



Pennsylvania Association of School Business Officials

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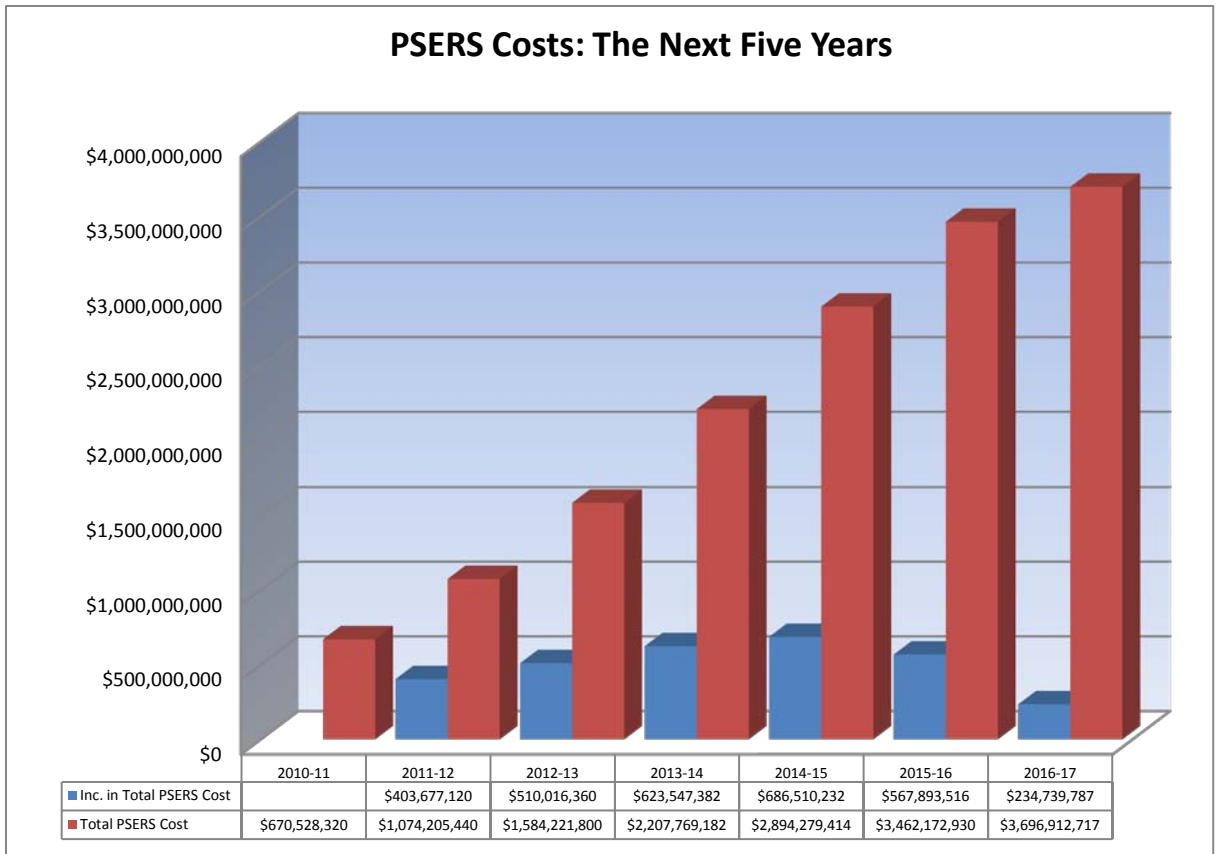
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Testimony
Of the
Pennsylvania Association of School Business Officials
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Public Hearing on Fiscally Distressed School Districts

Good afternoon. My name is Jay Himes. I am the executive director of the PA Association of School Business Officials, a statewide association covering a wide spectrum of non-instructional disciplines required to support student achievement and classroom learning. More about our organization can be found at the end of this testimony. I want to thank Chairman Piccola, Chairman Dinniman and all members of the committee for the opportunity to discuss the critical issue of distressed school districts which is unfortunately rapidly escalating in its severity.

The current school finance landscape is in an historically critical status. Perhaps only in the Great Depression has there been a simultaneous collapse of all school revenue sources—local, state and federal—concurrent with a significant increase in mandated costs. In a two year period we have had to respond to the termination of the federal stimulus programs, reductions or eliminations of state funding sources and local tax base declines which have stunted real estate and Earned Income Tax proceeds. Add to the dark clouds of the revenue picture an estimated increase of \$400 million in mandated school retirement costs for 2012-13 (and higher in the two fiscal years following as indicated in the chart below) and you have the makings of a financial crisis in every school district across the state.



It may be virtually impossible for districts to weather this financial tsunami without substantial program and personnel reductions, local tax increases and growth in the economy to stop the bleeding from property tax assessment appeals.

To pile on even more on the financial bad news, districts are having to fund construction projects out of local revenues because promised state funding exceeds demands for reimbursement which has resulted in months and years of delays in state funding. And finally, we need to mention the impact of the convoluted process of calculating real estate market values by the State Tax Equalization Board that somehow indicates double digit growth in property values in some counties that will reduce transportation reimbursement payments just as fuel prices are escalating again. Then sprinkle all of this bad news with the lowest Act 1 Index since the inception of the law in 2006 and you have a recipe for financial

This description of the school finance landscape is not meant to be hyperbole. It is real and will have real consequences which will result in a drastic increase in the number of financially distressed school districts—some of which may not survive without a quick economic recovery or additional state aid. While recognizing the likelihood of either of the last two conditions is remote the consequence will be either less school districts or less locally controlled school districts. We are not in a transition phase for some districts; we are in a transformative stage of significant change.

We often hear the term “distressed school district” but it is a general descriptive reference, sometimes to academic results, sometimes to financial status, sometimes to both, without specific definition. The School Code in §691 contains language adopted in 1998 that provides some criteria for the effects of financial distress. These effects include:

- (1) The salaries of any teachers or other employes have remained unpaid for a period of ninety (90) days.
- (2) The tuition due another school district remains unpaid on and after January first of the year following the school year it was due and there is no dispute regarding the validity or amount of the claim.
- (3) Any amount due any joint board of school directors under a joint board agreement remains unpaid for a period of ninety (90) calendar days beyond the due date specified in the joint board's articles of agreement.
- (4) The school district has defaulted in payment of its bonds or interest on such or in payment of rentals due any authority for a period of ninety (90) calendar days and no action has been initiated within that period of time to make payment.
- (5) The school district has contracted any loan not authorized by law.
- (6) The school district has accumulated and has operated with a deficit equal to two per centum (2%) or more of the assessed valuation of the taxable real estate within the district for two successive years.
- (7) A new, merged or union school district has been formed and one or more of the former school districts which compose the merged or union school district was a distressed school district at the time of the formation of the merged or union school district.

These financial distress effects are caused by several interrelated factors. Financial distress could be created by a single or isolated multiple factors but in most cases the district could make adjustments that would relegate financial distress to a short term and curable situation. Unfortunately what has developed in some school districts is chronic fiscal distress that combines several factors which leads to longer term consequences.

A chronically distressed school district has experienced changes in its tax base that reduces local revenues. Most notably in distressed school districts assessed valuation has declined or stagnated so property taxes do not grow to cover escalation in operating costs. The loss of the steel industry in western PA is a prime example of property tax base decline. Loss of industrial and commercial property valuation also can mean less jobs and higher unemployment. Consequently, a district's largest local tax revenue sources—real estate taxes and the Earned Income Tax—decline. To prevent revenue losses, higher taxes are levied but unfortunately may not generate any new significant income since the tax base has declined as well. Higher taxes might mean producing the same amount of revenue—an unfortunate syndrome that further exacerbates fiscal distress.

Spending in chronically distressed school districts can be near or at the same levels of surrounding districts with growing and robust tax bases. Of course this can appear to be the inability of the distressed district to control spending. However, a distressed district is not immune to regional pay scales. A distressed district will not attract staff if the pay differential is drastically lower than surrounding districts and pre-existing collective bargaining agreements may also limit the immediate ability to reduce personnel costs—wages and benefits. Moreover, some operational costs for districts in addition to personnel are not within the control of the district e.g. fuel costs for building utilities and student transportation. Further, some of the real spending reduction strategies are the most politically unattractive—building closures and limiting student transportation for example—and there may be a lack of political will to overcome unpopular but financially necessary cost reduction strategies.

Many chronically distressed districts also have a significant educational challenge as well. Their student population generally has a higher poverty rate that translates to additional instructional support and higher special education rates which drive higher costs. Other so-called “educational difficulty” factors also drive higher costs. Comparing what appears to be similar spending patterns in poorer vs. wealthier districts may be an unfair process that fails to take into consideration what can be extremely different student populations with extremely different instructional needs.

A chronically distressed district like all other districts is also susceptible to state and federal mandates. As previously mentioned many poorer districts have much higher incidence rates for special education services. Poorer districts are much more reliant on state funding for Basic Education Funding, Special Education Funding and reimbursement for transportation costs to cite a few of the larger state subsidies.

In particular the retirement mandate will create significant new costs to all districts but it will have a greater financial impact on poorer districts.

Changes in state funding priorities which create an inability to reliably predict future budget impacts are a significant contributor to fiscal stress. Without any predictable funding levels, future financial planning is difficult. Without a longer term perspective year-to-year financial decisions can promote short term savings with long term liabilities.

When there are sudden changes in state funding e.g. the elimination of charter school cost reimbursement schools cannot suddenly replace the revenue loss when the Act 1 Index has declined to the lowest point in its history.

All of these factors contribute in some way to chronic financial distress. In most cases, they are interrelated factors that combine to put disadvantaged districts in a financial strait-jacket. Consequently, no one silver bullet is going to provide an easy solution. The interrelated conditions that lead to chronic financial distress require a multifaceted cure. You can't cure chronic financial distress with spending cuts only just as you don't provide a remedy by increasing revenue—whether local, state or federal.

The complexity of most school district fiscal dilemmas requires an effective and balanced set of measures. State law should impose a set of required financial planning and funding actions to focus a short but hopefully effective period of changes to prevent further fiscal deterioration. By setting up a workable framework, state policy should set in place financial standards for districts. We would suggest that these standards would include the following to create a multifaceted approach for distressed school districts:

1. *Independent Five Year Financial Plan*

- Require a five-year financial projection that reflects reasonable and measureable financial assumptions for both revenues and expenses. Only a longer term projection can effectively identify how to take a preventative approach to fiscal distress. Ideally you want to initiate changes that result in keeping expenditures in balance with revenues that prevent drastic and immediate actions in favor of longer term and more deliberate management of school district finances. The plan should be a local decision-making process that could include state parameters e.g. estimated future funding levels.

2. *Annual Report of Fiscal Indicators*

- A set of fiscal indicators should be adopted statewide for all districts. The fiscal indicators, which for the most part, can be obtained easily from the district's annual audit, should be a required disclosure of every district. As examples the following are good indicators of fiscal health (or the lack of it) that are readily available for district disclosure. A sliding scale could be developed for each indicator and districts failing to maintain an appropriate level or benchmark would be required to act on the other aspects of this framework.

LEA Fiscal Indicators		
Indicator	Data Source	Justification
Local Annual Audit Indicators		
An Unqualified Opinion in the Local Annual Audit	Audit submitted to Single Audit Office	Qualified opinion is a serious financial warning sign that also effects other indicators such as bond ratings.
Local Annual Audit Does Not Disclose Any Instance(s) Of Material Weaknesses In Internal Controls.	Audit submitted to Single Audit Office	Internal control is a financial integrity and safety factor.
No Disclosures In Local Annual Audit Indicating Default On Bonded Indebtedness Obligations.	Audit submitted to Single Audit Office	Default increases future borrowing costs or could eliminate ability to finance other projects
Annual Financial Report Indicators		
Annual Financial Report Filed Within One Month After Deadline Depending Upon The District's Fiscal Year End Date.	Annual Filing w/Comptroller's	Late filing is a warning sign.
Fund Balance Indicators		
Total Fund Balance (Assigned and Unassigned) Greater Than Zero In The General Fund.	AFR Data	Fund balance is vital for financial stability including cash flow.
Assigned and Unassigned Fund Balance as a Percentage of Total Expenditures (general fund only) of at least 3%.	AFR Data	Necessary for stable financial operation.
Budget Indicators		
Aggregate Of Budgeted Expenditures And Other Uses Less Than The Aggregate Of Total Revenues, Other Resources and Fund Balance In	PDE 2028	Balanced budget is a legal and financial requirement
Total Debt Service Not to Exceed 10% of General Fund Expenditures	AFR Data	Indicator of the budgetary burden of debt payments.
Asset Indicators		
Liquidity (Current Assets / Current Liabilities) as Reflected in Balance Sheet for Total Governmental Funds Greater Than One	AFR Data	Indicator of financial solvency
Aggregate Total Of Cash And Investments In The General Fund More	AFR Data	Necessary for stable financial operation.

This type of annual review and disclosure of fiscal indicators could be an early warning system for the department to monitor in order to begin a series of interventions like the suggestions below.

3. Sustained State Funding Levels

- A five-year plan needs to contain valid estimates of future revenues. Once the five year plan and fiscal indicators move a district toward state intervention the state should commit to funding that not only provides an opportunity to plan but to provide stability as well. This state funding commitment should include existing state support and also additional state assistance for distressed districts that would be conditioned on other actions below.

4. Expenditure Reduction Requirements

- Using a base line of previous expenditure patterns over five years, a fiscally distressed district should be required to reduce expenditures. If new state dollars are committed to financially distressed districts, there should be a matching requirement for spending reductions to assure that additional state dollars are just not feeding a structural deficit.

5. Additional Local Resources Requirements

- Financially distressed school districts should be required to tax annually at the Act 1 Index as part of a financially distressed school district recovery program. The sustained and new state dollars combined with mandated expenditure reductions should align income and expenditures. Additional property tax revenues can help create resources including increasing fund balance levels that can address future, unanticipated and unexpected needs or adverse developments such as declining assessed values.

6. *Additional Fund Balance Requirements*

- The five year plan should include a requirement for a minimum fund balance level of 5% of annual expenditures. Fund balance is critical to schools. We frequently see in the media criticism of too much fund balance but seldom is there any focus on the lack of fund balance. It is a tell tale sign of fiscal distress. No one indicator is probably so easy and quickly identifiable as a potential indicator of fiscal distress. Sustained and repetitive negative fund balance results in chronic fiscal distress, particularly if negative fund balance is growing. In Pennsylvania we are seeing historical levels of growth in negative fund balance. For the 2009-10 fiscal year districts with negative fund balances (excluding Philadelphia School District) increased the level by \$20 million from the 2007-08 fiscal year—a two year increase of more than 150%. This situation is no doubt worse if we looked at the Annual Financial Report aggregate data for the 2010-11 fiscal year. That data has not been released by PDE. Heading into another round of steep retirement expense increases for the next three years during which the economy is not expected to improve significantly the use of fund balance at extremely dangerous levels will unfortunately continue for many districts. Eventually the continued use of significant levels of fund balance creates a structural deficit which necessitates in many cases a significant increase in real estate taxes. With the current Act 1 Index not expected to increase significantly in the short term, that option may not be available without voter approval—an extremely unlikely circumstance.

7. *Mandate Waivers*

- Distressed school districts should be granted sweeping mandate waivers that would allow them to implement cost reduction and efficiency measures. Most importantly, distressed districts should see relief from the no furlough mandate to allow immediate savings for the largest expenditure of any school district—personnel. The ability of distressed districts to furlough personnel is fundamental to immediate savings but a waiver for furloughs would be an incentive for collective bargaining agreements to be structured to prevent distressed status. Mandated payments to charter schools—critically for special education payments—should be examined for every distressed school district and adjusted downward for a specified period. We would also recommend relief from the grandfathering of part-time employee eligibility for PSERS coverage. If a district reduces employment levels of part time employees, PSERS coverage will continue if the employee qualified in a previous year for PSERS coverage.

8. *Protection for Financial Decision-Makers*

- The equivalent position of chief financial officer in a school district has no independent decision-making authority and has no independent ability to implement cost reduction measures. We would suggest that the CFO position in a distressed school district be granted special powers to implement the five-year financial plan discussed previously.

- Cost reductions and budget reductions in schools are difficult business decisions. Unfortunately a business-like approach is not possible when the hands of the business administrator or business manager are tied behind his or her back. Granting special temporary powers to the position would allow a more effective and more productive process that would enable a more critical response to the financial dilemma of a distressed district. These powers need to be granted to the position with a proviso that the position is also not subject to termination for implementing difficult financial decisions. The business administrator or business manager needs special protection while trying to restore financial credibility in a distressed district.

Thank you again for the opportunity to present our comments on this important issue. We would certainly offer our cooperation and participation in the development of any legislative effort to address financially distressed school districts. I would be glad to respond to any questions you may have.

ABOUT PASBO

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Smart Business + Informed Decisions = Great Schools

The Pennsylvania Association of School Business Officials (PASBO) is a statewide organization with more than 3,000 members, two-thirds of whom are K-12 non-instructional administrators serving in the areas of finance, accounting, facilities, transportation, food service, technology, communications, human resources, purchasing and safety. PASBO's focus is on educating its members through professional development opportunities as well as keeping them informed on the latest legislative issues affecting school business through workshops, the annual conference, specialty conferences and publications. Business Associate members provide products and services that can improve the operation of schools and support classroom learning.