

**Pros and Cons of Various Actions**

The benefits and weaknesses associated with the current Financial Assurance and Accountability System (FAAS) were obvious during the announcement of the March 2001 Financial Watch List and also from the Decatur and Homewood School Districts’ testimonies. This resulted with the Board asking staff to return with a proposal for a more informative and predictive financial accountability system. The Board indicated that the new system should provide more useful and understandable information for all educational stakeholders and lead to a public that is better informed and more engaged with school finance matters.

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<th>Pros</th>
<th>Cons</th>
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<td>• We are continuously improving on the accuracy and timeliness of our annual assessment of school districts' financial health.</td>
<td>• The process will require an accumulation of data over several years before the system can be fully implemented and a predictable trend line can be established.</td>
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<td>• We are expanding our practical knowledge by engaging critical stakeholders (i.e., IFAC, LUDA representatives, EDRED, etc.)</td>
<td>• The technical resources of ISBE are being challenged by the continuing need to provide more intensive on site assistance. Staff development and functional realignment is underway to address this urgency.</td>
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<td>• We are developing multi-faceted strategies to not only predict financial difficulties but more importantly to intervene in a proactive manner.</td>
<td>• Our ability is extremely limited to seamlessly connect the financial and academic analysis, reporting and accountability systems.</td>
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**Superintendent’s Recommendation**

- The State Board should provide concurrence with staff plans for:
  - proposed changes to FAAS ratio analysis and Financial Watch List implementation; and
  - conceptual design and implementation strategy for the new School District Financial Profile system.
Next Steps

- Collect and analyze the 2001 Annual Financial Reports
- Release enhanced FAAS and pilot the School District Financial Profile in March 2002
- Continue the research and assess options for linking the state’s financial and academic accountability and reporting systems
- Develop communication strategies and engage additional stakeholders.