ILLINOIS STATE BOARD OF EDUCATION
October 17, 2001


Materials: Data Analysis Exhibits

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Purpose of Agenda Item

➢ Status report on progress in developing
  • An expanded system for analysis of school districts’ financial condition;
  • An expanded financial condition reporting system, including a “Financial Report Card” for all school districts; and
  • An improved Financial Assurance and Accountability System (FAAS).

Expected Outcome(s) of Agenda Item

➢ General direction from the Board on the following:
  • Proposed elements of the Financial Report Card, modifications to FAAS and the Financial Watch List criteria;
  • Potential linkages to the State Board’s academic reporting/accountability systems;
  • Strategies for public and stakeholder engagement and
  • Projected timelines.

Background Information

In 1981, the State of Illinois placed into law a structure for identifying and responding to serious financial difficulties in local school districts. This was precipitated by the need to consolidate the many small and under financed school districts and took place many years before the academic accountability process was placed into law.

Later that same decade, the State Board of Education expanded its focus from a financial certification designation process to an annual assessment of the financial viability of all school districts. The goal was to identify, in addition to districts that qualified for certification as “in financial difficulty” under Section 1A-8, those districts in the greatest risk of becoming certified and assist them to avoid being certified or being forced to adhere to more drastic state interventions. This involved ISBE Finance consultants to provide specialized assistance to the high risk districts in developing multi-year financial plans as well as providing guidance on reorganization options.
A part of this system included the announcement each year of the media-popular Financial Watch List; this list identified the “at risk” districts as well as those that were certified or subject to an oversight panel.

In the mid 1990s, the State Board of Education further expanded the state’s financial accountability processes. The expanded system, known as Financial Assurance and Accountability System (FAAS), was intended to provide a financial-health designation for every Illinois school district and establish a basis for technical assistance to districts that might be in various degrees of financial difficulty, even though they were not eligible under Section 1A-8 to be certified.

FAAS was developed collaboratively with by the Illinois Financial Advisory Committee (IFAC), the Large Urban District Association (LUDA), the South Cook Organization for Public Education (SCOPE), Education Research and Development (ED-RED), Illinois State University and Southern Illinois University. It classifies districts according to a ratio that compares operating fund balances to operating fund revenues at a single point in time, the end of the fiscal year as validated by the independent financial audit report as filed with ISBE. As a result of this analysis, every district is placed in one of five categories ranging from “financial recognition” to supervision by a “financial oversight panel” (see Exhibit A).

The most recent addition to the financial accountability system is the ILEARN website, which provides electronic access to selected financial data regarding all Illinois districts. This data resource gives parents, policymakers and the general public entrée to information about a given district, and allows them to easily compare school districts. Since its inception, we have had over 10,000 hits (the average length of time spent on the site is 9 minutes) and positive feedback from many of the education stakeholders.

**Problems and Issues**

The impact of the state’s increasingly proactive financial accountability system has been notable. Over time, there has been a significant decrease in the number of districts that meet the criteria to be placed on the official watch list or certified (see Exhibit B) and most of those districts that have been certified have earned “decertification” approval. Increased funding from the state (e.g., through the new foundation levels, categorical full funding, school construction, etc.) has undoubtedly contributed to these improvements; however, there is evidence that a majority of those districts that have been certified or identified by the financial watch list have taken affirmative steps to improve their own financial position. Many of these districts have convinced their public to support additional revenues by approving local tax referenda (see Exhibit C). There is also evidence of a strong correlation between school reorganizations and the number of districts on the Financial Watch List. The attached Exhibit B also documents the trend in district consolidations and the corresponding decline in number of districts on the financial watch list. The increased number of reorganization studies this year is an indication of the growing pressure to develop alternative strategies to forestall financial difficulties.
However, the FAAS system also has several limitations. One of the most critical is the lack of other financial indicators. The single point in time measure used to classify districts under FAAS cause some districts to be categorized in the “Financial Recognition” category even though they have financial problems that are not captured by the operating fund balance ratio. Likewise, some districts assigned to the “Technical Assistance” category have positive financial resources that are not identified via the operating fund balance ratio. In addition, this method for classifying a district’s financial condition does not consider financial events beyond the fiscal year ending that may drastically alter a district’s ongoing financial position. For example, the current FAAS analysis does not reflect district plans such as curriculum expansion, contracts, legal action, growth, class size reduction, etc.

A second problem with the current FAAS is its limited usefulness. It does not show financial movement over time. As a result, the system has a limited value for assessing the impact of earlier decisions, forecasting the financial condition of a given district, or predicting its future viability.

A third concern is the method for calculating the FAAS ratio of operating fund balances to revenues includes a fund that has no consequential impact on that ratio. The current ratio is determined by combining five fund balances -- the Educational, Operations and Maintenance, Transportation, Municipal Retirement/Social Security, and Working Cash Funds -- and dividing the total by the combined total revenues of the same five funds. However, the Municipal Retirement/Social Security fund is supported by an “as necessary” or no-maximum rate tax levy and the revenue this levy yields may not be loaned or transferred as can funds generated from the permissive tax rates in the other four funds. The result is a self-contained fund whose obligations are off-set by revenue as needed. Including the Municipal Retirement/Social Security fund in the ratio adds nothing to an understanding of a district’s financial condition, makes the computation more complex, and may confuse the public by masking the district’s actual condition.

Finally, the current FAAS functions in relative isolation from academic concerns and in complete isolation from the State Board’s academic accountability system. The State Board motion to certify a district indicates that the district is expected “to assure the best education possible for the pupils of the school district” while remedying its financial problems; however, this aspect of the district’s operation is seldom considered in determining whether a district should be removed from financial certification. Several targeted efforts have been made by the state agency to address both financial and academic issues in a given district (e.g., East St. Louis, Round Lake). These have had limited success and no system-wide impact.

The benefits and problems associated with the current FAAS were highlighted during the March 2001 Financial Assurance and Accountability System (FAAS), Financial Watch List and the Decatur and Homewood School Districts’ presentations. As a result of that discussion, the Board asked staff to return in the fall 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 education stakeholders and lead to a public that is better informed and more engaged with school finance matters.

Proposal

In response to the Board’s direction, staff consulted with the Illinois Financial Advisory Committee (IFAC). That group, in turn, created a special subcommittee to guide staff in the development of a new and improved financial analysis and accountability process.

The structure recommended by the subcommittee and endorsed by our staff includes the following elements:

- Modification of the FAAS to classify and designate school districts based on multiple dimensions; and
- Modification of the ILEARN website to provide a more user-friendly, multi-level representation of school financial data, suitable for varying levels of user-expertise and analytic needs.

**Illinois Financial Report Card**

Access to accurate and comprehensive information about a district’s financial condition is important at several levels. At the broadest level, industries are attracted to communities because of the strength of the local school system, and real estate values are strongly correlated with the financial viability of the public education system. At another, more personal level, families seek out housing in order to enroll their children in what they believe to be quality educational programs. At a third level, businesses and individual taxpayers want to know how their taxes are invested and how they support a quality education program. Finally, decision-makers want to be able to make good choices. They need to be able to analyze options for the allocation of resources and to look ahead to the consequences of potential decisions. Every local administrator and board member knows that some of the most difficult and contentious decisions they face, such as building closures, program cuts, and union contracts, will revolve around the adequacy and accuracy of financial information.

Despite the need for accurate and comprehensive school district financial data, it is not now easily accessed. Even though the public receives an annual School Report Card for every public school in the state, the limited financial data in these report cards are inadequate to inform parents and policymakers about the overall financial condition of their school districts. In addition, as noted above, the FAAS system uses only one measure for making judgments about a district’s financial condition, and the ILEARN website has been limited to the information that has been available rather than on what is needed.
To provide information about school districts’ financial conditions that will better inform Illinois educators, policymakers and the general public, we are proposing creation of the Illinois Financial Report Card System. This system will include the following:

- Use of multiple factors for analysis of school district financial condition (see below)
- Use of common standards for making judgments about financial circumstances (e.g., when does long-term debt endanger a district’s financial viability?)
- Reporting on key financial indicators and their meaning for the district, using multiple layers of data, each with increasingly rich and complex analysis.
- Presentation of the overview or “top layer” in easily understood terms (for example, there may be a red zone for danger, etc.).

The variables chosen for analysis and reporting will be those that are central to a district’s financial condition, reflect past trends and take into account the interactions among variables that may have an impact on the district’s future circumstances. The ultimate goal is to provide a mosaic of information that accurately represents each district’s financial condition and supports reasonable predictions about that district’s financial viability.

The proposed data sets or indicators for the Illinois Financial Report Card System are:

- Improved FAAS ratio analysis
- Net income/results of operations analysis
- Short-term debt analysis
- Long-term debt analysis
- Other major considerations/mitigating circumstances

A full description of each proposed data set and relevant timelines are presented on the following pages.
FINANCIAL REPORT CARD INDICATORS

(A) Improved FAAS Ratio Analysis

Effective for 2000-2001, the Municipal Retirement/Social Security fund revenues and fund balances will be removed from the ratio calculation. This change factors out pension obligations and Medicare from the true operating funds of a school district. (As noted earlier, the tax levy for this fund is “as necessary” meaning that there is no permissive maximum tax rate. Revenues generated by this levy are restricted and may not be loaned or transferred as can funds generated from the other four funds’ tax rates.)

In addition, five (5) years of data will be used to show the extent to which “reserves” or “Fund Balance” has changed over time. This will illustrate the amount of reserves each district has at the end of the fiscal year and add a forecasting dimension to the system.

(B) Net Income/Results of Operations Analysis

Five (5) years of data will be used to show whether the district “operated within its means” (i.e., it had revenues greater than expenditures at the end of each year) or did it expend more than it received. Net income as a result of operations will be used, in addition to the FAAS ratio to forecast outcomes grounded on a trend analysis.

(C) Short-Term Debt Analysis

Short-term debt is generally relied upon to meet cash flow necessitates; taxes and/or state aid that will be received by the district within one year are “pledged” against these warrants/notes or certificates. The general types of short-term debt instruments include Tax Anticipation Warrants/Notes and General State Aid Certificates.

A statement of each district’s outstanding short-term debt will be reported on the 2001 Annual Financial Report. This information will be incorporated into the piloted Financial Report Card come spring 2002. When the Financial Report Card system is fully operational in 2006, short-term debt will be reported as a trend analysis and will be used as a predictor of increased risk for each district.

(D) Long-Term Debt Analysis

The long-term debt analysis will show the extent to which a district relies on bonded debt/leases, etc. to meet ongoing operations. School districts have statutory authority to extend long-term debt up to 6.9% of a district’s Equalized Assessed Valuation (EAV) for elementary and high school districts and up to 13.8% of EAV for unit districts. This analysis will determine the percentage and dollar amount of long-term debt margin remaining at the end of each fiscal year. This is particularly important because many
districts have attained their legal debt limits and consequently have little authority to sell bonds to meet critical needs (i.e., Health/Life Safety, etc).

The first year of complete data for this dimension will be available come spring 2002. The long-term debt margin analysis will be extended each year until we reach full implementation in 2006.

(E) Other Major Considerations/Mitigating Circumstances

A new component of the 2001 Annual Financial Report will address “other major considerations and mitigating circumstances”. We are soliciting districts to list and explain any of the following categories that may have a material fiscal impact on the school district:

Pending litigation
Material decrease in EAV
Material increase/decrease in enrollment
Adverse arbitration ruling
Passage of referendum

This data set is valuable because there may be significant financial implications that are not otherwise taken into consideration in evaluating a district’s financial condition. In addition, this data set identifies circumstances that may be out of the control of the administration. As an example, a school district might be required to come into compliance with a desegregation order and therefore seek long-term debt to remediate.

The State Board’s “Annual Financial Report” form has been revised to include data required to implement the proposed Financial Report Card System. Further, we propose to test pilot the System in 2002, using data collected from the 2001 audit/Annual Financial Report. Modifications will be made at the end of each fiscal year as required to assure alignment of the system with the desired outcomes.

At this time, the proposed Financial Report Card System is not linked to the academic reporting system. See discussion below under “policy issues.”
**Redesigned FAAS**

The Illinois Financial Report Card System is intended to serve as a multi-dimensional analysis and reporting system. It will complement and ultimately serve as the basis for a redesigned FAAS, which will continue to serve as the state’s accountability structure.

We propose to maintain the five-band FAAS designation for 2000-2001 school year report. Although the current FAAS ratio will be modified through removal of the Municipal Retirement/Social Security fund from the calculation, districts will continue to be placed on the financial watch list based on the same criteria that were used last year.

Concurrently, we will test pilot the use of selected variables to better identify districts as in need of Financial Technical Assistance. For example, if the analysis of a district’s short- and long-term debt indicates that both are in the “red zone,” we would expect to move the district into a higher attention band.

Future redesign of the FAAS will be undertaken as and will include changes based upon data collected from the pilot test of the Financial Report Card System. Such changes may include the use of additional and/or different criteria for placing districts on the published Financial Watch List.

**Redesigned ILEARN**

We are proposing that the ILEARN website be redesigned to provide broader and deeper information about each school district’s financial condition. As suggested above, this will be presented in a user-friendly format and will provide multiple levels of data, suitable for varying levels of user-expertise and analytic needs.

Our challenge will be to assure that the ordinary citizen can access and understand a district’s financial condition and the implications of that information.

At this time, the proposed redesign for ILEARN does not include any new connections to ILSI. See discussion below under “policy issues.”

**Timetable and Implementation Plan**

The State Board’s “Annual Financial Report” form has been modified to allow us to begin immediate collection of the additional data needed to implement this proposal.

  - Financial Watch List and FAAS (with modifications as proposed)
  - Pilot Financial Report Card
  - Make appropriate changes to ILEARN
• 2003 – March for 2001-2002 Annual Financial Reports
  o Implement Financial Report Card
  o Continue long-term debt analysis
• 2004-2005
  o Continuously improve presentation and clarity of Financial Report Card data
• 2006
  o Continue long-term debt analysis and incorporate into full scale Financial Report Card System.

Analysis and Implications

Policy Issues

This proposal raises at least three important policy issues:

➢ Standards to differentiate between financial health and financial difficulty

Developing such standards is an important aspect of the proposed system; it is necessary for reporting purposes and it would provide a common frame of reference for citizens throughout Illinois. However, setting such 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 not all long-term debt is “bad.” It may have been issued for construction of new buildings or may be offset by some anticipated revenue. In addition, a level of debt that is acceptable in one community may be unacceptable to the citizens of another community. These are factors that we must deal with as this process moves forward.

➢ Link to academic reporting and accountability systems

Although there is no necessary correlation between a district’s financial and academic conditions, there is a widespread intuitive understanding that financial considerations can have a significant impact on education opportunities and resources. District decisions regarding the allocation of financial resources will usually have an effect on their educational programs, and decisions about the educational program will usually have an effect on their overall financial condition.

The connection between resources and student achievement is also being examined as a part of EFAB’s efforts to redesign the state’s school funding system. John Augenblick’s report to EFAB incorporated this element in his analysis of successful and efficient schools with recommendations for a methodology for benchmarking the foundation level plus poverty grants.
The State Board has indicated its desire to connect or align its financial and academic reporting and accountability systems but there is much work to be done before such a connection can be made. We believe it is appropriate to move forward with the proposed improvements to the Board’s current financial analysis and reporting systems while we explore options for making such connections. One such option is the proprietary analysis/reporting system developed by Standard and Poor’s and in use in other states. Information on this and other possible strategies will be shared with the Board starting with this meeting and periodically as we continue to improve the Financial Report Card System.

GASB 34

The Governmental Accounting Standards Board (GASB) is responsible for developing standards of state and local governmental accounting and reporting. Some Illinois districts already use the accrual accounting method recommended by GASB proclamation 34 and the Board will be asked later this year to consider whether to move to such a standard for all districts. A study of the issue and the implications at the state and local levels is underway and should be available in December or January. That Board discussion may have implications for the proposed Financial Report Card System.

Budget and Legislative Issues

This proposal may have implications for State Board staff resources. If more districts require technical assistance as a result of the new analysis, we may be challenged to provide it within available agency resources. However, we have begun to reengineer audit staff assignments to better address these anticipated demands.

In addition, the proposal may have long-term implications regarding state funding of local school districts. We expect that the new system will provide a much better understanding of local school districts’ financial condition and particularly of the problems facing districts in deep financial distress.

Finally, subsequent decisions (e.g., consideration of the Standard and Poor’s evaluation system) may have significant financial ramifications. As such issues arise, they will be described as part of the Board’s discussion materials.

No legislative action is needed to implement the proposed School Finance Report Card, to redesign FAAS or to redesign ILEARN. At some point in the future, when we have a track record of using multiple indicators for evaluating district financial conditions, the Board may want to reconsider the criteria for certification of districts as “in financial difficulty” or as in need of a financial oversight panel.
**Communication Issues**

The proposed changes to the State Board’s analysis, reporting and accountability systems are predicated in part on providing better information to the public. Therefore, the extent to which the systems effectively communicate will be critical. State Board staff will work closely with a variety of partners and customers to address this goal.

In addition, the Board will need to communicate with local district officials about the purpose and goals of the new system. Development of the system should be done in collaboration with the “experts” who are represented on the IFAC and with local educators, citizens and other stakeholders.

**Summary and Pros and Cons of Proposal**

The evolution of the Illinois Financial Report Card System will address the following Board concerns:

- Greater public understanding and appreciation for the challenges for adequate school funding
- Improved user friendly access to ILEARN and other accountability systems
- Development of a more “predictive” financial analysis model
- Sharpen ISBE focus on resources to those districts that have multiple categories of financial difficulty
- Develop coalitions to support School Finance/Business Professional Development
- Focus ISBE budgetary requests to address educational program efficiencies plus best practice models.
- Legislation to increase Financial Oversight Panel authorities and additional interventions in cases of school district foreclosures.
- Initiate a multi-faceted public education program on financial resources for school districts.

**Pros**

- We are continuously improving on the accuracy and timeliness of our annual assessment of school districts’ financial health.
- We are expanding our horizons by engaging other stakeholders (i.e., Taxpayers Federation, Realtors Association, etc.)
- We are developing multi-faceted strategies to not only predict financial difficulties but more importantly to intervene in a proactive manner.
Cons

- We must rely on a process of accumulating data over several years before the system will be fully implemented.
- The technical resources of the ISBE are being challenged by the continuing need to provide more on site assistance with school districts. We must be careful not commit to what we cannot provide.
- We are not yet able to seamlessly connect our financial and academic analysis, reporting and accountability systems.

Superintendent’s Recommendation

- The State Board should endorse and/or provide direction regarding
  - the proposed changes to FAAS criteria and implementation;
  - the conceptual design and strategy for the Illinois Financial Report Card System; and
  - modifications to ILEARN and other web based applications (i.e., district Budgets, Annual Financial Reports, etc.)

Next Steps

- Staff collection and analysis of 2001 Annual Financial Reports
- Regular reports to the Board on progress and issues
- Continued research regarding options for linking state finance and student achievement accountability and reporting systems
- Develop communication plan and engage our stakeholders.
EXHIBIT A

Based on FAAS, districts are placed in one of five categories, or bands:

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<tr>
<th>Category</th>
<th>Description</th>
<th>Criteria</th>
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<td>Financial Recognition</td>
<td>Districts with a FAAS ratio greater than +10%.</td>
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<td>Financial Technical Assistance</td>
<td>Districts with a ratio of 0 to +10%.</td>
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<td>Financial Watch List</td>
<td>Districts with a ratio of less than 0% or those who meet criteria for certification pursuant to the</td>
<td>Districts with a ratio of less than 0% or those who meet criteria for certification pursuant to the School Code, Section 1A-8.</td>
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<td>Financial Certification</td>
<td>Districts certified as &quot;in financial difficulty&quot; under provisions of the School Code, Section 5/1A-8.</td>
<td>Districts certified as &quot;in financial difficulty&quot; under provisions of the School Code, Section 5/1A-8. Districts must develop and adhere to a multi-year financial plan approved by ISBE. No indebtedness can be issued by a certified district unless and until the financial plan has been approved by ISBE.</td>
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<td>Financial Oversight Panel</td>
<td>Districts certified as &quot;in financial difficulty&quot; under provisions of the School Code, Section 5/1A-8 may be recommended for a financial oversight panel and emergency financial assistance. Recommendations will depend on the school district's petition for emergency financial assistance or failure to comply with its approved plan.</td>
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